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# **THE SHELL COMPANY CONUNDRUM: TOWARDS PROACTIVE LEGAL REGULATION**

AUTHORED BY - V DASARATHI - [II LL.B]

CO-AUTHOR 1 - A KAVINN THENRAL - [II LL.B]

CO-AUTHOR 2 - A SAMIYUTHYA - [II LL.B]

INSTITUTION - School of Law, Sathyabama Institute of Science and Technology

## **ABSTRACT**

Shell companies have emerged as a serious challenge to economic governance, financial transparency, and regulatory enforcement in India. These entities, though legally incorporated, often lack genuine business operations and are frequently used as instruments for money laundering, tax evasion, round tripping of funds, and other financial crimes. One of the major concerns in regulating shell companies is the absence of a clear statutory definition and a proactive identification mechanism, which creates uncertainty for regulators regarding the timing and scope of intervention. This paper critically examines the legal and regulatory gaps surrounding shell companies in India. It analyses the limitations of the existing framework under company law, securities regulation, and tax laws, highlighting how reactive enforcement has failed to prevent misuse. The study further explores the role of regulatory bodies such as the Ministry of Corporate Affairs, Securities and Exchange Board of India, and enforcement agencies, and evaluates their effectiveness in detecting shell entities. The paper suggests comprehensive measures for improved detection and regulation, including the introduction of a statutory definition of shell companies, enhanced inter-agency coordination, strict disclosure of beneficial ownership, use of technology-driven surveillance, and stronger penal provisions. By adopting a proactive and coordinated regulatory approach, the paper argues that India can significantly strengthen corporate accountability and safeguard the integrity of its financial system.

**Keywords:** Shell Companies; Corporate Governance; Financial Fraud; Money Laundering; Regulatory Mechanism

## INTRODUCTION

A shell company is a business entity that exists solely on paper, lacking substantial business activities, assets, or employees. These entities are primarily created for financial or strategic reasons without engaging in active business operations, serving as vehicles for asset holding, ownership transfer, and transaction facilitation. While shell companies are not inherently illegal, they can be used for legitimate purposes such as facilitating mergers and acquisitions, holding assets, or enabling cross-border investments. However, they are often linked to tax evasion, money laundering, and corruption. The issue has gained international attention in recent years due to several high-profile financial scandals and global investigative leaks. Disclosures like the Panama Papers and the Pandora Papers have revealed the extensive use of shell companies by politicians, business leaders, and wealthy individuals to hide assets and move funds across borders. These revelations have shown how complex corporate structures and offshore entities can be used to obscure beneficial ownership and evade regulatory oversight. Such developments underscore the urgent need for enhanced corporate transparency mechanisms and improved regulatory frameworks.

## MEANING

The term "shell" in "shell companies" is used literally, as these companies have a solid outer layer but are hollow inside. They are inactive corporations without business operations or significant assets. Simply put, a shell company is an empty corporate structure used for financial or legal purposes. While not entirely illegal, shell companies can also serve legitimate functions.

## SCOPE AND SIGNIFICANCE

The legal and regulatory challenges surrounding shell companies primarily stem from the difficulty in identifying them and distinguishing between legitimate and illegitimate corporate structures. In many jurisdictions, including India, there is no comprehensive statutory definition of a "shell company." The lack of a precise legal definition creates ambiguity for regulatory authorities and enforcement agencies. Consequently, regulators often rely on general characteristics such as the absence of commercial operations, minimal assets, lack of employees, and suspicious financial transactions to identify potential shell entities.<sup>1</sup>

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<sup>1</sup> Ministry of Corporate Affairs, Report of the Task Force on Shell Companies, Government of India, <https://www.mca.gov.in> (last visited Mar. 21, 2026).

The Indian context, shell companies are regulated indirectly through a range of existing laws rather than through a single dedicated statute. The Companies Act, 2013, governs the incorporation, operation, and governance of companies and provides mechanisms for investigating corporate fraud and striking off inactive companies. Similarly, the Prevention of Money Laundering Act, 2002, criminalizes laundering illicit funds through corporate structures, including shell entities. Other laws, such as the Benami Transactions (Prohibition) Act, 2016, and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, also address the misuse of corporate vehicles for concealing ownership and evading taxes. Despite these legislative measures, enforcement remains challenging because of several structural and regulatory gaps. Shell companies often operate through complex ownership layers, nominee directors, and cross-border financial arrangements, making it difficult to identify the real individuals controlling them. Moreover, regulatory agencies frequently face difficulties in coordinating investigations and sharing information across jurisdictions. Consequently, identifying and regulating shell companies requires a comprehensive approach that combines legal reforms, stronger corporate transparency standards and enhanced cooperation among national and international regulatory authorities.

## **CREATION OF SHELL COMPANIES**

Shell companies are usually created through the ordinary process of company incorporation. Modern corporate laws allow companies to be incorporated with relatively simple procedures and minimal capital requirements. As a result, individuals or entities may establish companies that exist only as legal entities without engaging in real commercial activities. Another common practice involves establishing shell companies in foreign jurisdictions known as tax havens, where corporate taxes are low and disclosure requirements are limited. Such jurisdictions make it easier to conceal ownership structures and financial transactions. In some cases, shell companies are formed as part of layered corporate structures where several companies are created to obscure the identity of the ultimate beneficiary.<sup>2</sup>

While the process of creation is legally valid, the lack of transparency in ownership and financial operations raises serious regulatory concerns. formed as part of layered corporate structures where several companies are created to obscure the identity of the ultimate

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<sup>2</sup> Directorate of Enforcement, Prevention of Money Laundering Act, 2002, Government of India, <https://enforcementdirectorates.gov.in> (last visited Mar. 21, 2026).

beneficiary. While the process of creation is legally valid, the lack of transparency in ownership and financial operations raises serious regulatory concerns.

## LEGITIMATE USES OF SHELL COMPANIES

It is crucial to recognize that shell companies are not automatically illegal. In numerous instances, they fulfill legitimate and practical business functions. For instance, businesses might create shell entities to aid in corporate restructuring or during mergers and acquisitions. A shell company can also serve as a holding entity to oversee assets like intellectual property, real estate, or investments. Moreover, multinational corporations occasionally establish shell entities to streamline international investments or to penetrate new markets. When these companies operate transparently and adhere to regulatory standards, their existence is deemed lawful within the realm of corporate law.

## MISUSE OF SHELL COMPANIES

Despite their legitimate uses, shell companies are often exploited for illegal purposes due to their capacity to hide ownership and obscure financial dealings. One prevalent form of misuse is money laundering, where illegal funds are funneled through shell companies to mask their origin and make them appear legitimate. Shell companies are also commonly employed for tax evasion. Individuals or corporations might transfer profits to shell companies situated in tax havens to evade taxes in their home country. Another misuse involves concealing the identity of the actual beneficiaries behind layers of corporate entities and nominee directors.

## PRIMARY REGULATING ACTS COMPANIES ACT, 2013

The main act under governing corporate entities is companies act, 2013. This act provides direct tools for identifying and eliminating shells via inactivity and fraud checks.<sup>3</sup>

**Section 7(7):** Holds incorporators personally liable if formation involves fraud; pierces corporate veil for sham entities used to deceive creditors or evade obligations.

**Section 248:** Empowers Registrar of Companies (RoC) to strike off names of defunct firms failing to operate within one year of incorporation or inactive for two years; applies to shells with no business, leading to over 2 lakh disqualifications post-2017 crackdown.

**Section 447:** Punishes fraud (including shell misuse) with 6 months to 10 years imprisonment

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<sup>3</sup> Jason C. Sharman, Shell Companies and the International Financial System, 34 Yale Journal on Regulation 1 (2017).

and fines up to three times the fraud amount. Companies (Restriction on Number of Layers) Rules, 2017: Caps subsidiaries at two layers to prevent fund layering; violations incur ₹1,000 daily fines; blocks investments solely for siphoning.

### **PREVENTION OF MONEY LAUNDERING ACT (PMLA), 2002**

Targets shell companies that convert black money into legitimate funds.

**Section 3:** Forbids direct or indirect involvement in transactions with tainted money; shell companies routing illicit funds face attachment and prosecution by the Enforcement Directorate (ED). Enforcement collaborates with MCA data to identify red flags such as high share premiums, low turnover, and cash heavy balances. Benami Transactions (Prohibition) Act, 1988 (Amended 2016) Closes loopholes for anonymous asset holding. Prohibits benami transactions where shell companies hold property for actual owners to evade taxes; requires disclosure in all transactions Penalties: Up to 7 years imprisonment, fines; properties confiscated. Invocation follows the 2017 PMO directives against deviant shell companies.

### **THE INCOME TAX ACT, 1961**

Lacks a specific definition for shell companies but plays a pivotal role in curbing their misuse for tax evasion through scrutiny mechanisms and integration with other regulators, such as the MCA. It targets red flags These include accommodation entries, fictitious billing, and round-tripping via shells. Shells often facilitate tax dodging by inflating expenses or layering funds, which is indirectly addressed in these sections.<sup>4</sup>

**Section 68:** Unexplained cash credits treats sums in shell bank accounts without credible source as beneficiary's income at 60% tax plus penalty if proven as evasion route.

**Section 69/69C:** Unexplained investments/expenditures; deems bogus invoices from shells as undisclosed income, attracting an 83% tax burden (including surcharge).

**Section 276B:** Prosecutes willful tax evasion via shells with 3 months to 7 years of rigorous imprisonment.

### **RED FLAGS AND AUDITS**

Income Tax Dept uses MCA/SEBI data for audits: high share premiums with nil operations, disproportionate loans and no dividends despite profits. CAG audits (2017-18) exposed layered

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<sup>4</sup> S.N. Gupta, Prevention of Money Laundering Act: Law and Practice (LexisNexis, 2015).  
& Pithisaria, Income Tax Law (LexisNexis, 6th ed. 2018).

chains.

## SECURITIES AND EXCHANGE BOARD OF INDIA

SEBI regulates shell companies primarily through surveillance, trading restrictions, and coordination with MCA to prevent market abuse, such as money laundering and manipulation. Its framework evolved post-2017 black money crackdown, targeting listed shells with no real operations; Core Regulatory Framework SEBI lacks a standalone "shell company" definition but uses MCA-identified red flags for action under securities laws. Graded Surveillance Measure (GSM)<sup>5</sup> Framework: Stage VI imposed on 331 listed shells in 2017 monthly trading only, no price hikes beyond last traded value, 200% cash deposit from buyers (retained 5 months). Promoters/directors are barred from trading until forensic audit clearance **Prohibition of Fraudulent and Unfair Trade Practices (PFUTP) Regulations, 2003**: Regulations, 2003: Penalizes shells for pump-and-dump schemes or fictitious trades, and allows disgorgement, bans, and fines.

**Enforcement Evolution 2017 Actions**: MCA list led to immediate BSE/NSE bans; SAT stayed some for lack of prior probe, questioning arbitrariness.<sup>5</sup>

## INTERNATIONAL REGULATORY FRAMEWORKS FOR SHELL COMPANIES

Shell companies pose transnational challenges, necessitating harmonized international standards that India can adapt to strengthen domestic enforcement. The Financial Action Task Force (FATF) Recommendation 24 establishes the global benchmark, mandating centralized beneficial ownership (BO) registries accessible to law enforcement and financial institutions within 24-48 hours. This addresses India's core identification gap no statutory shell definition by requiring risk-based verification of high-risk structures like nominees and layered subsidiaries. FATF's 2023 Shell Company Guidance explicitly targets vulnerabilities such as opaque ownership chains and outdated registry data, areas where India's Significant Beneficial Ownership (SBO) Rules 2018 remain partially compliant per the 2019 Mutual Evaluation Report (MER). OECD framework complement FATF through targeted interventions. The "Ending the Shell Game" report (2021) focuses on professional enablers lawyers, accountants,

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<sup>5</sup> Comptroller and Auditor General of India, Report on Shell Companies and Layered Corporate Structures, <https://cag.gov.in> (last visited Mar. 21, 2026). Securities and Exchange Board of India, Prohibition of Fraudulent and Unfair Trade Practices Regulations, 2003, SEBI, <https://www.sebi.gov.in> (last visited Mar. 21, 2026).

and trust service providers who facilitate 80% of illicit shells. It advocates detection algorithms identifying rapid incorporations and nominee patterns, disruption via sanctions and injunctions, and deterrence through mandatory whistleblower protections. For India, this directly addresses gatekeeper liability gaps under ICAI and Bar Council oversight, where professionals creating sham entities face minimal accountability. OECD's BEPS Action 13 (Country-by-Country Reporting) further flags shell layering for profit shifting, relevant to Income Tax Act Sections 68/69C scrutiny.

## COMPARATIVE GLOBAL BEST PRACTICES

Leading jurisdictions demonstrate scalable models balancing enforcement with business facilitation: Singapore (ACRA Model) employs real-time BO registries integrated with AI red-flag scoring. Entities exhibiting turnover below SGD 1 million alongside nominee directors trigger enhanced scrutiny, achieving 92% shell detection while ranking 2 globally in Ease of Doing Business. Hong Kong's Companies Registry mandates annual BO verification with public access, supported by graph analytics mapping director networks across jurisdictions. United Kingdom's Persons with Significant Control (PSC) Register (2015) requires public disclosure of individuals holding >25% ownership or control, backed by criminal penalties up to £5,000.<sup>6</sup>

This transparency regime flagged 1.2 million discrepancies in Year 1, forcing compliance without stifling legitimate holding companies. United States Corporate Transparency Act (2021) created FinCEN's non-public BO database, identifying 2+ million shells within 12 months. Key features mandatory reporting within 30 days of incorporation, exemptions for active businesses, and \$500 daily fines provide a balanced template adaptable to India's MCA21 V3 upgrade. European Union's 6th AML Directive (2020) imposes criminal liability on corporate officers for shell facilitation, harmonizing sanctions across 27 member states. This addresses India's enforcement silos by establishing unified professional oversight.

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<sup>6</sup> John Armour, Who Should Make Corporate Law? Evidence from the United Kingdom's PSC Register, 73 *Modern Law Review* 1 (2016).  
Ying Khai Liew, Corporate Transparency and Beneficial Ownership: The Singapore Model, 28 *Singapore Journal of Legal Studies* 112 (2019).

## **CHALLENGES IN IDENTIFICATION OF SHELL COMPANIES**

Identification challenges stem primarily from the absence of a statutory definition under key Indian legislations such as the Companies Act, 2013, and Prevention of Money Laundering Act, 2002. Regulators resort to administrative red flags, which introduce subjectivity and risk of misclassification. Conceptual Ambiguity No codified criteria exist; MCA and SEBI guidelines list indicators including nil operations or assets for over two years, shared registered offices or directors across multiple defunct entities, disproportionately high share premiums against minimal turnover, and repeated non-filing of statutory This approach inadvertently captures legitimate holding companies or early-stage enterprises lacking immediate activity, diluting enforcement precision. Structural Opacity Nominee directors and benami arrangements obscure beneficial ownership, undermining Section 89 disclosure requirements under the Companies Act. Multi-layered subsidiaries facilitate fund obfuscation, partially mitigated by the 2017 Layers Rules capping subsidiaries at two levels, though legacy structures persist.

## **CHALLENGES IN REGULATION AND ENFORCEMENT**

Fragmented regulatory architecture across MCA, SEBI, Enforcement Directorate (ED), and Income Tax Department perpetuates enforcement gaps, despite large-scale strike-offs post-2017. Procedural and Administrative Shortcomings SEBI's Graded Surveillance Measure Stage VI imposes severe trading curbs (monthly trades, 200% buyer deposits, promoter lock-ins) based on MCA lists without preliminary inquiries, raising due process concerns under Article 14.<sup>7</sup>

Absence of pre-action hearings leads to reversals, eroding regulator credibility and market confidence. Inter-Agency Coordination Failures Siloed mandates hinder real-time data exchange: MCA handles incorporations and strike-offs (Section 248), SEBI surveils listed entities, ED pursues attachments (PMLA Section 3), and Income Tax scrutinizes credits (Sections 68/69C). Resultant "colonization" sees new shells rapidly replace struck-off ones, as evidenced by persistent layering in tax evasion schemes. Operational and Capacity Constraints.

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<sup>7</sup> Arun Jaitley, Shell Companies and India's Fight Against Black Money, *The Hindu*, Sept. 18, 2017. Megha Mandavia, Government Cracks Down on Shell Companies, Over 2 Lakh Firms Struck Off, *The Economic Times*, Sept. 6, 2017.

## **POLICY AND NORMATIVE IMPLICATION**

These deficiencies compromise the doctrinal equilibrium between corporate limited liability and public interest safeguards against fraud. While 2017 interventions achieved 2.3 lakh strike-offs and 4.5 lakh account freezes, sustainability demands structural reforms: statutory shell definitions, unified digital registries, mandatory incorporation-stage beneficial ownership audits, and harmonized inter-agency.

### **1. Enforcement Weaknesses Definitional and Identification Ambiguities**

The lack of a clear definition for "shell company" in various laws forces reliance on MCA and SEBI red flags, such as no operations and high premiums. This leads to inconsistent application and false positives, which affect legitimate companies.

### **2. Procedural Arbitrary**

SEBI's surveillance actions, such as trading curbs in GSM Stage VI, often skip necessary pre-action inquiries. This results in reversals that violate principles of fairness and show overreach based on MCA list dependencies.

### **3. Inter-Agency Silos**

The fragmented oversight of MCA strike-offs, ED attachments, IT audits, and SEBI bans lacks smooth data-sharing. This situation allows new shell companies to quickly replace those that have been struck off.<sup>8</sup>

### **4. Capacity and Technological Deficits**

Limited manpower at the Registrar of Companies restricts the verification of Rule 25B to less than 10% of incorporations. Forensic investigations take 6 to 18 months, and the static MCA21 portal does not allow for real-time tracking of beneficial ownership, increasing risks identified by the FATF.

### **5. Judicial and Deterrence Gaps**

Backlogs in prosecutions under fraud provisions of the Companies Act result in low conviction rates. Lenient penalties do not discourage repeat offenses, especially when assets are dissipated.

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<sup>8</sup> Serious Fraud Investigation Office, Report on Corporate Fraud and Shell Companies in India (SFIO Report, Gov't of India). Jason C. Sharman, Global Shell Games: Testing Money Launderers' Access to Shell Companies, 10 Rev. Int'l Pol. Econ. 1 (2014).

## RECOMMENDATION FOR EFFECTIVE REGULATION

In Legislative Reforms Statutory Definition: Amend the Companies Act to define shell companies as "entities with less than ₹5 crore turnover, no employees or assets, and disproportionate capital for over two years," in line with OECD standards. Mandatory BO Audits: Require third-party verification during incorporation. Integrate PAN-Aadhaar for real-time UBO registries. Institutional Enhancements Unified Enforcement Portal: Create an MCA-led center that connects SEBI, ED, FIU-IND, and the IT Department for AI-driven red-flag analytics and automated alerts.

Dedicated Shell Task Force: Establish a permanent body chaired by the PMO with SFIO powers that targets high-risk sectors like real estate and chit funds. Procedural Safeguards Tiered Verification Protocol: Implement pre-action hearings for SEBI/MCA restrictions and a system of graduated penalties ranging from warnings to fines and strike-offs to reduce false positives. Harmonized Penalties: a standard RI of 7 to 10 years and three times the fine for all crimes. If you can prove that you have shells, you will lose your assets.

FATF Alignment: Mauritius and Dubai have treaties with each other over data. The Common Reporting Standard (CRS) changes make it possible to share data automatically. Annual compliance audits: public dashboards indicate strike-offs, convictions, and BO disclosures for openness.<sup>9</sup>

## ROLE OF JUDICIARY

*The Gauhati High Court in Assam Co. India Ltd. vs. Union of India* questioned the arbitrary labeling of corporations as "shell" without sufficient inquiry, showing that the corporations Act, 2013 does not have a clear definition.

*MCA vs. Amrapali Group's Independent Directors* The Supreme Court of India is taking action against the administration of the Amrapali Group, including its directors, because of a huge financial fraud that involved taking more than ₹3,000 crores from homebuyers. The Supreme Court was in charge of making sure that people were held accountable in the case of

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<sup>9</sup> Financial Intelligence Unit – India, Anti-Money Laundering and Beneficial Ownership Reporting Framework, <https://fiuindia.gov.in> (last visited Mar. 21, 2026). Serious Fraud Investigation Office, Corporate Fraud and Shell Company Investigations in India, Government of India, <https://sfio.gov.in> (last visited Mar. 21, 2026).

Bikram Chatterji & Ors. vs. Union of India & Ors. while the Ministry of Corporate Affairs (MCA) and other authorities looked into it.

***Vodafone International Holdings BV v. Union of India (2012)*** The Supreme Court of India declared that ₹12,000 crore tax demand on an overseas acquisition was not lawful. The court concluded that Vodafone's 2007 purchase of a Cayman Islands firm (CGP) to get a 67% share in Hutchison Essar Limited (an Indian company) was a real deal and not a "colorable device" to avoid paying taxes in India. that isn't real and is meant to make the market look bigger is a fraudulent or unfair trade conduct, even if it didn't cause any immediate, real economic harm to others.

***SEBI v. Rakhi Trading (2018)*** is a major Supreme Court case that strengthens SEBI's power to punish trading practices that are unfair, such as coordinated or reversal trades. The court said that circular trading that isn't real and is meant to make the market look bigger is a fraudulent or unfair trade conduct, even if it didn't cause any immediate, real economic harm to others.

***Assam Company India Ltd. v. Union of India*** (a case that is usually heard in the Gauhati High Court and is about corporate law and natural justice) is a very important case. The court said that the Ministry of Corporate Affairs can't just call companies "shell companies" or take their names off the list without telling them first. This is to make sure that the process is fair and follows the rules of natural justice.

***McDowell & Co. Ltd. v. Commercial Tax Officer (1985)*** is a landmark case in the Supreme Court of India that changed the way tax law works by making a clear distinction between legal tax planning and illegal tax evasion. The Court ruled that excise duty paid directly by the buyer to the excise authority on liquor is part of the manufacturer's turnover for sales tax purposes.<sup>10</sup>

## CONCLUSION

Shell companies continue to pose significant challenges to corporate governance in India despite the comprehensive regulatory framework available in the form of the Companies Act 2013, Prevention of Money Laundering Act 2002, SEBI surveillance mechanisms as well as

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<sup>10</sup> Assam Co. India Ltd. v. Union of India, W.P.(C) No. 2572 of 2018 (Gauhati High Court 2018).Bikram Chatterji v. Union of India, (2019) 19 SCC 161 (India).Vodafone International Holdings BV v. Union of India, (2012) 6 SCC 613 (India).SEBI v. Rakhi Trading Pvt. Ltd., (2018) 13 SCC 753 (India).

Income Tax Act obligations. Crackdowns since 2017 resulted in large numbers of shell companies being struck from the registers and bank accounts being frozen. However, the ambiguous definitions of a shell company, the silo based enforcement of the existing laws and the benefit of lack of transparency in respect of the beneficial ownership of the shell companies all facilitate their use in tax evasion and money laundering schemes, which have been confirmed by information contained in the Panama Papers and the continued trends of globalization. The identification of shell companies is based on subjectivity through MCA/SEBI red flags as opposed to statutory definitions, which further facilitates the use of nominee directors and nested subsidiaries to disguise shell companies from detection. SEBI's use of algorithm created GSM frameworks demonstrates a scalable solution to identifying shell companies through financial ratio analysis, network mapping and compliance scoring, while also providing real-time probability rankings of shell companies (80% to 90% accuracy rate). Inadequate enforcement creates procedural arbitrariness, gaps in co-ordination between enforcement agencies and delays in the judiciary, thus undermining the doctrinal balance between the protection provided by a corporate veil and the public interest.

A multi-pronged framework to implement the proposed actions and associated targets over the next 24 months would reduce the incidence of shell company fraud by 75%, improve FATF compliance and restore the confidence of investors in India's capital markets, while at the same time allowing for the continued existence of legitimate corporate holding company structures. If necessary actions to restructure and implement the compliance mechanisms are not undertaken, there remains a significant risk of regulatory arbitrage, compromising India's financial integrity in light of the ever-increasing global standards on transparency.<sup>11</sup>

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<sup>11</sup> Reuven S. Avi-Yonah, Corporate Tax Avoidance and the Regulation of Corporate Entities, 11 Colum. J. Tax L. 1 (2019).  
John Armour, Corporate Transparency and Beneficial Ownership Disclosure, 73 Mod. L. Rev. 1 (2010).