

General Studies – 3; Topic: Money-laundering and its prevention

Shell Companies in India

1) Introduction

- Shell Company is a corporate entity without active business operations or significant assets.
- There is no clear definition of shell companies under the Companies Act, 2013 in India.
- The Centre has been cracking down on shell companies in recent months.

2) Recent Initiatives

- SEBI directed to stock exchanges to initiate action against 331 suspect shell companies and ban them from trading.
- BSE and NSE moved 162 and 48 companies, respectively, into Stage-VI of the Graded Surveillance Measure (GSM), implying these stocks would not be available for active trading.
- With over ₹7,000 crore of public money stuck in them, investors are rankled by the move.
- A 'Task Force on Shell Companies' was constituted in February, 2017 for effectively tackling the malpractices by shell companies.

3) Why is Shell Companies Setup?

- Either to avoid tax or use them as conduit for money laundering, these are generally viewed as dubious and questionable enterprises.
- Most of the shell companies are registered in tax havens, where there is nil or low tax.
- Shell companies had been set up in the recent past to launder black money and hold benami property or companies
- Shell companies were used to deposit large amount of cash during the period of demonetization
- The leaked Panama Papers (2016) exposed a global network of shell companies operating from tax havens used for moving assets and cash from one country to another illegally.
- Not all shell companies are illegal.
- Some were formed to raise funds to promote startups.

4) Why is tackling Shell Companies Important?

- It is important to protect investor interest.
- To contain the menace of black money.
- The crackdown of shell companies will hit tax evasion
- To ensure Ease of Doing Business.

5) Concerns / Challenges

- Challenge lies in gathering data on transactions and being able to distinguish between genuine business transactions and transactions that lack substance.
- There is potential for dormant companies being misused as shell companies
- Transactions from multiple accounts will make tracking difficult.
- Shell companies could be the result of the complex corporate structure that exists in India.

6) Way Forward

- Capital markets regulator must consider having a rigorous approach to discern shell companies that are genuine and those that are being used for money laundering

- Define shell companies based on revenues, assets, employee strength, or other operational metrics.
- Stepping up the surveillance measures, independent audit and if required, forensic audits to check their credentials.
- A balance needed to be maintained between ease of doing business and ensuring that wrongdoing is stamped out.
- The real owners behind such entities need to be identified
- The government should be careful in taking action against shell companies as it can affect investor confidence and market sentiment.
- Use of information technology to track multiple transactions done by a single person or entity.
- Government intends to make the Aadhaar mandatory for regulatory filing. This will help track individuals indulging in illegitimate activities.
- Use Big Data for tracking tax evaders.
- Target individuals who are suspected to be avoiding taxes.

7) **Conclusion**

- Reducing the menace of black money will over time result in higher tax revenue which will not only help the government enhance public spending, but will also lower the tax burden on honest taxpayers.

