



CHALLENGES TO SHELL COMPANIES IN INDIA

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INTRODUCTION

CHARACTERISTICS OF SHELL COMPANY:

- Exists only on Paper
- No legal definition for shell company, they are also not defined under the companies Act 2013.
- ICAI is **now looking to define a “Shell Company”** for the purpose of effective regulatory action against such firms.
- **OECD Defined SHELL COMPANY as**
 - formally registered
 - incorporated, or
 - otherwise legally organized in an economy
 - but which does not conduct any operations in that economy other than in a pass-through capacity.



OECD- Organization for Economic Co-operation and Development.

LEGALITY OF SHELL COMPANIES

A Shell Companies operation may be legal or illegal.

➤ Shell companies do have legitimate business purposes.

➤ **However**, the term shell company is mostly used for illegal shell companies and such companies should be identified on the basis of purpose of their creation.



This purpose is to :

- Divert money for tax evasion
- Route money generated from illegal activities to formal financial institutions and
- Transfer assets from one company to new company without the transfer of liability of the former company to save tax.



IMPACT OF SHELL COMPANIES IN CORPORATE RESTRUCTURING

❖ Corporate restructuring is redesigning of the corporation in one or more aspects to tackle the

- ✓ Financial difficulties,
- ✓ Business expansions or
- ✓ To make it more profitable enterprise which is possible either through
 - ❑ Organizational restructuring
 - ❑ Financial restructuring
 - ❑ Or both.



- Incorporation of shell company is one of the methodology embraced by the firms for efficient corporate restructuring.

“the First firm gets the oyster, the second one gets the shell”.

- Incorporation of a shell company is one of the expeditious ways to go public via the acquisition of a dormant public company and merging a private company into it, commonly termed as ‘**reverse merger**’



- No doubt shell companies play a key role in reverse mergers as they deliver time-efficient and cost-effective means for the transformation of a private company into a public company. Along with the easy process here are some more benefits:
 - Lower foremost cost
 - No over extravagant banking fees
 - Reduction of a time frame in the conversion of the private company into a public company.
 - No amenity of getting approval from any regulatory authority
 - No supervision over transactions
 - Capitalization is possible through the stock of the private company so no need to raise funds for acquisition or merger.
 - Easy fundraising as investors will have a defined exit strategy



HOW ARE THESE SHELL COMPANIES MISUSED:

- Many studies show that this type of corporation is a viable choice if you're empirical to save taxes or hide assets.
- It has become one of the most prevailing unethical practices used to hide the assets and real income of the business through the Shell Companies.
- Shell company works as a prominent tool existing merely on papers, no employees, no office or no assets which are registered to the company.
- These shell companies repose criminal effect when these are used for the criminal purposes like black money laundering, tax evasion.
- The Shell Companies provides the corporates with an easy way to evade tax and enjoy the fruits of black money earned by evading the taxes to be applied as per the government regulations.



- Given the objectives of the formation of a Shell Company, it ends up violating the following laws:



**Benami Transactions
Prohibition (Amendment)
Act, 2016**



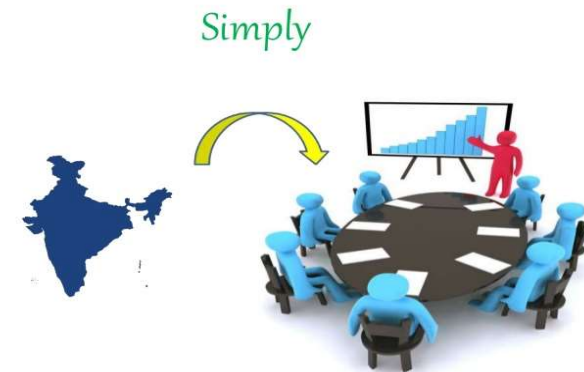
**Prevention of Money
Laundering Act (PMLA)**



**INDIAN
PENAL CODE
1860**



**The companies (restriction
on the number of layers)
rules 2017**



**PoEM Guidelines issued by
CBDT**

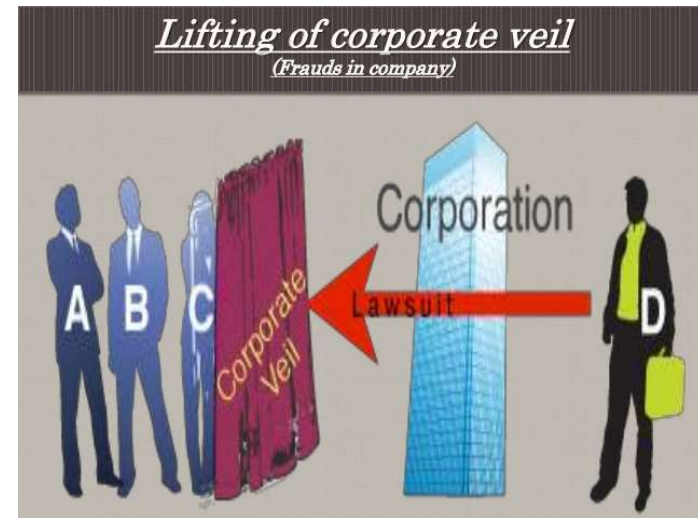
LEGITIMACY WITH REGARD TO SHELL COMPANIES IN INDIA

- As per the **Indian legislation setting up of shell companies is legal** in India which has paved way for the companies to evade taxation and money laundering for many years.
- But to curb these illicit practices prevailing in the country central government has taken various crucial steps to crack down upon the fraud companies set up for merely hiding the assets of the real owners such of few steps are :
 - Lifting of Corporate Veil
 - Introduction of task force
 - Other Regulatory Measures



LIFTING OF CORPORATE VEIL

- The company having this corporate personality acts as haystack where directors, promoters, or other such persons are able to act in the name of **the company and hide themselves in the haystack like a needle**.
- However, over the period of time, Judiciary around the globe has evolved many methodologies and approaches to **make sure no one takes advantage of this shield for carrying out their immoral and tainted practices**.
- Respective penalties and punishments have been prescribed by Legislatures of different countries for committing different types of illegal acts in the name of the company.



INTRODUCTION OF THE TASK FORCE

- The ‘Task Force’ was **set up in February, 2017** by the Prime Minister’s Office under the joint Chairmanship of the Revenue Secretary and Secretary, MCA with a mandate to check in a systematic way, through a coordinated multi-agency approach, the menace of companies indulging in illegal activities including facilitation of tax evasion and commonly referred to as ‘Shell Companies’.
- Department of Financial Services, CBDT, CBEC, CBI, ED, SFIO, FIU-IND, RBI, SEBI, DG GSTI and DG-CEIB are its Members.

- CBDT – Central Board of Direct Taxes
- CBEC – Central Board of Excise and Customs
- CBI – Central Bureau of Investigation
- ED – Enforcement Directorate
- SFIO– Serious Fund Investigation Office.
- FIU-IND—Financial Intelligence Unit India.
- RBI– Reserve Bank Of India.
- SEBI– Securities Exchange Board Of India.
- DG GSTI—Director General of Goods and Service Tax Intelligence.
- DG CEIB ---Director General Central Economic Intelligence Bureau



INTRODUCTION OF THE TASK FORCE

Major Achievements of Task Force.

The major achievements of the Task Force include the compilation of a database of shell companies by SFIO (Serious Fraud Investigation Office). This database, as on date, comprises of 3 lists, viz.,

- **Confirmed List** : has a total of 16,537 confirmed shell companies on the basis of the information received from the various Law Enforcement Agencies of the companies found to be involved in illegal activities.
- **Derived List** : The Derived List has 16,739 companies identified on the basis of 100% common directorships with the confirmed shell companies.
- **Suspect List** : The Suspect List has 80,670 suspected shell companies and has been drawn up by SFIO using certain Red Flag Indicators.

(Source: Press Information Bureau Government of India Ministry Of Finance)



OTHER REGULATORY MEASURES

- **Reserve Bank Of India** : Government had requested the **Reserve Bank of India (RBI)** for freezing of accounts of the defaulting companies who have long exceeded the stipulated time limit, for filing of Financials Statements and returns, under the Companies Act.



- **SECURITIES EXCHANGE BOARD OF INDIA** : **SEBI (Securities Exchange Board Of India)** has asked exchanges to verify credentials / fundamentals of suspect companies by appointing an independent auditor. If exchanges do not find appropriate fundamentals about existence of the Company, the stock can be delisted.



- **REGISTRAR OF COMPANIES:** The **Registrar Of Companies** has been ordered to examine balance sheets and other financial records of companies that raise money through public issue, along with how the money is being utilized.



- **Tie up Between Ministry Of Corporate Affairs and Central Board Of Direct Taxes** **MCA and CBDT** have signed MoU (Memorandum Of Understanding) for automatic and regular exchange of tax information. The purpose of the MoU is to curb the menace of shell companies, money laundering and black money in the country and prevent misuse of corporate structure by shell companies for various illegal purposes.



- Money Control had reported, on that the corporate affairs ministry has launched a mega KYC drive for Company directors, in which they have to provide passport, PAN number and contact details such as personal phone number and email addresses. This is part of the government's larger strategy to clamp down on shell or paper companies that seek to operate outside regulatory boundaries. Many such companies are under the authorities' lens for allegedly serving as conduits of undisclosed funds to evade taxes.



- Serious Fraud Investigation Office is creating a database of shell companies.



CONCLUSION

- Bringing more transparency on corporate governance, curbing the menace of black money would result in higher tax revenues which will not only help the government enhance public spending, but will also lower the tax burden on honest taxpayer.
- The government should be careful in taking action against shell companies as it can affect investor confidence and market sentiment.
- Companies with legit operations and business activities can avoid being reprimanded for irregularities through increased focus on compliance of various statutes
- Setting the right tone at the top, improving governance, conducting due diligence, and avoiding corrupt practices will lead to keeping a check on potential surreptitious activities and build trust among entities in the economic ecosystem.
- While encouraging compliance is high on government's agenda in its journey towards making the economy clean, it may definitely be worthwhile for offenders to come out of their "shell" before it is too late.



“Fighting against black money is not just good governance.
It's self-defense. It's patriotism.”

People must understand the importance of paying the tax and should **refrain** from **concentrating black money**. The small contribution each citizen does in the form of taxes helps in the development of the country. And remember, the government alone cannot bring this issue to an end. It can only be curbed if each and every citizen of the country contributes his part.





THANK YOU