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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

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“AN EFFECTIVE REGULATORY FRAMEWORK TO COMBAT ILLICIT ACTIVITIES OF SHELL COMPANIES IN INDIA”

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Abstract

The present Research paper provides an overview of the shell companies, its working and legal implications. Firstly, the Paper delves into the global impact & international regulatory framework including various organizations providing guidelines to tackle this global challenge. Secondly, the Regulatory framework present in India at the domestic level. Thirdly, the research extensively scrutinizes the various misuses of shell companies including money laundering, tax evasion etc. Fourthly, the research discusses briefly some of the noteworthy cases due to the proliferation of shell Companies. Fifthly, the research discusses the concept of SPACs and lack of proper regulation to regulate it. Lastly the authors of the research paper not only evaluate the present legislation but also propose recommendations to improve it.

Keywords: Shell Companies, International Framework, Panama Papers, DHFL Scam, Special Purpose Acquisition Company (SPACs).

INTRODUCTION

Shell companies, which are generally defined as companies lacking human or physical substance, continue to be at the center of significant global controversies. The Panama Papers are the most well-known example of the "Papers" and "Leaks" news series. However, the majority of global specialists in corporate finance and transactions were not surprised by these disclosures because shell corporations have long been a fundamental component of tax and corporate planning.

Anonymous Companies have been extensively identified as exacerbating a variety of high priority global problems, including the drug trade, organized crime, terrorism, money laundering, tax evasion, corruption, corporate crime, and systemic financial instability. As a result, a number of international laws encourage financial institutions to Know Your Customer, which requires the beneficial ownership of corporate vehicles. Corporate governance principles (OECD Principles of Corporate Governance, Chapter V A3), money laundering (Financial Action Task Force Recommendations 5, 33, and 34), banking oversight (Basel Core Principle 18), corruption (UN Convention Against Corruption, Article 52), securities regulation (International Organization of Securities Commissions Multilateral Memorandum of Understanding, paragraph 7(b)ii), and others are among them.¹

Shell Companies

A shell Company or corporation with a limited liability is an entity with no staff, no mercantile activities, and no physical existence in the jurisdiction. This structure, which is often constructed in a tax haven or secrecy country, shields the true beneficial owner from taxes, transparency, or both. Shell companies are also known as international business companies, personal investment companies, front companies, and "mailbox" or "letterbox" businesses. Because they can open bank accounts, they are useful for money transfers.²

SHELL COMPANIES: A GLOBAL PERSPECTIVE & INTERNATIONAL FRAMEWORK

The exponential growth of shell companies that are directly connected to criminal activity is a global problem. The usage of shell firms has been connected to numerous legal and regulatory issues, such as money laundering, financing of terrorism, tax evasion, and other financial crimes. The main issue is the lack of transparency in the determination of the beneficial owners of the shell business. Through the use of registered agents, nominated directors and officers, and multi-levels, beneficial owners, also known as the natural person, are concealed. In numerous nations across the world, beneficial owners, sometimes known as the natural person, are concealed through the use of registered

¹ J. C. Sharman, Shopping for Anonymous Shell Companies: An Audit Study of Anonymity and Crime in the International Financial System, 24 TJEP 127, 129, 2010.

² Fabiano Angélico and Lígia Zagato, SÃO PAULO: DOES CORRUPTION LIVE NEXT DOOR?, Transparency International (2017), <http://www.jstor.com/stable/resrep20590.7>.

agents, nominee directors and officers, and multiple levels of additional company ownership (FATF, 2014).³

According to the Financial Transparency Coalition, the nation of registration has a significant impact on the ability of law enforcement or competent authorities to pierce the shell company's veil of secrecy and determine beneficial ownership. The current regulatory and legal structure for shell firms is fragmented and chaotic, with regulation and governance mostly at the national level. The legal structure for shell corporations registered within the border of a certain country is established by that country. Institutions such as Financial Action Task Force, FATF, an intergovernmental body founded in 1989 to establish international legal, regulatory, and operational measures addressing threats to the integrity of the international financial system, actively work to standardize the information gathered about shell companies and provided to law enforcement and authorities.⁴

A standardized structure, however, is not currently in place to guarantee that the described data is recorded and made accessible. There are currently no effective enforcement measures in place to ensure that nations either comply with the disclosures of real beneficial ownership data or promptly supply the required information upon request from law enforcement agencies.⁵

Financial Action Task Force (FATF)

The use of shell companies to carry out illegal activity and conceal the names of beneficial owners is a global issue. International policy making guidelines to guarantee that national legislation regarding shell companies and their beneficial owners correspond to international norms. The FATF 40 Recommendations contain the FATF's recommendations (FATF, 2003). The 40 recommendations contain guidelines aimed at ensuring that nations create and put into place efficient anti-money laundering (AML) policies. Country mutual evaluations are the main tool the FATF uses to guarantee adherence to its recommendations. These evaluations look at a nation's AML framework and gauge

³ Larry R. Bateman, SHELL COMPANIES: A REGULATORY AND LEGAL FRAMEWORK, ProQuest LLC (2016, <https://www.proquest.com/openview/17c3884f84dbd2bbb7b5d2e8b5ae3fa9/1?cbl=18750&parentSessionId=hZD1gF6Ro8BCa%2FAu8kHta%2BTyhetdGa%2FquTLioKEDQj8%3D&pqorigsite=gscholar&parentSessionId=GRjUG7ZCxi9hbqLyaiGvvB8aViXYbH0UrEpE%2F3aTa0%3D>).

⁴ Id.

⁵ Id.

how much it complies with the FATF's 40 recommendations (FATF, 2016b).⁶

In their report, *Money Laundering & Terrorist Financing through the Real Estate Sector* (FATF, 2007), the FATF showed how easily domestic shell corporations can be used to support illegal activity. The FATF study gave an example of a criminal setting up a shell business to buy real estate. The criminal repurchased the property at a considerably higher price than that paid by the shell business after the initial purchase after the shell company was disbanded. As a result, illicit funds in the amount of the initial purchase price plus the alleged capital gain from the property repurchase were injected into the American financial system. Additionally, the use of the domestic shell firm masked the money's origin. The FATF (2014) study confirmed the idea that illegal usage of shell companies calls for globally imposed measures. According to the FATF *Guidance Transparency & Beneficial Ownership* study, it would be easier for law enforcement to avoid the exploitation of shell companies if they had easy access to information on both the legal and beneficial owners. The report stated that using the described information will make it easier for the agencies who enforce law and authorities who have the competency to pin down the individual responsible for the unlawful activity. Beneficial owners are those who have a controlling interest in a legal company, such as a shell company, according to the FATF's broader definition.

Financial Transparency Coalition

The Financial Transparency Coalition is an organisation that brings governments and civil society together from all over the world in an effort to stop illicit financial flows⁷. According to the Financial Transparency Coalition, a wide range of international laws and regulations governing the legality, procedures for forming, permitted applications, and users of shell companies serve to exacerbate the global issue caused by their use. The absence of standardisation in the global governance of shell firms is what these issues highlight and why it is so important. Due to the lack of standardisation, one country's strong legal and regulatory framework merely transfers the issue to another that has laxer rules.

⁶ Id.

⁷ Financial Transparency Coalition, <https://financialtransparency.org/about/>, (last visited Oct. 6, 2023)

International Monetary Fund (IMF)

As indicated in the IMF paper, "spillovers"—weaknesses in one country's framework for combating money laundering—often enable corruption in that nation. For instance, in a \$1 billion bank fraud in 2014 that involved dishonest judges and government officials, Scottish shell companies were an essential aspect. It nearly brought the Moldovan economy to ruin by costing the country an eighth of its yearly GDP.⁸

The challenge, which came to light during the 2019 IMF Annual Meetings with support from SECO, received more than 120 applications from more than 30 countries. Four winning proposals were chosen, one of which is: Optimizing Beneficial Ownership Detection in High-Risk Firms in Brazil—A technology has been created to automate and improve the detection of shell companies involved in public activities, as well as their potential beneficial owners. According to the research, numerous enterprises, including those acquired by the government for emergency spending, had warning signals attached to them.⁹

OECD

The OECD is an organisation of 39 member nations that together represent around 80% of global trade and investment¹⁰. The OECD has assisted in putting strategies and standards into place to improve transparency & accountability in an effort to stop the unlawful transfer of money through shell companies. Recent standards include the Base Erosion and Profit Standard for Automatic Exchange of Financial Account Information in Tax Matters.¹¹

World Bank

The Stolen Asset Recovery Initiative, or StAR, is a World Bank Group and UNODC collaboration that supports global programs to eradicate safe havens for corrupt money. StAR works with disadvantaged nations and financial hubs to prevent the laundering of illicit money and to expedite

⁸ TransparencyInternational, <https://www.transparency.org/en/news/new-imf-anti-corruption-framework-3-things-well-be-looking-for>, (Last visited Oct. 7 2023).

⁹ Id.

¹⁰ History, OECD, <http://www.oecd.org/about/history/> [https://perma.cc/2FVSSEWS]

¹¹ Nicholas Vail, Cracking Shells: The Panama Papers & Looking to the European Union's Anti-Money Laundering Directive as a Framework for Implementing a Multilateral Agreement to Combat the Harmful Effects of Shell Companies, Texas A&M Review, (Oct. 7 2023 at 10 PM) <https://scholarship.law.tamu.edu/lawreview/vol5/iss1/7/>

the restitution of stolen property. The Report on How Nominee Services for Shell Companies Are Abused to Hide Beneficial Owners investigated a family of similar corporate arrangements in which nominees operate as the agents of principals with authority over shell companies. Nominee arrangements can be used to enable financial crime by concealing the identities of those in charge of shell companies. It also focuses on regulations aimed at preventing such violations.

REGULATORY FRAMEWORK FOR SHELL COMPANIES IN

INDIA

Company's Act 2013

Under this Act, shell companies are not defined, this makes both its operation and identification problematic. This makes it more challenging to identify shell companies and encourages their operations. In the USA, that keeps tabs on the account of shell companies in operation in the United States, shell companies are defined correctly. Shell companies mask the actual motives of those who support corporate enterprises. Companies like these assist their clients. It is very challenging to determine who is the genuine beneficiary. Shell's conscientious behaviour is demonstrated by scandals like Panama Papers leak. Today, it is necessary to remove the corporate entities' veil of secrecy. Controlling anti-money laundering activities should involve monitoring illegal money flows. Therefore, it is essential to identify the individual who has a significant impact.

Sections 92 & 164 of the Companies Act, 2013¹² came into force on April 1, 2014. This section penalizes Shell corporations. According to these sections, all business entities are required to file returns, and directors who fail to file annual returns for three consecutive financial years are barred from serving as directors for a span of five years. This Section penalizes Shell corporations. These parts are implemented retrospectively. A company Law Settlement Scheme (CLSS) was developed by the Ministry of Corporate Affairs. Companies had two years under this method to file any outstanding annual returns. Immunity has been extended, and filing fees have been cut. Furthermore, it stated that directors of companies using CLSS would not be disqualified.

¹² The companies act § 92 (2013).
The companies act § 164 (2013).

Restriction on Number of the Subsidiaries

Companies (Restriction on Number of Layers) Rules 2017 limit a company's number of subsidiaries to 2. Companies with more than 2 layers of subsidiaries must notify the government of the adoption of these laws within 150 days. This would obstruct the use of shell firms for illicit purposes. In the event of a continuous breach, the fine may reach 1000 Rupees per day for violations of the above mentioned regulations. Investments subsidiaries cannot be created for the purpose of siphoning off funds under the Companies Act of 2013. It avoids the exploitation of multiple loans by protecting minority investors.

Benami Transaction Prohibition Amendment Act, 2016

The Indian government has implemented a number of initiatives to counteract shell companies. Certain sorts of financial transactions are prohibited under the Benami Transaction Prohibition Amendment Act of 2016. Its goal is to prevent black money and other forms of illegal economic activity. Benami transactions are defined, prohibited and punished under the statute. The government has the authority to seize benami property without compensation. To combat corruption and black money, the government has launched a sustained operation and enacted stringent measures over the last four years, including the establishment of a distinct investigation team for black money, the passage of the black money act, and the passage of the Benami Transaction Prohibition Amendment Act, 2016. This kind of approach will restrict the circulation of black money and the evasion of taxes.

Prevention of Money Laundering Act, 2002

The Prevention of Money Laundering Act of 2002 was brought into effect to counteract the threat of white washing of money from unlawful sources. The government may seize property obtained illegally under this act. Shell Companies are mostly used for money laundering. The act makes it illegal for shell firms to launder through their operations. Various ministries and law enforcement agencies have joined forces to prohibit the formation and functioning of shell companies participating in unlawful affairs. Government authorities have discovered a number of examples of massive money laundering. Money laundering companies were shut down.

HOW SHELL COMPANIES ARE MISUSED

1. Tax Evasion

Tax evasion frequently employs the use of shell corporations. The ICIJ Offshore Leaks Database, depicts an intricate grid of companies, individuals, and governmental bodies connected to offshore firms in tax havens, serves as an illustration of this. This database was created for the four networks known as the Bahamas Leaks, Offshore Leaks, Paradise Papers, and Panama Papers. The formation of shell corporations in bank accounts with multiple legal representatives is the trend for tax evasion seen in these documents. For the advantage of the primary owner, these legal agents oversee the accounts. The money is transferred to tax havens through bank transfers through domestic and foreign shell businesses in a sophisticated network.¹³

2. Corruption & Bribery

Shell companies are used in about 70% of incidents of large-scale corruption (Young, & Crain (2018) and Nielson & Sharman 2022). Government is actively involved in the usage of shell companies in cases of bribery and corruption.

In order to transfer public funds to personal accounts, politicians and governmental officials frequently employ shell corporations as intermediaries. They work with a vast network of shell companies to negotiate various contracts for public and charitable projects, giving the impression that they are legal (Jancsics, 2018). After that, the diverting of funds is carried out via bank transactions between the governmental body and the network of fictitious corporations that hide the name of the beneficiary.¹⁴

3. Black Money

Shell corporations can be utilized during either the layering or the integration stage of money laundering. These businesses are used to layer laundered money at the layering stage, and because they are located in a tax haven or a country where banks are required to maintain bank secrecy, it is impossible to trace the flow of illicit funds via them. In order to prevent identification of the source

¹³ Jos´e-de-Jesús Rocha-Salazar a, María-Jesús Segovia-Vargas, María-del-Mar CamachoMinano, Detection of shell companies in financial institutions using dynamic social network, ESWA 207 (2022) 117981, <https://www.sciencedirect.com/science/article/pii/S095741742201209X>

¹⁴ *Id.*

of the investment and the owner of the black money, shell companies are frequently used to reinvest in the financial system at this stage.¹⁵

4. Patent Trolls

Today's patent trolls frequently own a large number of shell corporations. The biggest patent trolls can control thousands of shell firms that are the owners of tens of thousands of patents. Because judges are "hesitant to pierce the corporate veil," it might be challenging to identify these shell firms in court or even to recover damages from them.¹⁶

5. Financial Crimes

To commit financial crimes like loan fraud and identity theft, shell companies are the ideal means (Nielson & Sharman, 2022). The financial institution requests specific documentation when a person applies for a loan (mortgage loan or business loan) to verify their ability to pay back. Legal entities sometimes turn to the creation of shell companies to satisfy the credit conditions when these requirements are not met. Once the credit has been approved, the shell companies vanish just as the financial institution is alerted to the financial statements' falsification (FFIEC, 2009; Singh, 2010).¹⁷

6. Money laundering

To hide the source and ownership of resources that have been gained illegally, criminals employ a number of devices and strategies. Financial Action Task Force (2014, 2018) claims that the primary method of this shadowy activity in financial systems is shell companies. Placement, layering, and integration are the three steps of money laundering in financial systems. During the placement phase, the majority of the funds are introduced in cash via a number of deposits to shell firms..¹⁸

¹⁵ Sachet Singh and Abhishek K. Singh, Black Money and Voluntary Disclosure of Income Scheme: Two Sides of the Same Coin?, 1 KIIT Student L Rev 1 (2014)

¹⁶ Ryan Hauer, Another Attempt at Patent Reform: S. 1013 The Patent Abuse Reduction Act of 2013, 24 DEPAUL J. ART TECH. & INTELL. PROP. L., 371, 372

¹⁷ Supra Note 16

¹⁸ Id.

ILLICIT ACTIVITIES CONDUCTED THROUGH SHELL COMPANIES

No nation around the globe has declared the 'mailbox' companies as illegal as they can also serve legitimate purposes. Some of the legitimate uses of a shell company are:

- ✓ It can be used as a Special - Purpose Acquisition Company (SPAC) which is used for securing capital for an established private company through a public stock offering
- ✓ If a company intends to engage in business with a disreputable company, in order to save its image, it may create a shell company.
- ✓ To temporarily hold or store money an owner of a company may create a shell company.

However, shell firms are mostly utilised for criminal purposes such as money laundering and tax evasion. It can be incorporated like any other company under the domestic laws of the country, for example to incorporate a shell company in India, it has to follow prescribed procedures outlined by the Ministry of Corporate Affairs (MCA) and the Companies Act, 2013. Nevertheless, defrauders prefer to create shell companies in tax havens, some of the common tax havens are Cayman Islands, Switzerland, British Virgin Islands, Bahamas and many others.

To illustrate the workings of fraudulent activities conducted through shell companies, some notable cases are employed for clarification.

1. Ganga Builders Scam

In 1982, a shell company by the name of Ganga Builders was established. On February 14, 2008, a significant financial transaction occurred involving 18 companies located in Delhi, Mumbai, Guwahati and primarily in Kolkata. These companies collectively invested Rs 10 crore in a company named Ganga Builders. Interestingly, on the very same day, a much larger transaction took place, drawing the attention of numerous investigation agencies such as the Central Bureau of Investigation (CBI) and the Income Tax Department. Seventeen companies, many of which were linked with significant industrial firms, invested a total of Rs. 121.24 crore in Jagathi Publications, Jagan Reddy's main media venture. Over the years, the CBI expanded its investigation to encompass investments totalling over Rs 1,100 crore into Jagathi. Notably, a subset of Kolkata and Mumbai-based firms that

had invested in Jagathi shared common investors with those who had invested in Ganga Builders. Income tax investigators conducted a visit to the address of Ganga Builders, situated in a commercial area at the heart of Kolkata, with an office complex. A few other companies that had invested in Ganga Builders also shared the location. During their visit, they came across a single office with a peon who validated the companies identities at the location but was unable to provide any further information about the owners.

On February 14, 2008, a business called Ganga Builders received a Rs 10 crore investment from 18 companies primarily based in Kolkata, but also in Delhi, Mumbai, and Guwahati. A much larger transaction also occurred on the same day as this one, and it was this transaction that eventually caught the attention of several investigative organisations, including the Income Tax Department and the Central Bureau of Investigation (CBI). The flagship media firm controlled by Jagan Reddy, Jagathi Publications, received a total investment of Rs 121.24 crore from seventeen enterprises, several of whom are members of well-known industrial conglomerates.

A smaller group of Mumbai- and Kolkata-based companies were among the investors in Jagathi in 2008; here is where their paths crossed that of Ganga Builders. They were typical for a large portion of the investors in Jagathi and Ganga. Income tax investigators paid a visit to the office location of Ganga, situated in the bustling area of Kolkata, within an office complex. The business shared the address with a couple of other paper companies who were prominent investors in Ganga. They only came across one office, where a peon corroborated that the company functioned at that location but was unable to provide additional information about the proprietors.

2. DHFL Scam

This scam is the biggest financial fraud ever committed in India, uncovered in the year 2019 it involved an amount approximately Rs 34,615 crores.¹⁹

Dewan Housing Finance Corporation Limited (DHFL) is a non- banking finance company (NBFC),

¹⁹ Raghav Ohri, DHFL scam: Promoters Wadhawans set up 87 shell companies, says CBI charge sheet, The EconomicTimes(Nov.28,2022),<https://economictimes.indiatimes.com/news/india/dhfl-scam-promoters-wadhawans-set-up-87-shell-companies-says-cbi-charge-sheet/articleshow/95812374.cms?from=mdr>.

it specializes in offering loans to individuals from lower and middle income brackets in rural and semi-urban areas throughout the country.

From the period of 2010-2018, Union Bank of India along with other 16 banks granted loan to DHFL amounting to approximately Rs 42,871 crores²⁰ out of which it defaulted in the repayment of approximately Rs 34,615 crores.

The directors of the company created around 87 shell companies²¹ with nominal capital of Rs 1,00,000, these companies had the same addresses, most of them had the same nominal directors and also had the same group of financial auditors to mask the fraudulent activities.

The amount borrowed by DHFL was given as loans and advances to these shell companies without any collateral or securities, this amount further was flown into other companies which were owned by the promoters of DHFL, which was subsequently used by them to purchase assets in other countries, therefore, the shell companies in this case was used as an intermediary for round- tripping of funds.

3. Panama Paper Leak

In 2015, an anonymous source contacted Süddeutsche Zeitung newspaper, which sent volumes of documents extending from 1977 to 2015, which was termed as Panama Papers, these documents were sent to the International Consortium of Investigative Journalists (ICIJ) which took an year to analyse these documents, at the start of April 2016, its results were published.

Mossack Fonseca is a Panamanian law firm specialising in financial services, this firm had its operations in more than 35 jurisdictions during the past 40 years, it helped its clients to launder money, evade tax etc. by selling anonymous offshore companies in tax havens. Panama papers revealed that over the span of 37 years, 15,600 shell companies were set up to keep the financial affairs secret; it

²⁰ DHFL fraud: The Wadhawan brothers, a multi-crore scam and ongoing cases, BusinessToday (Aug. 29, 2023), <https://www.businesstoday.in/latest/corporate/story/dhfl-fraud-the-wadhawan-brothers-a-multi-crore-scam-and-ongoing-cases-396126-2023-08-29>.

²¹ Raghav Ohri, DHFL scam: Promoters Wadhawans set up 87 shell companies, says CBI charge sheet, The Economic Times (Nov. 28, 2022), <https://economictimes.indiatimes.com/news/india/dhfl-scam-promoters-wadhawans-set-up-87-shell-companies-says-cbi-charge-sheet/articleshow/95812374.cms?from=mdr>.

involved various celebrities, government officials, sports figures, business directors and many others in offshore dealings with Mossack Fonseca. Furthermore, it established covert shell firms or nominee companies for a variety of infamous individuals, encompassing criminals, members of organized crime syndicates and individuals subject to sanctions. The leaked documents revealed that the Panamanian law firm collaborated with a minimum of 33 individuals and organizations designated by the US Treasury for sanctions related to Iran, Syria, Zimbabwe and North Korea.²²

The law firm frequently assumed management roles for these newly established offshore companies, providing representation and advocacy on behalf of its clients before the government agencies in offshore jurisdictions.

Mossack Fonseca concealed the actual owners' identity information in public records by registering the companies under its own name. To facilitate the establishment of companies, trusts and foundations for its clients, Mossack Fonseca collaborated with an extensive network of 14,000 law firms and financial institutions, which included notable names such as Deutsche Bank, HSBC, Société Générale, Credit Suisse, Commerzbank, and Nordea.²³

SPECIAL - PURPOSE ACQUISITION COMPANY (SPAC): A LEGAL APPLICATION OF A SHELL COMPANY

Around the world, no country has accorded illegal status to shell companies because these companies can also be used for lawful purposes. Some of the legitimate uses of a shell company are: It can be used as a Special - Purpose Acquisition Company (SPAC) which is used for securing capital for an established private company through a public stock offering, this type of company also may not have assets, company operations, employees etc., like shell companies it also exists on documents, therefore SPAC's are also termed as shell companies.

A SPAC is an alternative to its traditional counterpart, the Initial Public Offering, in terms of raising money. The concept of SPACs (hereinafter referred to as an IPO) has been a topic of discussion

²² Will Fitzgibbon, Law Firm's Files Include Dozens of Companies and People Blacklisted by U.S. Authorities, ICIJ (Apr. 4, 2016), <https://www.icij.org/investigations/panama-papers/20160404-sanctioned-blacklisted-offshore-clients/>.

²³ Explore the Panama Papers Key Figures, ICIJ (Jan. 31, 2017), <https://panamapapers.icij.org/graphs/>.

among business entities due to the mature market, favorable terms for investors, and a growing presence of banks that lead their sectors. These factors have all contributed to making these acquisition companies attractive bargains for investors. Due to their convenience, SPACs have become one of the main sources of capital for small and mid-sized businesses. These acquisition companies have been existent for years in developed countries, such as the United States, Canada and other economies, but they have recently become common. SPACs have become extremely popular in the US over the last two years since Covid-19 entered the market. IPOs of SPACs raised approximately \$82 billion in 2020, and \$162 billion in 2021, exceeding that figure SPACs have also gained significant traction in the Indian context. Through SPACs, companies like "renewable energy giant ReNew Power" and "Grofers" entered the NASDAQ market. Also in 2015, Videocon D2H chose the SPAC route to get listed on the NASDAQ through "Silver Eagle Acquisition Corporation." In 2008 and 2014, NASDAQ-listed SPACs acquired Solar Semiconductor, Citrus Power, and Yatra, among other Indian private companies. SPACs are extremely popular, but they do not receive the large-scale research they probably deserve despite their popularity. Although there are many SPACs operating in India, none have been registered locally. In spite of the number of SPACs in the country, the Indian market has received even less coverage. Laws that make it difficult for SPACs to operate, as well as investor dubiety, make it difficult. However, with the thriving Indian capital markets, the country will soon witness locally registered SPACs governed by exclusive laws

Regulatory Challenges for SPACs in India

SPACs are not well addressed in the present regulatory framework in India as compared to other developing countries such as the USA. India needs to address certain roadblocks before it can be referred to as a SPAC-friendly nation."Companies Act 2013" and "Companies Act 1956" do not specifically mention SPACs. To eliminate legal ambiguity, make doing business easier, and avoid blatant litigation, a parliamentary panel urged the "Ministry of Corporate Affairs" in 2018 to define "shell companies." The "Objects clause" in the "Companies Act, 2013" has been found to be a stumbling block in the legal enforcement and administration of SPACs in several cases. Contrary to this provision, SPACs do not have such goals and objectives, since their sole purpose is to acquire a target.

The Registrar of Companies may also delete a company's name from the Register if it fails to begin

its operations within one year of its legal establishment. As a result, SPAC acquisitions average 18 to 24 months in duration, since sponsors pick the best target in order to maximize shareholder value. As a result, the concept of SPACs is hindered.²⁴

REFORMS NEEDED IN INDIA TO EFFECTIVELY COUNTER FRAUDULENT ACTIVITIES PERPETRATED BY SHELL COMPANIES

The rise of shell companies in India has been a significant concern for the country's regulatory authorities and the government, these entities are being used for various illegal purposes such as money laundering, tax evasion, fraud etc. There are many laws and regulations in India to combat the fraudulent activities of shell companies such as Director Identification Number which is assigned to the directors of the companies, it requires all the directors to obtain a DIN which involves a background check.

Furthermore, regulations are also provided by different acts such as SEBI, Foreign Exchange Management Act (FEMA), Insolvency and Bankruptcy Code (IBC) etc.

However, with the advancements in technology, increased globalisation and cross-border transactions, a regulatory gap is created which has allowed shell companies to exploit the weaknesses in the system.

Shri Rao Inderjit Singh, Union Minister of State for Corporate Affairs, in a response to a question asked in Rajya Sabha stated that the government has identified and struck down total 238223 companies from the year 2018 to June 2021 across India²⁵ These companies were used for unlawful purposes such as obscuring ownership, tax evasion, money laundering, benami properties etc.

Therefore, India should consider the adoption of some reforms to effectively oversee and control the

²⁴ Amisha Raghuvanshi, The Embryonic Stage of Special Purpose Acquisition Companies in India: Prevailing Obstacles and the Way Forward, SCC Online Web Edition 103-110 (2022).

²⁵ Government identified 2,38,223 companies as shell companies between 2018-2021, (July 27, 2021), <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1739583>.

operations of shell companies.

Effective functioning of SPAC's in India

Over the past few years , Indian companies have also taken this route , which is why SPACs need to be regulated by Indian regulators. As of now, Indian regulatory regime is not favourable to SPACs , and this concept is barely mentioned in laws.. Laws tailored to Indian markets can make SPACs an attractive alternative to their traditional counterparts. To address the regulatory issue regarding SPACs in India, the following recommendations should be considered:

Firstly, SPACs must be clearly distinguished from shell companies, as shell companies are presumed to be the main means of laundering money. SPACs should also not be recognized as blank check companies, which were once illegal. The SPACs should therefore be distinguished from shell companies and identified separately.

Secondly, the current laws in India are unfavourable to SPACs, and there are too many regulators which hinders the growth of startups. In order to make the laws more relevant today, they need to be changed.

Thirdly, committees should be established to study the SPAC mechanism in other jurisdictions and its feasibility in India. Since only a few jurisdictions regulate SPACs globally, it may be possible for the government to convene a special committee to study how these countries regulate them and whether the Indian market is familiar with the conditions for adopting or integrating these laws. Upon establishing the impact of SPACs in these economies, India can tailor its own regulations to suit certain industries such as start-ups.

Fourthly, legislation should amend the "Companies Act, 2013" to include a separate chapter on SPACs and any other aspects associated with them, such as management, board members, shareholders, etc. The legislature should recognize the differences between SPACs and traditional IPOs, as well as the need for laws specifically targeting them. Since the SPAC does not pursue the traditional IPO route, once it has achieved its acquisition goal, it should not be subject to prevailing laws. SPACs may also qualify for tax deductions and exemptions offered to startups, angel investors,

and venture capitalists.

Amendment in Companies Act, 2013

Company Act, 2013 fails to define the term ‘shell companies’, a well-crafted definition within the law can help the authorities and regulatory bodies in India better target and address the issues associated with the shell companies. Such a definition might include criteria related to lack of genuine business activities, nominal or inactive operations and the potential misuse for fraudulent and illicit purposes.

According to Section 248 of Companies Act, 2013²⁶, the Registrar is authorized to eliminate a company’s name from the Companies Register, however, this provision gives the Registrar powers under three circumstances:

If the company does not commence its operations within one year of its formation. The company qualifies for its name removal if it has been inactive and devoid of any business or operations during the two consecutive financial years leading up to this period. Additionally, the Company has not made an application during this time frame to attain the dormant company status as defined in Section 455²⁷. Furthermore, if the members decide, either through a special resolution or with the consent of 75%, to remove the Company’s name from the Register of Companies.

The scope of power granted to registrar under this section is narrow, there is a need to widen the ambit of its power, The registrar should be empowered to confirm the registered address of the company, and in the event that the company is not located at its registers address, the registrar should have the authority to remove its name from the company’s Register.

Setting-up of Risk-based Anti-Money Laundering Program in Firms

Firms must comply with the regulations and recommendations set out by Global money laundering and financial regulatory organizations such as Financial Action Task Force (FATF), International Monetary Fund (IMF), firms can set up risk-based Anti Money Laundering programs to deal with the

²⁶ The companies act § 248 (2013).

²⁷ The companies act § 455 (2013).

problems posed by Shell companies. This program shall gather information and put risk- assessment on the customers.

For example, if a reputed manufacturing company in India, say X asks for a loan from a private bank in India named, Y.

The AML team of Y should perform customer due diligence processes, in which it should verify the beneficial ownership of the entities of X and confirm ultimate beneficial ownership of all the entities of X. After this step, Y should perform transaction screening and identify any unusual transaction patterns. Y should also perform Adverse Media Monitoring, it should check for any adverse stories from traditional screens, print media and online sources.

Amendment in Prevention of Money Laundering Act, 2002

Prevention of Money Laundering Act (PMLA) was introduced in the year 2002 to prevent money laundering being in the country by various means and channels including shell companies. However with changing times and rapid developing technologies, for example, central bank digital currencies, cryptocurrency, non-fungible tokens etc., new channels have been discovered for money laundering through these shell companies.

In order to curb these channels various amendments must be made in the act to include these new technologies and accordingly necessary training and powers should be provided to the government officials to enforce the Act.

Identifying areas of heightened activity and implementing measures to manage them effectively

In the year 2017, a task- force was instituted with the aim of preventing the creation of Shell-companies, this task-force found out that Kolkata is the most preferred address for a Shell company, in the total number of shell companies uncovered by the task-force, 90% of them were registered in Kolkata.²⁸

There are number of reasons for being the most preferred choice of venue for these companies, some of them are:

- 1) It has the easiest availability of professionals who are required in this type of activities (such as CA's) with an established network. Kolkata's strength lies in its community of chartered accountants (CAs) who readily act as "directors" for these companies
- 2) The expense associated with hiring a Chartered Accountant in Kolkata is notably less than that in Mumbai
- 3) In this city, traders utilize shell companies to effectively handle the tax responsibilities linked to capital gains. The financial ecosystem of the city provides a ready solution to optimize tax- liabilities on short-term speculative gains.

Therefore, with the advent of AI and other digital tools, the Government and its regulatory bodies should identify the hotspots of these companies and accordingly, manage the loopholes that the companies are exploiting.

CONCLUSION

The research paper has conducted in-depth investigations into the complexities and issues associated with shell companies operating in India and the indispensable need for an effective regulatory framework to combat the illegal activities. We have embarked a journey from understanding the concept of shell companies to examining their global perspective and the international framework that seeks to address their operation on a broader scale.

Our focus has predominantly centered in India, where we have scrutinized the existing regulatory framework, highlighting the pivotal roles played by the Companies Act 2013, PMLA, 2002 and Benami Transaction Prohibition Amendment Act, 2016 and in addressing shell- company related issues. Furthermore, our research has underscored the diverse ways in which these entities are manipulated for various unlawful activities such as tax evasion, generation and circulation of black money, patent trolling etc.

Real-world examples such as DHFL scam, Panama Paper Leaks have exemplified the gravity of the issue and the pressing needs for stringent regulatory reforms.

Within the context of regulatory reform we have also explored the unique challenge presented by

Special Purpose Acquisition Companies (SPACs), requiring particular attention and vigilance.

The paper has elucidated the urgent need for reforms within India to effectively counter fraudulent activities perpetuated by Shell Companies. These reforms include amendments to Companies Act, 2013 and PMLA, 2002, identification of hotspots of shell companies and measures to manage the same. Furthermore, it is essential for the firms to establish risk-based anti- money laundering programs to bolster the defense against illicit financial flows and money laundering.

By enhancing the regulatory framework and staying vigilant in identifying and managing risks, India can foster a more transparent, accountable and trustworthy business environment. The collective effort to combat illicit activities associated with shell companies is a step towards upholding the nation's reputation and reinforcing its commitment to ethical and lawful business practices. As we look into the future, it is imperative for India to take these steps to ensure the well-being of its financial systems and prosperity of its citizens.



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