

# Shell Companies

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## ABSTRACT

The term ‘shell company’ has been heard quite often in recent years. Though most of the people have heard this term, not many people know the exact meaning behind it. In our country, there is no specific definition for this term. No legal definition is mentioned in The Companies Act or any other Act. Efforts to define it have been going on. However, it can be said that a shell company is a company that has no or few significant assets or operations. The main objective behind establishing such companies would include money laundering, tax evasion, converting black money into white money, etc., These shell companies affect the economy of a country by making the poor into poorer and rich into richer. In order to curtail these companies there is no specific provision, Act, or law related solely to shell companies. Issues related to these companies are generally dealt with under The Prevention of Money Laundering Act, 2002; Benami Transactions Prohibition (Amendment) Act, 2016; Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015; The Income Tax Act, 1961; Indian Penal Code; and The companies Rules 2017. Hence the Author is going to discuss what is a shell company, how to identify it, the reason behind the creation of shell companies, laws that are violated, the effects of shell companies, and the challenges faced while curtailing shell companies. Finally, the author will end the discussion with probable suggestions.

**Keywords:** Shell company, Money laundering, Tax evasion, curtail, Prevention of Money Laundering Act 2002, Benami Transactions Prohibition (Amendment) Act 2016, Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015, The Income Tax Act, 1961, Indian Penal Code, and The companies Rules 2017.

## 1. Introduction

### 1.1. Meaning

The usage of the term ‘shell’ in the ‘Shell Companies’ literally means that just like a shell, these companies have a thick outer covering while the inside is hollow. It is a company that only exists on paper.

A shell company is basically an inactive corporate entity that does not have any business operations, nor does it have any significant assets in its name.<sup>1</sup> Unlike any other company, these shell companies do not have employees and may or may not be legally registered, incorporated, and listed on the stock exchange.

These companies do not have a real office. They use a duplicate address for their purposes. These are deliberately created to avoid tax evasion, money laundering, and other illegal purposes. They do not make money, nor do they provide the customers with any products or services. This is a type of White Collar Crime.

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<sup>1</sup> [What Is a Shell Corporation? How It's Used, Examples and Legality \(investopedia.com\)](https://www.investopedia.com/terms/s/shell-company/), Will Kenton, Jul 17, 2022.

## 1.2. Definition

In India, there is no legal definition given in the Companies Act or any of the other Acts. But it is defined in the Securities Act enacted in the USA.

The Securities Act Rule 405 and Exchange Act Rule 12b-2 define a Shell Company as a company, other than an asset-backed issuer, with no or nominal operations; and either:

- no or nominal assets;
- assets consisting of cash and cash equivalents; or
- assets consisting of any amount of cash and cash equivalents and nominal other assets.<sup>2</sup>

## 2. How to identify a shell company?

Though shell companies are not defined in India, as per the above given definition mentioned in the Securities Act of the USA can be taken into consideration to understand a shell company.

Including SEBI, there are other individuals and agencies that tried to give some characteristics of a shell company that can be used to identify a shell company. They are as follows:

- These companies have no or minimal business activities.
- They have no or minimal number of assets.
- They do not have employees or a real office address.
- They are set up to facilitate cross-border currency.
- They only exist on paper because they do not have physical existence.
- They do not provide any products or services to customers.
- There is no economic rationale behind their monetary transactions.
- The transactions have no connection with the business operations.
- They carry out rotational transactions without any legitimate reason.<sup>3</sup>

## 3. Reasons behind the creation of shell companies

The Panama Paper leaked about various political leaders, banks, and wealthy people who had allegedly hidden their money in shell companies.<sup>4</sup> Most of these shell companies are located in tax haven places like Panama, Switzerland, the British Virgin Islands, or the Cayman Islands. Tax haven countries are the places where the tax levied is low or nil. In these Tax haven companies, registration of shell companies is quite simple.<sup>5</sup> By usage of a few dollars would incorporate such companies without any need for legal requirements.

These companies are usually created by big companies, politicians, or influential and wealthy people. There are certain reasons why they create these types of companies. These are some of the main reasons are as follows:

- Tax Evasion: Usually these companies are created in a tax haven country to evade the tax payments.

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<sup>2</sup> [SEC Rules Affecting Shell Companies - HG.org](#), Brenda Lee Hamilton.

<sup>3</sup> [Shell Companies In India - Corporate and Company Law - India \(mondaq.com\)](#), Ashima Obhan and Nishtha Jaisingh, 29 Aug 2019.

<sup>4</sup> [What Is a Shell Company \(Shell Corporation\)? Example and Benefits | SmartAsset](#), Amanda Dixon, Apr 20, 2023.

<sup>5</sup> [Tax Haven: Definition, Examples, Advantages, and Legality \(investopedia.com\)](#), By The Investopedia Team, Jan 05, 2022.

- Money Laundering: Many companies create these companies to store their black money and convert it into white money. In 2016, during Demonetization, a lot of such shell companies were discovered.
- Ponzi Schemes: These companies are also used to defraud people through fraudulent schemes. Even if the fraud is found out, it is difficult to find the people behind it. Hence the company alone is blamed while the fraudsters escape.
- Illegal transactions: They are also used for illegal transactions like Hawala transactions etc.<sup>6</sup>
- Hiding the true identities: They are also used to hide their identities so as to escape easily, if a situation arises.
- Giving contracts to shell companies to swindle the profits by showing more expenditure.

#### 4. Violation of Law

Even though, in India, there is no separate law for these shell companies, they are still punishable under violation of various other laws. They are as given below:

- Prevention of Money Laundering Act: The transaction of black money to shell companies is punishable under Section 3 of this Act.
- Benami Transactions Prohibition (Amendment) Act, 2016 prohibits anyone from avoiding taxation by holding any assets under a fake name.
- Black Money and Imposition of Tax Act, 2015.
- The Income Tax Act, 1961: The guidelines issued by the Central Board of Direct Tax.
- The Companies Rules, 2017 restricts the number of subsidiaries a company can have.
- Indian Penal Code: scams involving shell companies such as Ponzi schemes shall be punishable under Section 420.<sup>7</sup>

#### 5. Effect of Shell Companies on Society

The creation of shell companies is a white-collar crime. A murder affects only the victim's family while a white-collar crime affects the entire society as a whole. These companies affect society in the following ways as given below:

- The money will be concentrated in the hands of a few i.e. Hoarding of money.
- Scams such as Ponzi schemes loot the money of middle and poor people.
- The poor will become poorer while the rich will become richer.
- Increase in illegal and Hawala transactions.
- Increase in white collar crimes.
- Increase in Black Money.
- Lack of employment.
- Decrease in Gross Domestic Product (GDP) of the country.
- Fall of economy, rise of inflation.

#### 6. Measures taken by the government

Our government has taken the following measures subjected to the shell companies as given below: The Ministry of Corporate Affairs has caught shell companies that have filed their affairs to the Registrar of Companies (ROC) and Securities and Exchange Board of India (SEBI) in a fraudulent manner i.e. filing

<sup>6</sup> [Legal Implications of Shell Companies in India | Enterslice](#), Narendra Kumar, 13 Dec 2021.

<sup>7</sup> [The legality of creating shell companies in India - Lexology](#), Sakshi Sairwal, Aug 16, 2021.

wrong financial or non-financial information regarding the company or its members. For example, the Address of the company, the Address of the Directors of the company, the Investment of the Directors, the financial statements of the company, the list of shareholders of the company and their addresses, etc., and also the companies that did not file the required financial statements. Under Section 248 of the Companies Act, 2013, the Registrar of Companies (ROC) removed many such companies from the register of companies.

The income tax department conducted investigations and made searches on such shell companies engaged in illegal activities and also launched criminal prosecutions against such companies. They also collect taxes on such money. The Enforcement Directorate seizes the assets and black money of such companies.

In Feb 2017, a Task Force was set up which was headed by the Secretary and Revenue Secretary of the Ministry of Corporate Affairs. The members of this force shall include the RBI<sup>8</sup>, SEBI<sup>9</sup>, SFIO<sup>10</sup>, CBDT<sup>11</sup>, CBI<sup>12</sup>, ED<sup>13</sup>, DG GSTI<sup>14</sup>, FIU-IND<sup>15</sup>, DG-CEIBs<sup>16</sup>, and The Department of Financial Services. This Task Force compiles the database of shell companies which is divided into three lists namely Confirmed List, Derived List, and Suspect List. The Confirmed List contains the list of companies that have been found to be involved in illegal activities. The Derived List contains the list of companies identified as shell companies on the basis of common directorships with confirmed shell companies. The Suspect List contains the list of companies that are suspected by the Serious Fraud Investigation Officer on the basis of Red Flag Indicators.

Securities and Exchange Board of India (SEBI) takes action by restricting the suspected shell companies from trading.<sup>17</sup>

## 7. Problems faced by Government while taking measures

The main problems faced by the government while taking measures to stop such shell companies are as follows:

- No legal definition of shell companies under any law.
- No specific law for such shell companies.
- Lack of experts in this field of knowledge.
- Difficulty in differentiating between legal and illegal shell companies. (In **Assam Company India Ltd. And Another vs The Union of India**<sup>18</sup> On 7 Mar 2019, a company owning a number of substantial tea estates which produces millions of kilograms of tea on an annual basis and provides

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<sup>8</sup> The Reserve Bank of India

<sup>9</sup> The Securities and Exchange Board of India

<sup>10</sup> Serious Fraud Investigation Office

<sup>11</sup> Central Board of Direct Taxes

<sup>12</sup> The Central Bureau of Investigation

<sup>13</sup> The Directorate of Enforcement

<sup>14</sup> Director General of Goods and Services Tax Intelligence

<sup>15</sup> Financial Intelligence Unit-India

<sup>16</sup> Director General of Central Economic Intelligence Bureau

<sup>17</sup> [All you need to know about a concept of the shell companies \(ipleaders.in\)](#), Srishti Kaushal, Jan 27 2020.

<sup>18</sup> [The legality of creating shell companies in India - Lexology](#), Sakshi Sairwal, Aug 16, 2021.

support to thousands of families was branded as a ‘Shell Company’. The Hon’ble Gauhati High Court held that considering the negative implications, it is not justified to treat it as a shell company.)

## 8. Suggestions

Though the Government is making efforts to control and suppress the shell companies as mentioned above, it still has a few loopholes which make it difficult to eradicate these shell companies. Hence, the author would like to give some suggestions for the eradication of shell companies which are as follows:

- A legal definition of shell companies must be given.
- An exclusive law relating to the shell companies.
- Experts regarding the shell companies are needed.
- Rigorous punishment for persons who create and indulge in the creation of such shell companies.
- A separate Enforcement Directorate (ED) must be established for the implementation of the law.
- The people who Aid these shell companies must also be punished.
- The victims of the shell companies must be given justice.

## 9. Conclusion

In India, for reasons of tax evasion, money laundering, etc., such shell companies are cropping up in leaps and bounds which is affecting the economy at large. They are used by politicians, criminals, businessmen and wealthy people to stack their black money, transport it to other places and turn it into white. They also try to scam people using such shell companies.

Even though there are various legal authorities like SEBI<sup>19</sup>, RBI<sup>20</sup>, ROC<sup>21</sup>, CBI<sup>22</sup>, etc., which are trying to control and minimize these shell companies, they are not able to eradicate them completely.

This has become a big issue for the country. There is no proper definition, provisions or any Act to bring shell companies behind the bars. Recognition of a shell company has become difficult. Shell companies have become a colorable device in the hands of white-collar criminals.

Hence it is believed that there is a need for a balanced legal definition along with a law that explicitly deals with shell companies. The Task Force created to seize the shell companies can be said as the first step made to eradicate these shell companies. From the foregoing observations, it is clear that there must be a separate stringent law to punish the persons involved in shell companies and put them behind bars.

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<sup>19</sup>The Securities and Exchange Board of India

<sup>20</sup> The Reserve Bank of India

<sup>21</sup> Registrar of Companies

<sup>22</sup> Central Bureau of Investigation.