Misuse of Corporate Structure –Prevention & Remedies

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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October 2017

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Preface

यदा यदा हि धर्मस्य ग्लानिर्भवति भारत। अभ्युत्थानमधर्मस्य तदात्मानं सृजाम्यहम् ॥
परित्राणाय साधूनां विनाशाय च दुष्कृताम् । धर्मसंस्थापनार्थाय संभवामि युगे युगे ॥

The above *shloka* is one of the most popular *shloka* of the *Bhagvad Gita*. Citing these words, one need not mention the source even; rather the source gains a lot much of its popularity because of the significance and relevance of these words in the modern day scenario especially corporate one. While the *shloka* definitely has a religious angle to it, the context and its relevance as on date can be put forth as follows:

Stability and long term sustainability of the system happens because there are regenerative points. When the system attains disequilibrium and shows signs of being unstable and going out of control measures have to be taken to restore the equilibrium in the system.

Since times immemorial, the fundamental features of business have been to provide profits for investors, employment to unemployed, growth to the economy and a much needed raise to the standard of living for its customers.

Considering the fact that the benefits of the existence of businesses are humongous especially in a nation like India which is on its path of development, the same especially the corporate of the country have been promoted by the government by way of numerous schemes, incentives and benefits. At the same time, dedicated efforts have been made to put in place a legal structure which provides it with a rock solid foundation.

Despite the above, various issues crop-up, bringing to light the loopholes requiring immediate preventive and curative measures. The very recent actions of the regulatory bodies against companies involved in dubious

transactions puts across a message that any corporate action which falls beyond the prescribed code of conduct shall entail consequences both for the companies and their Boards alike.

This document has been prepared compiling the recent regulatory actions taken against corporate misfeasance with an intent to deliberate upon the finer nuances of this issue, the entailing consequences, the remedies, the global scenario and the ultimate takeaway of avoiding this route in whatsoever circumstances.

I commend the dedicated efforts of CS Deepa Khatri, Deputy Director; and CS Kalpesh Mehta, Assistant Director under the guidance of CS Banu Dandona, Joint Director, Directorate of Corporate Law and Governance, and leadership of CS Dinesh Chandra Arora, Secretary, ICSI in writing the manuscript of this publication. I place on record my sincere thanks to CS Amit Gupta, Company Secretary in Practice and Mr. Vijay Kumar Jhalani, Government Nominee on the Council of ICSI for their valuable inputs while reviewing the draft of this publication.

I am confident that through publication, ICSI shall play a crucial role in taking forward another initiative of the Government of India by bringing about awareness on the consequences of misusing corporate vehicles for money laundering and corporate benefits thereby restraining the same to a large extent.

There is always scope for improvement. I would personally be grateful to readers and users for their suggestions/comments for bringing about further refinement in the Publication.

Place: New Delhi
Date: October 04, 2017

CS (Dr.) Shyam Agrawal
President
The Institute of Company Secretaries of India

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POSSIBILITIES OF MISUSE OF CORPORATE STRUCTURE

INTRODUCTION

Corporate vehicles play an essential role in the global economic system. Corporate entities have been credited for their immense contribution to rising prosperity in market-based economies. They are the basis of most commercial and entrepreneurial activities in market-based economies and contribute to the prosperity and globalisation of any country.

In recent years, the issue of the misuse of corporate structure entities for illicit purposes has drawn increasing attention from policy makers and regulators. There has been growing concern that these vehicles may be misused for illicit purposes, such as money laundering, bribery and corruption, shielding assets from creditors, illicit tax practices, market fraud, and other illicit activities.

DIFFERENT MECHANISMS OF MISUSE CORPORATE STRUCTURE

Corporate structure may be misused by using variety of means including corporates, trusts, foundations, partnerships, chain of corporate subsidiaries etc.

When speaking about corporate entities, it shall be noted that these vehicles are legal forms of business that are established to conduct commercial activities and to hold assets. For misuse, the preferable entities are those which enable to hide an identity of the owner and successfully keep assets out of the reach of creditors and other claimants. The entities that are used, for example in bankruptcy cases, to shift the individuals assets are mainly shell companies and trusts established in other favourable jurisdictions (also called tax havens), from where it is very difficult to gain any information and enforce confiscation.

Any jurisdiction, that possesses regulations permitting effectively to conceal the ultimate identity behind a corporate veil and at the same time, has provisions that restrain authorities from obtaining and sharing

information on ownership and control for regulatory/supervisory and law enforcement purposes, may be a target of the misuse of such business forms.

Identification of Misused Corporate Structure

Those entities which misuse the corporate structure commonly have the following attributes:

- Nominal/meagre paid up capital
- Huse reserves mostly consisting of high share premium
- Deployment of funds by these companies in unlisted/listed companies with no dividend income from these investment; high proportion of cash in hand (or cash equivalents)
- Mostly such companies are private limited companies
- Common directors across such companies
- Such Companies do not have any operational income
- Involved in dubious transactions;
- Involved in diversion of loan funds along with creating fake invoices
- Involved in round-tripping (Round tripping is a means of tax evasion and black money generation);
- Used for converting black money into white.
- Companies share common registered office addresses

Below are the most common forms of misuse of corporate structure

- Corporate
- Trusts
- foundations
- partnerships
- Fictitious entities

Corporate

Corporate form has the benefit of formation of an entity having a different legal entity separate from the individuals involved in formation of company. The legal separation of the individual from the assets vested in a company may be used as a protection for doing illicit activities.

The more relevant distinction made to tackle corruption relates to each company's purpose rather than to their legal definition.

Private limited companies and public limited companies whose shares are not traded on a stock exchange may be preferred form for such activities.

Some of the mechanisms which are reportedly being used for laundering of black money by the corporate:

– *Spending in Corporate Social Responsibility activities*

The statutory corporate social responsibility (CSR) norms introduced two years ago were expected to revolutionise funding of social causes, but some sections of India Inc may now be abusing these for laundering of black money, according to sources privy to such transactions.

Some companies are using charitable trusts to fabricate CSR spending, at least two sources who have helped craft and execute such transactions said. They spoke to ET on the condition of anonymity.

India is the first and only country to have statutorily mandated corporate social responsibility for certain class of companies but the law allows a lot of leeway. CSR spends disclosed by companies need not be vetted by statutory auditors unlike other spending. Moreover, financials of charitable trusts also come under little statutory scrutiny. This combination of factors has left the new CSR norms wide open for abuse.

– *Share Application Money used for illegitimate purposes*

'Share application money' has reportedly emerged as a convenient way for promoters to channel equity investments into their companies to guise questionable, perhaps illegal, financial practices.

Share application money represents an investment that has come in to a company without corresponding shares being issued to investors, and can thus be reversed. Several promoter investments in companies all had share application money that was a large multiple of their equity capital.

These companies continuously use share application money for four purposes: illegal (channelling black money into a company and legitimising it), contentious (moving funds between multiple entities to shake off a money trail), ingenious (paying lower taxes) and strategic (keeping its options open). "The fact that share application money was larger than issued capital means the intention was never to convert in to shares, but to route money."

– *Hiding identity of people*

A company may hide the identity of persons who are beneficial owners.

A 'beneficial owner' is a natural person – that is, a real, live human being, not another company or trust – who directly or indirectly exercises substantial control over the company or receives substantial economic benefits from the company.

– *Companies with Bearer Shares or Share Warrants*

Bearer shares often come up for discussion in the context of anti-money measures because they allow for anonymous transfers of control. Bearer shares are company shares that exist in certificate form, and whoever is in physical possession of the bearer shares is deemed to be their owner. Transfer requires only the delivery of the instrument from person to person (in some cases, combined with endorsement on the back of the instrument). Unlike "registered" shares (for which ownership is determined by entry in a register), bearer shares typically give the person in possession of the certificate (the bearer) voting rights or rights to dividend. Almost identical in terms of function are unregistered "share warrants." A share warrant may be thought of as a voucher entitling the holder to the

right to acquire shares. Concerns have been raised in forums that companies that issue bearer shares are used extensively for illegal activities, such as tax evasion and money laundering.

Shell companies

As per OECD report (2001) on 'Behind the Corporate Veil -Using Corporate Entities For Illicit Purposes', the term 'shell company' refers to the entity that has no independent operations, significant assets, current business activities or employees. Organisation for Economic Co-operation and Development **(OECD)** Glossary defines a Shell Company as ***"A shell company is a company that is 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. Shells tend to be conduits or holding companies and are generally included in the description of Special Purpose Entities".***

Shell companies, when used illicitly, are generally used in combination with additional mechanisms to obscure beneficial ownership. The mechanisms include exercising control surreptitiously through contracts (rather than "standard" ownership and control positions), adding layers of corporate vehicles, hiding behind bearer shares, and ensuring that the beneficial owners are located (or the identifying information is stored) in another jurisdiction.

Shell Companies also known as "Paper", "Briefcase", " Post-box", " Shelf", "dabba" companies.

A study conducted by the Performance and Innovation Unit of the UK Cabinet Office noted that U.K. shell companies have been involved in almost all complex UK money laundering schemes.

Using corporate vehicles as conduits to perpetrate illicit activities is potentially appealing because these vehicles may enable the perpetrators to cloak their malfeasance behind the veil of a separate legal entity. A report commissioned by the EC concluded that the ability of legal entities to effectively conceal the identity of their beneficial owners stimulates their use for criminal activities.

Trust

The concept of "trust" originated from the English common law and today, trusts are used primarily in common law jurisdictions.

A trust is an important, useful, and legitimate vehicle for the transfer and

management of assets. Trusts provide an effective mechanism for managing assets given to minors, individuals who are incapacitated, and others who are otherwise inexperienced in financial management. Trusts can also be used to promote charitable purposes and for estate planning.

The trust is a vehicle that provides for the separation of legal ownership from beneficial ownership. To establish a trust, the trust creator (the "settlor") transfers the legal ownership of a property to a person or corporate entity (the "trustee"). The trustee holds and manages the property, in accordance with the provisions of a trust deed, for the benefit of the beneficiaries, who are identified in, or ascertainable from, the trust deed. To create a valid trust, the settlor is required to give up control of the assets he has transferred to the trustee. In turn, the trustee is obligated to observe the terms of the trust deed and has a fiduciary duty to act honestly and in good faith in the best interest of the beneficiaries or, in the event there are no named beneficiaries, in the best interest of the trust.

One form of misuse of trusts is to conceal the existence of assets from tax authorities, creditors, ex-spouses, and other claimants or to conceal the identity of the beneficial owner of assets. Trusts can also be misused for money laundering purposes. In addition, trusts may be used to perpetrate fraud. For example, settlors attempting to evade taxes may transfer assets into a trust and then falsely claim that they have relinquished control over the assets. Once the assets are transferred into an offshore trust, it is very difficult and expensive to locate them and to identify their beneficial owners. Even if the trust assets are found, creditors will incur considerable time and expense in the attempt to repatriate the assets.

Public trusts are a favoured route to launder money because they are not adequately governed or monitored. Though some states such as Maharashtra have their own law such as the Bombay Public Trusts Act, 1950, trusts are not governed by a nationwide law. If a state law doesn't exist such as in Delhi, these trusts are governed by the Indian Trusts Act of 1882 that applies to private trusts. There is no centralized repository – like the registrar of companies for corporates – of information on.

Various other forms like **multiple layers of companies, Foundations, partnerships Fictitious entities** are reportedly corporate structure which are being misused.

Primary reasons for misusing the corporate structure :

- ➜ For masking the true ownership of assets – "Benami Properties"
- ➜ To hide "bad money" or money amassed out of corrupt practices
- ➜ Link of terror & drug money- financial network of anti-national and underworld operators
- ➜ Tax Evasion
- ➜ Money laundering

Abusive impacts of misuse of corporate structure

The misuse of corporate vehicles for illicit purposes impacts the domestic as well global financial system. In particular, such practices may cause the following harmful effects in any economy:

(a) Drug smuggling

(b) Corruption

(c) Arms smuggling

(d) Mafia

(e) Sanctions Busting

(f) Bribery

(g) Terrorist Financing

(h) Tax Evasions

(i) Money Laundering

(j) Asset Shifting

(k) Improper Insider dealings

(l) Criminal financial schemes

(m) Investment in Benami Properties

RECENT REGULATORY ACTIONS

The regulator is also keeping a close watch on cases where entities are availing LTCG (Long Term Capital Gains) benefits through sham transactions in stocks.

Constitution of 'Task Force on Shell Companies' for effectively tackling the malpractices

Government is monitoring the malpractices of shell companies in comprehensive manner adopting 'whole of the Government approach'. "In order to create a credible deterrence, a 'whole of government approach' will be adopted through coordinated efforts and by leveraging technology".

A 'Task Force on Shell Companies' under the Joint Chairmanship of Revenue Secretary and Secretary, Ministry of Corporate Affairs was constituted in February, 2017 for effectively monitoring the malpractices of shell companies/ponzy companies/khoka companies in a comprehensive manner adopting whole of the government approach.

Other members of the Task Force are from Department of Financial Services, Central Board of Direct Taxes, Central Board of Excise & Customs, Central Bureau of Investigation, Enforcement Directorate, Serious Fraud Investigation Office and Financial Intelligence Unit.

Decisions taken by the Task Force focusing upon most effective and expeditious actions against shell companies and associated persons by the agencies concerned have duly been taken forward.

Brief highlights of actions taken against shell companies in recent past include the following:

(i) With a view to have consolidated relevant information at one place and based upon inputs from all law enforcement agencies, the Serious Fraud Investigation Office under the Ministry of Corporate Affairs has undertaken the exercise of preparing comprehensive digital database of shell companies and their associates that were identified by various law enforcement agencies.

(ii) Enforcement Directorate conducted nationwide searches in 16 states on 01.04.2017 in respect of shell companies and related professionals who were believed to the behind the creation and operation of these Companies.

(iii) The CBI has registered 30 cases against 201 shell companies during the last 3 years viz. 2014, 2015, 2016 and the current year as on 28.2.2017.

(iv) Out of these, charge-sheets have been filed in 17 cases.

(v) As on 12.07.2017, Ministry of Corporate Affairs has removed 1,62,618 Companies from the Register of Companies by following the due process under Section 248 of the Companies Act, 2013. Further, the exercise of identification of the directors of the companies defaulting in filing of Financial Statements or Annual Returns for continuous period of three financial years has been undertaken as part of the ongoing process for disqualification for reappointment as director in that company or in other company for a period of five years u/s 164(2) of the Companies Act, 2013.

(vi) FIU-India has also alerted its Reporting Entities on shell companies for enhanced due diligence.

Disclosure of information in respect of specific persons, however, is prohibited except as provided under section 138 of the Income-tax Act, 1961.

Comprehensive digital database of shell companies and their associates

Mechanism for sharing of information between various law enforcement agencies is already in place under the Regional Economic Intelligence Council (REIC) and Central Economic Intelligence Bureau (CEIB) forums. Further, with a view to streamline and strengthen the information sharing mechanism, a new Standard Operating Procedure (SOP) on sharing of information between various law enforcement agencies has been agreed to under the aegis of the Task Force.

In creation of a database, there would be challenge to prove that these entities are shell companies.

STEPS TAKEN BY VARIOUS AGENCIES

Central Board of Direct Taxes (CBDT)

There are many companies which are currently being examined by the

CBDT through a committee to check if they are legitimate or are being operated as shell companies.

Each and every bank account is under the scanner of Income Tax department to find out possible tax evasion. Individuals are advised to declare their income sources. If that does not happen, intrusive action against such persons may be taken against tax evaders.

The Government is also taking action against shell companies which have been main route for converting black money into white.

Source: The Indian Express, dated 6th March, 2017

Income tax Department

The Income Tax Department has detected over 1,155 shell companies in the last three years through which non-genuine transactions of more than Rs. 13,300 crore were carried out which were used as conduits by over 22,000 beneficiaries.

Enforcement Directorate

As a part of the mandate given to the Enforcement Directorate (ED) under a Special Task Force (STF), the ED launched a nationwide crackdown against shell companies and conducted searches at 100 locations across 16 states to check the circulation of black money.

Multiple teams, comprising 300 officers, visited these locations and raided the premises of firms in prominent places like Delhi, Chennai, Kolkata, Chandigarh, Patna, Ranchi, Ahmedabad, Bhubaneswar and Bengaluru among others.

The agency reportedly found more than 700 shell companies at one address in Mumbai. The agency had attached assets worth crores of such companies.

The action is being carried out under the provisions of the Prevention of Money Laundering Act (PMLA) and the Foreign Exchange Management Act (FEMA) to check money laundering and illegal foreign exchange transactions.

Source: Prime Times. in India News Dated 13th April, 2017

Central Bureau of Investigation

CBI intends to prosecute the shell companies who were not filing returns for corruption and other associated offences. It also plans to refer cases

to appropriate authorities set up under laws including the Companies Act, Benami Transactions (Prohibition) Act and the Income Tax Act.

Fraudulent shell companies can further expect to face harsh action including freezing of bank accounts and disciplinary actions against professionals for malpractice in assisting deviant shell companies.

According to sources, the companies were used in round-tripping and diversion of loan funds along with creating fake invoices. CBI can now charge fraudulent companies under various laws.

Source: Dailyhunt, dated 8th May, 2017

Reserve Bank of India

Government has requested the RBI to circulate the details of defaulting companies to all the banks with the advice to exercise enhanced due diligence while dealing with these companies.

The government's advice on freezing the bank account of such companies' comes in the backdrop of the Ministry of Corporate Affairs removing a total of 1,62,618 companies from the Register of Companies as on July 12.

The government has requested the Reserve Bank of India (RBI) to freeze accounts of the defaulting companies who have not filed their financial statements and returns. The central bank, however, said that, at present, it has no powers to freeze such accounts.

Source: The Indian Express, dated 29th July , 2017

Securities and Exchange Board of India

SEBI vide its letter bearing no. SEBI /HO/ISD/OW/P/2017/18183 dated August 7, 2017 has forwarded a list of 331 shell companies and has directed the Exchanges to identify the companies listed on their trading platform and initiate following measures :

1. Trading in all such listed securities shall be placed in Stage VI of the Graded Surveillance Measure (GSM) with immediate effect. If any listed company out of the said list is already identified under any stage of GSM, it shall also be moved to GSM stage VI directly.

   Under the stage VI of GSM framework, trading in these identified securities shall be permitted only once a month under trade to trade category. Further, any upward price movement in these securities shall not be permitted beyond the last traded price and additional surveillance deposit of 200 % of trade value shall be

collected form the Buyers which shall be retained with Exchanges for a period for five months.

Accordingly, securities mentioned in Annexure II shall be moving to GSM framework under Stage VI w.e.f. August 8, 2017. Therefore, as per the provisions of GSM framework, the securities shall not be available for trading from tomorrow. Trading in these securities shall be permitted once a month (First Monday of the month).

2. The shares held by the promoters and directors in such listed companies shall be allowed to be transferred by depositories only upon verification by concerned exchanges and they shall not be allowed to transact in the security except to buy securities in the said listed company until verification of credential / fundamental by Exchanges is completed.
3. Exchanges shall initiate a process of verifying the credentials/ fundamentals of such companies. Exchanges shall appoint an independent auditor to conduct audit of such listed companies and if necessary, even conduct forensic audit of these companies to verify its credentials/fundamentals.
4. On verification, if Exchanges do not find appropriate credentials/ fundamentals about existence of the company, Exchanges shall initiate the proceeding for compulsory delisting against the company, and the said company shall not be permitted to deal in any security on exchange platform and its holding in any depository account shall be frozen till such delisting process is completed.
5. Out of the list of shell companies, if securities of any of the listed company are under suspension, the trading in such securities shall be placed under GSM Stage VI directly on revocation of suspension by Exchange.

Source: BSE Notice, dated 7th August, 2017

Serious Fraud Investigation Office (SFIO)

There are about 12 lakh registered companies in India; and only half of such lakh companies file their annual return. This means that large number of these companies may be indulging in financial irregularities. In a sample analysis of shell companies, the government said, it found that Rs 1,238 crore cash had been deposited in these entities during November-December period. Serious Fraud Investigation Office (SFIO) has filed criminal prosecution for cheating national exchequer after investigation

of entry operators running a group of 49 shell companies and other proprietorship concerns.

With a view to have consolidated relevant information at one place and based upon inputs from all law enforcement agencies, the Serious Fraud Investigation Office (SFIO) has undertaken the exercise of preparing comprehensive digital database of shell companies and their associates that were identified by various law enforcement agencies.

MINISTRY OF CORPORATE AFFAIRS

Removal of Name of Companies from Register of Companies

According to information available with the Ministry, the Registrars of Companies (ROCs) in various states and union territories had issued notices to more than two lakhs firms under the Companies Act, 2013, and sought to know why their names should not be struck off and strict action would follow in case the responses are not satisfactory.

These notices have been issued under Section 248 of the Act. This section pertains to striking off names of companies on certain grounds.

It is reported that as on July 12, 2017 the Corporate Affairs Ministry has removed 1,62,618 companies from the Register of Companies by following the due process under Section 248 of the Companies Act, 2013.

According to India today dated 5th September, 2017, the Government stuck off over 2.1 lakh companies from the records of the registrar of companies in a major crackdown against those who could be part of a large nationwide black money matrix.

Disqualification of defaulting directors

It is understood that as part of the government's intensified efforts against the black money menace, the exercise of identification of the directors of the companies defaulting in filing of financial statements or annual returns for continuous period of three financial years has been undertaken as part of the ongoing process for disqualification for reappointment as director in that company or in other company for a period of five years. As on 13th September, 2017, over 1 lakh directors of shell companies are identified as defaulters by the government as an continued effort to crack down against shell companies. [The Economic Times dated September 13, 2017].

It may be noted that section 164 deals with 'Disqualifications for Appointment of Director'.

Apart from serving show cause notices to companies that have been not submitting their financial statements under the Companies Act for a long time, the Corporate Affairs Ministry is in the process of preparing a database of shell firms which would further help in curbing illegal business activities.

RECENT AMENDMENTS IN COMPANIES ACT, 2013

Commencement of provision relating to 'restrictions on number of layers of subsidiaries' [proviso to clause (87) of section 2 of the Companies Act, 2013]

The proviso to section 2(87), along with layering restriction on investment subsidiaries under section 186(1) of Companies Act, 2013 were incorporated in the Act with a view to check misuse of multiple layers of subsidiaries for diversion of funds/siphoning off funds as a measure of minority investor protection and is in consonance with recommendations of the Hon'ble Standing Committee on Finance.

In view of reports of misuse of multiple layers of companies, where companies create shell companies for diversion of funds or money laundering, Ministry of Corporate Affairs had decided to commence the proviso to section 2(87).

In terms of the provisions, No company, other than a company belonging to a class specified in sub-rule (2), shall have more than two layers of subsidiaries.

Provisions proposed under Companies (Amendment) Bill, 2017

The Ministry of Corporate Affairs constituted the Companies Law Committee (the "CLC" or the "Committee") under the chairmanship of the Secretary, Ministry of Corporate Affairs vide an office order dated 4th June, 2015 to review the provisions of the Companies Act, 2013 in view of representation received on practical difficulties faced during implementation of Companies Act, 2013.

It has recommended incorporating provisions with regard to disclosure of significant beneficial ownership to the Registrar. The relevant extracts from the report are under:

"Beneficial Interest in Shares, Register of Beneficial Owners of a Company

Misuse of corporate vehicles for the purpose of evading tax or laundering

money for corrupt or illegal purposes, including for terrorist activities has been a concern worldwide. Complex structures and chains of corporate vehicles are used to hide the real owner behind the transactions made using these structures. Realizing this, jurisdictions world over have been putting in place mechanisms to identify the natural person controlling a corporate entity. Following recommendations of Financial Action Task Force (FATF), India has also tightened the concepts of beneficial interest and beneficial owner as contained in the Prevention of Money Laundering Act as well as introduced a comprehensive definition through SEBI guidelines. The SEBI guidelines issued in 2010 are aimed at identifying beneficial owners of security accounts held by various intermediaries. However, since then, jurisdictions world over have taken significant steps on beneficial ownership provisions. Changes have been made by many jurisdictions, for example Russian Union and UK in their laws to bring in transparency in company ownership and control. The English Companies Act, 2006 was amended in 2015 to require certain companies and LLPs to create and maintain a 'Persons with Significant Control' Register and make it available to public, as well as file the information with the UK Companies House. A publicly accessible central registry of UK company beneficial ownership information has also been established. Regulatory concerns have been raised in India also, drawing on examples set by these jurisdictions. The Ministry of Finance has suggested to introduce a Register of Beneficial Owners by mandating it in the Companies Act.

Section 89 of the Companies Act, 2013 deals with the concept of beneficial interest in a share which obligates every person acquiring/holding beneficial interest in a share as well as the legal owner to make a declaration to the company in respect of such beneficial interest. In view of the absence of a definition of beneficial interest in a share in a company, absence of any obligation on a company to collect information on beneficial ownership, the absence of the concept of beneficial ownership in a company, no enabling provisions to maintain a separate register on beneficial ownership, in the Act, the existing provisions are considered inadequate for the purpose of mandating a register of beneficial owners of the company.

The Committee, therefore, recommended to amend the Act to mandate the following:

a) Provide a definition of beneficial interest in a share, and beneficial ownership in a company. The existing definition under SEBI Circular/ Guidelines and the Prevention of Money Laundering Act may be

used as a basis for the definition in the Companies Act, 2013. The rules issued under the United States Securities Exchange Act of 1934 define beneficial ownership in a security, which can be used as a basis for the definition of beneficial interest in a share.

b) Companies and individuals may be obligated to obtain information on beneficial ownership. In this regard, companies may be empowered to seek information from members and in case of failure to supply the required information, apply sanctions in the form of suspension of rights against the beneficial interests subject to adequate safeguards.

c) Companies would also be mandated to maintain registers of beneficial owners and provide the information to the registry (MCA21). Periodic updating may also be mandated. Data privacy concerns may be addressed by making only part of the filed information available to the public.

d) Companies not complying with the requirements may be liable to fine and criminal prosecution."

In accordance with the recommendations, the Companies (Amendment) Bill, 2017 proposes to substitute section 90 with the following section:

For section 90 of the principal Act, the following section shall be substituted, namely : —

"Section 90: Investigation of beneficial ownership of shares in certain cases

'90. (1) Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent. or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of section 2, over the company (herein referred to as "significant beneficial owner"), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed :

Provided that the Central Government may prescribe a class or classes of persons who shall not be required to make declaration under this sub-section.

(2) Every company shall maintain a register of the interest declared by individuals under sub-section (1) and changes therein which shall include the name of individual, his date of birth, address, details of ownership in the company and such other details as may be prescribed.

(3) The register maintained under sub-section (2) shall be open to inspection by any member of the company on payment of such fees as may be prescribed.

(4) Every company shall file a return of significant beneficial owners of the company and changes therein with the Registrar containing names, addresses and other details as may be prescribed within such time, in such form and manner as may be prescribed.

(5) A company shall give notice, in the prescribed manner, to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe –

(a) to be a significant beneficial owner of the company;

(b) to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or

(c) to have been a significant beneficial owner of the company at any time during the three years immediately preceding the date on which the notice is issued, and who is not registered as a significant beneficial owner with the company as required under this section.

(6) The information required by the notice under sub-section (5) shall be given by the concerned person within a period not exceeding thirty days of the date of the notice.

(7) The company shall, –

(a) where that person fails to give the company the information required by the notice within the time specified therein; or

(b) where the information given is not satisfactory, apply to the Tribunal within a period of fifteen days of the expiry of the period specified in the notice, for an order directing that the shares in question be subject to restrictions with regard to transfer of interest, suspension of all rights attached to the shares and such other matters as may be prescribed.

(8) On any application made under sub-section (7), the Tribunal may, after giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares within

a period of sixty days of receipt of application or such other period as may be prescribed.

(9) The company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions placed under sub-section (8).

(10) If any person fails to make a declaration as required under sub-section (1), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

(11) If a company, required to maintain register under sub-section (2) and file the information under sub-section (4), fails to do so or denies inspection as provided therein, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than ten lakh rupees but which may extend to fifty lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

(12) If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.'

CONSEQUENCES OF MISUSE OF CORPORATE STRUCTURE AND REMEDIES

In view of the recent actions taken by the regulators, the possible consequences to the companies which are using the corporate structure for illicit purposes can be as under:

- Declaration of directors as disqualified
- Striking off names of companies
- Officers of the company may be penalised under provisions relating to fraud
- Freezing of bank accounts of the companies
- Freezing the bank account of disqualified directors
- Reputation risk

DIRECTORS TO BE DISQUALIFIED FROM APPOINTED AS DIRECTORS

The directors of companies may be disqualified to be re-appointed in the same company or appointed in any other company in terms of section 164 of the Companies Act, 2013.

The statutory provision

Section 164 of the Companies Act, 2013 (the Act) states various disqualifications for directorship of a company. A person who incurs any of these disqualifications is ineligible to be appointed as a director of any company in India.

"(2) No person who is or has been a director of a company which –

(*a*) has not filed financial statements or annual returns for any continuous period of three financial years; or

(*b*) has failed to repay the deposits accepted by it or pay interest thereon

or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so."

Rule 14 of the Companies (Appointment and Qualification of Directors) Rules, 2014 reads as follows:

"14. Disqualification of directors sub-section (2) of section 164.–

(1) Every director shall inform to the company concerned about his disqualification under sub-section (2) of section 164, if any, in Form DIR-8 before he is appointed or re-appointed.

(2) Whenever a company fails to file the financial statements or annual returns, or fails to repay any deposit, interest, dividend, or fails to redeem its debentures, as specified in sub-section (2) of section 164, the company shall immediately file Form DIR-9, to the Registrar furnishing therein the names and addresses of all the directors of the company during the relevant financial years.

(3) When a company fails to file the Form DIR-9 within a period of thirty days of the failure that would attract the disqualification under sub-section (2) of section 164, officers of the company specified in clause (60) of section 2 of the Act shall be the officers in default.

(4) Upon receipt of the Form DIR-9 under sub-rule (2), the Registrar shall immediately register the document and place it in the document file for public inspection.

(5) Any application for removal of disqualification of directors shall be made in Form DIR-10."

The following defaults committed by a company ("the defaulting company") would attract subsection (2) of section 164:

(a) the defaulting company has not filed financial statements or annual returns for any continuous period of three financial years;

(b) the defaulting company has failed to –

- repay the deposits accepted by it, or
- pay interest on the deposits accepted by it, or

- to redeem any debentures issued by it on the due date, or
- pay interest due on any debentures issued by it, or
- pay any dividend declared

and such failure to pay or redeem continues for one year or longer. The consequences of any default mentioned above are that a person who is or has been a director of the defaulting company –

- cannot be re-appointed as a director of the company in respect of which any of defaults has taken place; and
- cannot be appointed as a director of any other company for five years from the date on which any of those defaults takes place.

For example, if Mr X is a director of A Ltd, which has committed any of the abovementioned defaults, then-

- he can continue as a director of A Ltd till he is sought to be re-appointed (say at an annual general meeting on his retirement by rotation);
- if he is a director of B Ltd (or any other company / companies) being a non-defaulting company, he can continue to be its director even after A Ltd has committed the default;
- he cannot be appointed as a director of C Ltd or any other company of which he is not a director when the default is committed by A Ltd.

Further section 167 deals with the provisions related to 'Vacation of Office of Director'. Section 167(1)(a) provides that the office of a director shall become vacant in case he incurs any of the disqualifications specified in section 164.

Companies (Amendment) Bill, 2017 proposes to insert the following proviso to section 167(1)(a)

> "Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.";

In this regard, the Ministry of Corporate affairs has issued a notice, which reads as under:

> "Any person disqualified under section 164(2) of the Companies Act,

2013 [the Act] is advised not to act as director during the period of the disqualification and not to file any document or application with MCA as the same shall be summarily rejected. However, this shall be without prejudice to the liability of the said person for violation of section 164(2) read with section 167 of the Act including the action under section 448 r/w 447 of the wherever warranted."

STRIKING-OFF NAMES OF COMPANIES

Registrars are empowered to exercise its power under section 248 of the Companies Act, 2013. Section 248 of the Act, deals with power of the ROC to remove name of a company from the register of companies in certain circumstances such as failure to commence business within one year of incorporation, or for not carrying on business for two consecutive years without applying for the status of a dormant company.

Regulator has struck off the names of companies from the register of companies on account of their failure to comply with the requirements of law, suspicious transactions and for failure to carry out any operation within a year of incorporation or for the preceding two financial years.

In case, the company is inactive company and has plans to carry on business in some future date, the company may be legitimately exist and apply for getting dormant status. The definition of an 'inactive company' under the Act is provided under the *Explanation* to section 455, which states that inactive company means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years. Section 455 pertains to obtaining of dormant status by such inactive companies on an application made to concerned ROC or on *suo moto* basis by such ROC upon failure of filing financial statements/annual return for two consecutive financial years. Further, the ROC is required to maintain a register of dormant companies. It is relevant to mention here that even if a company has been given the status of a dormant company in terms of the section 455, such a company requires to comply with certain requirements such as filing of returns, having minimum number of directors, etc. Recently, the ROC has also exercised its powers under sub-section (6) of section 455, by striking off the name of such dormant companies, who have failed to maintain the status as a dormant company.

Section 252(1) of the Companies Act, 2013 provides that the name can

also be restored by way of an appeal filed by such companies against the orders of the ROC within three years from the date of the order of the ROC to the National Company Law Tribunal (NCLT).Previously under the erstwhile Companies Act, there was only one resort for restoration of name, i.e., application by certain person within a period of twenty years from the date the name had been struck-off.

Statutory provisions

Power of Registrar to Remove Name of Company from Register of Companies

As per section 248 (1), where the Registrar has reasonable cause to believe that –

(a) a company has failed to commence its business within one year of its incorporation or

(b) a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455,

he shall send a notice to the company and all the directors of the company, of his intention to remove the name of the company from the register of companies and requesting them to send their representations along with copies of the relevant documents, if any, within a period of thirty days from the date of the notice.

(2) Without prejudice to the provisions of sub-section (1), a company may, after extinguishing all its liabilities, by a special resolution or consent of seventy-five per cent members in terms of paid-up share capital, file an application in the prescribed manner to the Registrar for removing the name of the company from the register of companies on all or any of the grounds specified in sub-section (1) and the Registrar shall, on receipt of such application, cause a public notice to be issued in the prescribed manner:

Provided that in the case of a company regulated under a special Act, approval of the regulatory body constituted or established under that Act shall also be obtained and enclosed with the application.

(3) Nothing in sub-section (2) shall apply to a company registered under section 8.

(4) A notice issued under sub-section (1) or sub-section (2) shall be

published in the prescribed manner and also in the Official Gazette for the information of the general public.

(5) At the expiry of the time mentioned in the notice, the Registrar may, unless cause to the contrary is shown by the company, strike off its name from the register of companies, and shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the company shall stand dissolved.

(6) The Registrar, before passing an order under sub-section (5), shall satisfy himself that sufficient provision has been made for the realisation of all amount due to the company and for the payment or discharge of its liabilities and obligations by the company within a reasonable time and, if necessary, obtain necessary undertakings from the managing director, director or other persons in charge of the management of the company:

Provided that notwithstanding the undertakings referred to in this sub-section, the assets of the company shall be made available for the payment or discharge of all its liabilities and obligations even after the date of the order removing the name of the company from the register of companies.

(7) The liability, if any, of every director, manager or other officer who was exercising any power of management, and of every member of the company dissolved under sub-section (5), shall continue and may be enforced as if the company had not been dissolved.

(8) Nothing in this section shall affect the power of the Tribunal to wind up a company the name of which has been struck off from the register of companies.

OFFICERS OF THE COMPANY MAY BE PENALISED UNDER PROVISIONS RELATING TO FRAUD

Explanation of section 447 of the Companies Act, 2013

(i) "Fraud" in relation to affairs of a company or anybody corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

Section 447 provides that without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud. It is further provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

FREEZING OF BANK ACCOUNTS OF THE COMPANIES

Government has requested the Reserve Bank of India to freeze accounts of the defaulting firms who have not filed their financial statements and returns.

However, RBI, at present, has no power to freeze such accounts.

FREEZING THE BANK ACCOUNTS OF DISQUALIFIED DIRECTORS

Pursuant to a press information issued by the Ministry of Corporate Affairs (MCA) on '*Stricter Norms for Corporate Governance: Punishment for Siphoning off Money from Bank Accounts of "Struck Off" Companies; Disqualification of Directors from Being Appointed or Reappointed in Companies*', the directors and authorized signatories of the struck-off companies have been **prohibited from accessing the bank accounts.** Their bank accounts have been frozen and banks have been advised to be more diligent and scrutinize the financial transactions of companies in general meticulously in order to reaffirm that companies follow all regulatory guidelines more carefully. Further, such directors or authorised signatories of the struck-off companies will not be able to operate the bank accounts of their former companies till such entities are restored by an order of the NCLT. The MCA has also notified that apart from the action restricting the operation of bank accounts of these companies and consequential effect on the directors, all efforts are also being made to identify the actual beneficiaries and persons behind such shell companies.

As provided under section 164 of the Act that deals with disqualifications for appointment of director, the sub-clause (2)(a) disqualifies a person from being a director who is or has been a director of a company which:

(a) has not filed financial statements or annual returns for any continuous period of three financial years. Pursuant to the provisions of this section, several ROCs have published list of such directors who are disqualified under section 164(2)(a), including active as well as struck of companies. This step has been taken to ensure that directors of companies that have defaulted on statutory compliances are barred from serving on the boards of other firms as well. There have been instances of shell companies having directors who are drivers, cooks and other employees of tax evaders. However, debarring directors is a strong measure of deterrence. There is a possibility that some innocent directors who have been associated with non-compliant companies in the past may be caught on the wrong foot and their services may be denied to genuine companies.

DUE DILIGENCE BY BANKS

In addition to such struck off firms, banks have also been advised to go in for enhanced diligence while dealing with companies in general. A company even having an active status on the website of the Ministry of Corporate Affairs but defaulting in filing of its due Financial Statement(s) or Annual Return(s) of Particular of Charges on its assets on the secured loan should be seen with suspicion as, prima facie, the company is not complying with its mandatory statutory obligations to file this vital information for availability to its stakeholders.

MEDIA REPORTS

> **The money was being laundered using the banking channel through entry operators, including a chartered accountant, and shell companies.**
>
> (*The Hindu dated 5th December, 2016*)

The Enforcement Directorate (ED) has busted a network of jewellers which was converting old Rs.500 and Rs.1000 notes into gold in connivance with bank officials. The money was being laundered using the banking channel through entry operators, including a chartered accountant, and shell companies.

The gold purchased by the accused jewellers in the name of a shell company was again sold to other cash hoarders at prices higher than the legal prevailing rate.

The ED has arrested **Shashank Sinha** and **Vinit Gupta**, managers of **Axis Bank's Kashmere Gate branch here**, for allegedly helping the cash hoarders deposit close to Rs.40 crore in several bank accounts and transfer funds online. The ED has directed the banks concerned to freeze all transactions in 11 accounts for further scrutiny.

During interrogation, an alleged middleman disclosed that the bank officials had agreed to deposit cash on two per cent commission, in the form of gold bars. While one gold bar has been seized from Lucknow at the instance of one Shobhit Sinha, two gold bars, weighing two kg, were seized from a jeweller.

The managers revealed that bulk "change forms" and unverified identity documents – received from many customers for exchange of notes – were also used to facilitate further exchange of the demonetised currency.

In a press statement, Axis Bank said it had suspended the accused officials and was cooperating with the investigation.

The fraud was detected after the Delhi Police seized Rs.3.7 crore in old notes from three persons outside the Kashmere Gate branch on November 22. Subsequently, the Income-Tax Department conducted searches and

on the suspicion of money laundering, the Enforcement Directorate was involved. Based on the police FIR, the ED registered a case under the Prevention of Money Laundering Act and busted the network.

"The group of jewellers had collected advances in old currency against the sale of gold and laundered the cash using bank accounts, through entry operators chartered accountant Rajeev Kushwaha, Devendra Jha and Raj Kumar Sharma," said a senior ED official.

"Several shell companies, including Sunrise trading firm, Himalaya International and R.D. Traders – which have their bank accounts with the Kashmere Gate branch were used to deposit cash between November 10 and 22, in connivance with the bank mangers," said the official.

Interestingly, the cash deposits were made in multiple installments of Rs.90 to Rs.99 lakh to evade detection by government agencies. On several occasions, more than one such cash deposit in a day was made in these accounts. The cash deposits were then transferred by way of RTGS to Beagle Marketing Pvt. Ltd. the same day, which is another shell company being managed and controlled by Mr. Kushwaha through dummy directors," the official said.

The ED probe revealed that Ram Charan, one of the directors of Beagles Marketing, is a petty labourer working on daily wages. He lives in the Anna Nagar Jhuggi Camp area of Delhi. When contacted, he denied any association with the company. The other company "directors" also had nothing to do with its operations.

According to the ED, the funds were further transferred to several bullion traders for purchase of gold bars on the instructions of the jewellers and Mr. Kushwaha. Some of the bullion traders have been identified by the ED as Aadi Traders, Siddhi Vinayak Jewellers and Tushar Jewellers.

Though the invoices were raised by the bullion dealers in the name of Beagle Marketing, the physical delivery of gold was made to the jewellers in question. "This gold purchased by these Jewellers to various buyers at Rs. 45,000 to 50,000 per 10 gm, which is much higher than the legal rate," said the official, adding that further arrests were likely soon.

http://www.thehindu.com/news/national/Two-Axis-Bank-managers-held-in-Delhi-for-laundering-Rs.-40-cr./article16763429.ece

How shell companies are used in black money creation, laundering

http://www.livemint.com/Money/cwZv5QRQdWLDKJKqLKuXtK/How-shell-companies-are-used-in-black-money-creation-launde.html

The income tax (IT) department in Kolkata launched a probe into the operations of Anjali Jewellers Pvt. Ltd, a 25-year-old family owned enterprise, now a leading jewellery-maker in West Bengal.

"After closely tracking Anjali for years, it appeared to us that the company was expanding much faster than what its declared cash flow would permit," said a tax officer, who asked not to be identified. "There was some cash flow going into asset creation that the returns did not reflect."

Within days of starting the investigation, it was clear to the department that Anjali was struggling to reconcile its inventory with its books of accounts–there was more gold and jewellery lying in its stock than recorded in its books–and that the company bought "finished goods" from a clutch of vendors.

At the office of one such vendor, only a few hundred metres from the Aayakar Bhawan, which houses the tax department, in downtown Kolkata, tax sleuths stumbled upon ledgers. In them, every transaction with Anjali was neatly recorded with every detail–and for Anjali's comfort, one detail too many: cash returned to the company for every transaction.

It was immediately clear to the department that these were "bogus transactions", shown in Anjali's accounts to suppress profits, and all the "searching questions" about rapid asset creation were at once answered.

The department claimed Anjali had concealed at least Rs160 crore of income. Anjali disputed it, and after a few days of resistance, the company agreed to settle, admitting a tax liability of around Rs70 crore.

"As regards tax computations, we are legally analysing (the matter) and the process is on," Anargha Chowdhury, a director at Anjali, said in a statement. "We are cooperating with the department...it is improper to speculate on tax or income figures."

The probe into Anjali's operations also led the department to 26 other beneficiaries, according to officers. They had one common connection: the Dhanuka brothers, at whose Waterloo Street office the telltale ledgers were unearthed. When contacted, Sunil Dhanuka admitted to having worked with Anjali, but denied having served any other client.

For seasoned tax sleuths, it was a rather underwhelming investigation. "There was hardly any layering to cover the cash trail and even the ERP (enterprise resource planning) software was easy to crack," said the officer cited above.

Normally, when dealing with such bogus transactions, the department has to dissect through "layers and layers" of shell companies, or ones that do not have any legitimate business and are used only for tax rationalization and money laundering.

Chowdhury claimed in his statement that Anjali did not have any shell company. The department isn't alleging it does either.

But over the past two years, the department has identified around 16,000 shell companies based in Kolkata alone. Anjali had transactions with only a handful of them–all controlled by the same operator–a middle-aged chartered accountant, according to income tax officials.

Operators

Investigation shows this operator is in control of at least 322 companies, said one of the tax officers, but he is not on the board of any of them. He doesn't own any shares in these companies either.

The directors and shareholders of these shell companies are mere "name-lenders"–they sign on documents for a fixed fee.

The operators seek out people in distress to be appointed as directors. The tax department once came across an old lady who was supporting her husband's cancer treatment by signing on documents as a director of shell companies. Some, for sure, love the easy money.

Gautam Khaitan admits receiving money from Agusta Westland via shell company

(*The Indian Express dated 4th May, 2016*)

Delhi lawyer Gautam Khaitan, who was arrested in 2014 for allegedly laundering bribe money in Agusta Westland deal, on Wednesday accepted during CBI questioning that he set up a shell company to receive money from the aviation firm, according to news agency ANI.

Khaitan's name popped up in the ongoing investigation of Panama Papers by The Indian Express. The Delhi lawyer, who was on the board of Aeromatrix, provided a reference letter in favour of Navin Mehra, son of Mehrasons Jewellers owner Ashwani Kumar Mehra. Navin Mehra was a

director in two offshore entities registered by Panamanian law firm Mossack Fonseca, an investigation by The Indian Express has found.

Khaitan was also on the board of Emaar MGF Land Ltd as an additional director and was later redesignated as a director on the board on November 25, 2009.

India had in 2010 signed a Rs 3,546 crore deal with Agusta Westland to purchase 12 AW 101 choppers for use by VVIPs including the President and Prime Minister.

http://indianexpress.com/article/india/india-news-india/gautam-khaitan-agustawestland-shell-company-money-laundering-2784383/

CBI, ED find Vijay Mallya diverted most of Rs 6,000 crore loan to shell companies

Vijay Mallya diverted most of the Rs 6,000 crore he borrowed from a State Bank of India-led consortium of lenders, according to investigations by the Central Bureau of Investigation and the Enforcement Directorate.

They will soon file a fresh charge sheet based on these findings against the businessman, who's been in the UK since March 2016.

The funds were allegedly diverted to shell companies in half a dozen countries, according to the agencies. While the first charge sheet for loan fraud was filed by both agencies earlier this year for IDBI Bank's Rs 900-crore loan, this new and significantly bigger case will, they hope, help expedite Mallya's extradition, which is currently being heard in the Westminster Magistrates Court, in London.

"As matters are subjudice, I cannot comment in detail but I reject all these wild, baseless and deliberately fabricated allegations," Vijay Mallya, chairman, The UB Group.

"We are in the process of filing a second prosecution complaint. Our investigation in the matter has revealed that loans disbursed by banks to Kingfisher Airlines BSE 3.03 % was diverted by Mallya and his associates to shell companies.

We have sent letters rogatory and are expecting replies from the US, UK, France and Ireland soon," said a senior official aware of the development. The agencies didn't respond to ET's email queries.

Mallya has stayed away from India despite being asked to return for questioning over the alleged diversion of funds that haven't been repaid following the collapse of his airline.

Mallya has consistently denied any wrongdoing and has declined to return to India fearing that he'll be made a scapegoat for corporate debt defaults and won't get justice. He didn't respond to email queries.

Mallya has said before that he has been seeking to reach a settlement with banks over the money that's owed.

The new money-laundering case covers the loan of about Rs 6,027 crore from over a dozen banks led by SBI taken between 2005 and 2010 by the Mallya-owned Kingfisher Airlines. The loan amount along with interest now stands at over Rs 9,000 crore and a first information report (FIR) for non-payment and criminal conspiracy was filed last year.

Mallya has been declare a proclaimed offender in the IDBI Bank BSE - 2.41 % loan fraud case and the agencies have been trying to get him extradited from the UK.

In a charge sheet filed in May, investigation agencies had said that the absconding businessman laundered nearly half the loan taken from IDBI by creating a web of companies and nominating directors in them who were either his personal staff, retired company officials or third parties. It also said Mallya holds, directly or indirectly, movable and immovable assets in the form of shares of public listed companies, by way of creating a string of shell companies. "CBI will file the new money-laundering case within a month, detailing all funds diversion by Mallya," said another official.

EXTRADITION CONDITION

A dual criminality clause on illegal activities has to be established, according to the extradition treaty between the two countries. That is, Mallya's intention to cheat public banks in India and subsequent money laundering has to be established as a crime in British law as well.

Last week, media reported that Britain's Serious Fraud Office (SFO) is conducting a probe against Mallya for alleged money laundering in the UK and beyond through a circuitous route and a complex web of companies.

The agency began an independent probe against Mallya to examine whether the alleged money laundering involved British companies linked to him.

United Spirits, a unit of Diageo Plc, has filed multiple complaints against Mallya after inquiries revealed "improper transactions" worth Rs 1,225.3 crore.

USL said Mallya had diverted funds to nearly half a dozen companies in which he had a direct or indirect interest, mostly located in tax havens.

http://economictimes.indiatimes.com/news/politics-and-nation/cbi-ed-find-vijay-mallya-diverted-most-of-rs-6kcr-loan-to-shell-companies/articleshow/60820420.cms

The Securities Exchange and Board of India (SEBI) is trying to identify shell companies to tackle black money in India. But it turns out that the problem of identifying a "shell company" is not as small as it looks.

A shell company is an entity without any active business operations or significant assets. They are often created to avoid taxes and many big companies create shell corporations to avoid taxes without attracting legal actions.

Among the suspected shell companies – a list of 16 companies alone hold nearly Rs 9,000 crore market capitilisation on BSE. Moreover a total of 161 companies have over 2.7 million public shareholders.

16 suspected shell companies and their market cap

Companies	Market Cap (Rs. In Crore)
Prakash Industries	1,601.75
Jkumar Infraprojects	1,395.27
Parsvnath Developers	920.41
Gallantt Metal	321.22
Gallantt Ispat	601.43
SQS INDIA BFSI	490.48
Dwitya Trading	640.65
Adhunik Industries	488.21
VB Industries	451.77
PS IT Infrastructure & Services	349.44
Goenka Business & Finance	109.53
Innoventive Venture	92.22

Orissa Sponge Iron	526.56
Assam Company	202.27
Pincoin Spirit	252.83
Signet Industries	263.17

Data: BSE

It all started on August 07, 2017 when Sebi directed BSE, National Stock Exchange (NSE) and Metropolitan Stock Exchange to identify listed companies out of the list of 331 suspected shell companies received by the Ministry of Corporate Affairs vide letter dated June 09, 2017.

Out of these identified shell companies, 162 were active trading firms on BSE; while 48 were on the NSE and remaining have already been suspended by the respective stock exchanges on account of irregularities.

Since then, markets have been panicking so much so that Sensex and Nifty reached to a one-month low last week. Although global cues like rising tensions between North Korea and the US are also partly to blame.

Vibhor Singhal and Shyamal Dhruve, analysts at Phillip Capital said, “The suspension of trading comes as a shocker to the investors, with no anticipation of the same. We also do not recall the last time, when trading was simultaneously suspended in so many companies (162 in total) of such significant size together.”

Government sources were quoted in media reports as saying, “Sebi may probe role of big brokerage cartels involved in the banned companies trading. These big brokerage cartels must have provided platform for money laundering.”

Government feels these big brokerage cartels must have aided suspected shell companies in cash dealings during the demonetisation drive. Also they must have routed funds to show Private Equity (PE) investment in shell companies.

The market watchdog has asked BSE and NSE to verify credentials and fundamentals of these companies, also to seek auditor certificate from companies. It has asked to place these companies in Stage VI of Graded Surveillance Measures (GSM) with immediate effect.

Further, Sebi also started issuing a show-cause notice to 331 listed entities, suspected to have acted as shell companies for those with illicit funds,

while action has also begun against more than 100 unlisted entities that could have traded in stocks with laundered money, top regulatory, reported PTI.

However, many companies like Prakash Industries, J. Kumar Infraprojects Limited, Parsvnath Developers Limited, Gallantt Ispat Limited, Gallantt Metal Limited, Inter Globe Finance and SQS India BFSI Limited have denied the allegation imposed by Sebi.

These companies have knocked the door of Securities Appellate Tribunal (SAT) and managed to obtain a stay on the trading restrictions by way of an interim relief.

On February 10, 2017, according to Ministry of Finance, there were about 15 lakh registered companies in India with only 6 lakh companies filing their annual income tax returns.

The ministry carried an initial analysis to identify shell companies by nominal paid-up capital, high reserves & surplus on account of receipt of high share premium, investment in unlisted companies, no dividend income, high cash in hand, private companies as majority shareholders, low turnover & operating income, nominal expenses, nominal statutory payments & stock in trade, minimum Fixed Asset.

Analysis revealed that Rs 1,238 crore cash was deposited in these entities during demonetisation period of November-December.

Serious Frauds Investigations Office (SFIO) has filed criminal prosecution for cheating national exchequer after investigation entry operators running a group of 49 shell companies and other proprietorship concerns.

It was found that 559 beneficiaries have laundered money to the extent of Rs 3,900 crore with the help of 54 professionals. These information has been shared with SIT, Income Tax Department, Enforcement Directorate, SEBI and The Institute of Chartered Accountants of India (ICAI).

http://www.zeebiz.com/india/news-sebis-scanning-of-shell-companies-create-problems-for-investors-banks-21088

Shell companies : Putting tax evasion, money laundering under scanner

Shell companies, despite the unsavoury connotation, are legal entities, though often without tangible assets or business operations. They function as vehicles for pre-operation financing, control over conglomerates, tax

planning, but most commonly for tax evasion or even money laundering. The last two are the most common uses and there are a few examples.

In May 2016, internal investigators of a leading public sector bank uncovered a fraud, wherein some individuals, along with their cohorts, cheated the government and banks of several crores of rupees using a maze of 24 ghost companies operating from a single branch of the bank in Delhi.

In December 2015, in another branch of another bank, CBI began investigating fake foreign exchange remittances aggregating R6,000 crore from non-existent imports through various accounts of 60 companies, all of them operating from a single branch of the bank and controlled by a group of individuals masterminding the fraud.

The recent leaking of offshore financial records from a Panama-based law firm again brings into focus the labyrinth of global network of shell companies operating from tax havens, used purportedly to illegally shift assets and cash from one country to another and using structured transactions to evade tax.

An OECD report (Misuse of Corporate Vehicles for Illicit Purposes) concurs that shell companies are increasingly being used for illicit purposes.

Traditionally, shell companies in India have been used for rotation and siphoning off of funds by the promoters through fictitious sales, inflated purchases, unjust commissions or for creation of equity for ultimate owners who are shielded by cloaks of deceit.

The modus operandi is simple. The perpetrator floats a number of companies usually with the same registered address and with directors who despite being ‘real persons’ are untraceable or completely unrelated, or are usually poor and unlettered lending their names for a token payment. Dummy directors are used for anonymity or deniability, who pre-sign cheques and documents and hand over to the principals.

All too often, bank officials are hand-in-glove in these operations, including overlooking KYC norms and background checks for accounts opened in their branches. Often, suspicious transactions are below the threshold of automatic banking software triggers and hence can go undetected for years unless they form part of other investigations. The ‘seed’ receipt is introduced as capital in the bank account of one shell company with the knowledge of bank officials; this money is rotated through bank accounts of a set of shell companies—all transactions being completed the same day in the same branch of the bank. Thus, each company shows identical

sums as capital and instantly lends or invests in another company. The exercise is repeated several times. As banks need to balance their books only at the end of the day, colluding bankers ensure that the money rotates through 5-10 accounts in a day, i.e. the money multiplies 10 times in a day, not backed by real transactions, but the daily credit and debit balances in each account falsely display robust business activity. It is very much like the Panchatantra tale in which a fox shows one crocodile 10 times to its mother to convince her that there are 10 of them.

What happens to the capital when it is created? It is pledged for bank loans, or these shares are valued excessively by conniving valuers and then merged with listed companies which are dormant. Once merger fructifies, the fictitious investment gets converted into real shares at high prices, and more importantly, gets liquid in a stock exchange. The Supreme Court-appointed SIT noted in its report that investment in the secondary share markets to manipulate stocks and create non-taxable capital gains is becoming popular. With the collusion of promoters, some brokers arrange purchase or financing of scrips at nominal costs, and then manipulate their sales at exorbitant prices to create long-term 'capital gains' which attract nil or nominal tax.

In case of a fraud involving foreign exchange, large remittances are sent overseas towards fictional imports of stocks and machinery, advances, commissions, etc. Later, money is moved from such overseas accounts into another set of shell companies. Often, such money comes back through another bank account as receipts from exports or payments for share capital in listed and unlisted companies (called round tripping). SIT observed that investments from Cayman Islands, a tax haven, alone amount to R85,000 crore in India, highlighting the role of tax havens in money laundering. In either case, the perpetrators avail import credits from the government, like duty drawback on imports and export benefits. Otherwise, these shells hold properties or land on behalf of the real owners or hold payments for fictitious sale of goods or services in India till the money gets 'bleached white'.

Another route of introducing black money into the banking system is by showing large income from agriculture, processing and milling of agriculture products and scarp sales, all outside the radar of tax nets. There are examples of tiny companies with very small landholdings showing agricultural income in tens of crores of rupees. It is not an exaggeration to say that the output of such land would be many times over the total output of the district or the total annual sales in the local mandi.

The effects of money laundering could be catastrophic. There is no official figure yet, but various agencies estimate India's black money to the tune of 21-42% of its GDP.

How can India fight the menace? The symptoms are the best guide to some of the initial solutions. Real-time detection and monitoring of shell companies and oversight of unusual rise in the market price of companies with little business, empowerment of enforcement agencies to act without prior approvals and prompt enforcement action are some obvious answers.

MCA21, the portal on which all corporate filings reside, is a wonderful starting point for tracking and mining data for companies sharing characteristics like common directors, same registered address, little or no business, occasional large transaction, etc, to create early warnings against shell companies. A central KYC registry to track multiple transactions by one individual or entity will help create transaction histories of individuals and entities.

Once detected, action must be swift and act as a deterrent to others. Entities with no commercial substance for, say, five years, should be weeded out or frozen. Promoters and gatekeepers like bankers, accountants, auditors, valuers, etc, who facilitate shell operations, should be punished under the tough Prevention of Money Laundering Act and under the stringent provisos of the Companies Act 2013.

But these are short-run solutions. The long-run ones are a different order of collective efforts which need a strong, punitive and immediate deterrent mechanism brought about by diligent investigations backed by strong judicial decisions. The current level of conviction for white-collared crimes, as estimated by some experts at 0.006%, needs to significantly improve, if crime needs to be booked. In the process, projects across different enforcement agencies for preventive and punitive measures based on data and evidence are being put in place and that will create long-term impact on financial crimes. Let's hope this is done soon.

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GLOBAL SCENARIO

"Corruption [is] among the greatest obstacles to economic and social development"

– The World Bank

From Manhattan condominiums to California mansions to gentrifying neighborhoods in Brooklyn, shell companies are increasingly pervasive in the world of real estate. These articles explore the people behind the opaque deals.

– The New York Times

In recent years, a number of international fora have sought to examine the extent to which the misuse of corporate vehicles for illicit purposes impacts the global financial system. In April 2000, the Financial Stability Forum (FSF) Working Group on Offshore Financial Centres concluded that the misuse of corporate vehicles could threaten financial stability from a market integrity perspective. Over the past decade, the Financial Action Task Force on Money Laundering (FATF) has noted the role of corporate vehicles in money laundering schemes. Similarly, the Organisation for Economic co-operation and Development (OECD) Working Group on Bribery in International Business Transactions has found that the misuse of corporate vehicles in offshore financial centres1 (OFCs) can hinder otherwise successful anti-corruption investigations. Through its work on corporate governance, the OECD became aware that corporate vehicles can be misused to perpetrate improper self-dealing, circumvent regulations, and manipulate equity markets.

Other international organisations and institutions, including the United Nations (UN) and the European Commission (EC), have also observed the recurring misuse of all forms of corporate vehicles in organised criminal activity, particularly financial and economic crimes. Because of the potential for abuse of today's open and global financial system, which could result in the misallocation of resources and increase systemic risk, the issue of the misuse of corporate vehicles for illicit purposes has come to the forefront of policy makers' agendas.

There are various definitions for 'shell companies', which take into account different characteristics of shell companies. For example, the Securities Exchange Commission (SEC) in the U.S. "define the term "shell company" to mean a registrant, other than an asset-backed issuer, that has no or nominal operations, and either no or nominal assets; assets consisting solely of cash and cash equivalents; or assets consisting of any amount of cash and cash equivalents and nominal other assets". Black's law dictionary defines a shell company as "a firm that does not trade, is formed to raise funds, attempt the take-over, go public or act as the front for an illegal venture." Similarly, many double tax avoidance agreements (DTAAs) define shell companies to curb treaty abuse. Recently, India introduced, through amending protocols, modifications to its treaties with Singapore (Article 24A) and Mauritius (Article 27A) which contain definitions of shell/conduit companies. The treaty with Mauritius mentions that "a shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State" followed by expenditure test.

The issue of hidden company ownership was high on the agenda for the G8 in 2013 in Northern Ireland. The British Prime Minister David Cameron promised to "break through the walls of corporate secrecy" to tackle corruption and tax evasion, and the G8 leaders agreed to take some first steps to deal with the problem. The UK committed to create a central registry of who ultimately owns companies. France has indicated that it intends to do the same. A number of the UK's overseas territories, including the British Virgin Islands and Cayman Islands, as well as the Crown Dependency of Jersey, have committed to consulting on whether to put beneficial ownership information in the public domain. The European Union is also considering similar measures.

Moves like this could have a major impact on efforts to tackle poverty. Payments for oil, minerals, and other natural resources will be the largest inflow of wealth to Africa for the foreseeable future. In 2010, the value of exports of oil and minerals from Africa was worth $333 billion, about six times the value of exported agricultural products ($55 billion) and nearly seven times the value of international aid ($48 billion).

This huge transfer of wealth could be one of the best chances in a generation to lift many of the world's poorest out of poverty. Yet so far it has not worked out that way. Economist Paul Collier has noted that of the world's poorest one billion people, one-third live in resource-rich countries.

However, as a result of weak governance and widespread corruption, these finances do not always reach government accounts.

In fact, many of these resource-rich countries have been looted by the very politicians who have been entrusted with developing their country's economy. It is primarily companies that are used to move dirty money. The World Bank reviewed 213 big cases of corruption between 1980 and 2010.4 More than 70% of them relied on anonymous shell companies. And those anonymous companies did not just come from sunny Caribbean islands. Instead, companies registered in the United States topped the list, and the UK and its crown dependencies and overseas territories came second.

Global Witness' investigations have shown how through the use of opaque corporate structures, the people of the Democratic Republic of Congo lost out on billions of dollars of revenues when their copper and cobalt mines were sold. The mines were bought by companies incorporated in the British Virgin Islands at a fraction (sometimes 1/16th) of their real value, then sold on – to FTSE 100 companies – for closer to their true market. value. In doing so, someone pocketed a fortune (we don't know who) and billions were diverted from state coffers. Similarly, the son of Equatorial Guinea's President used Californian shell companies to purchase a $30 million home in Malibu and a British Virgin Islands (BVI) shell company to purchase a Gulfstream jet, despite his modest official salary.6 Both of these countries, DR Congo and Equatorial Guinea, are rich in natural resources, but flounder at the bottom of the human development index.

- In December 2009 a plane searched in Bangkok was found to be carrying North Korean arms bound for Iran, in violation of international sanctions. The plane had been leased by a New Zealand shell company, but there was no information on the individual who controlled the company.
- The Iranian government used shell companies from Germany, Malta, and Cyprus to evade international sanctions by concealing the ownership of its oil tankers.
- The British arms firm BAE Systems pleaded guilty in 2010 in connection with case which saw it pass secret funds through a series of middle-men and shell companies incorporated in Britain and the British Virgin Islands to key Saudi officials responsible for approving a massive arms purchase from BAE.

- Teodorin Obiang, son and heir-apparent of the president of the oil-rich West African nation of Equatorial Guinea, laundered corruption proceeds in the United States by using a series of Californian shell companies to hold bank accounts and title to his $35 million Malibu mansion.
- Corrupt Russian tax officials used shell companies from Cyprus and the British Virgin Islands to steal hundreds of millions of dollars in a case that led to the imprisonment and death of Russian whistle-blower Sergei Magnitsky.
- Recent cases against Swiss banks like UBS and Wegelin have often turned on the tendency of American clients to evade US tax obligations by the ruse of holding their accounts through shell companies controlled by these clients.
- Russian arms dealer Viktor Bout was convicted in November 2011 of conspiracy to provide aid to a terrorist organization. Bout's illicit activities were crucially dependent on a network of shell companies in Texas, Delaware, Florida, and elsewhere around the globe.
- The Mexican Sinaloa Drug Cartel employed New Zealand and other shell companies to launder tens of millions of dollars of cocaine profits through Latvian banks.

As a result of these and many other instances, time and time again international organizations, national governments, and NGOs have emphasized that progress in combating these and other financial crimes depends on the effective regulation of shell companies, especially in terms of being able to establish the link back to the beneficial owners.

In most of these cases Corporate Service Providers (CSPs) acted as crucial intermediaries supplying individual clients with shell companies. These firms make a living by receiving orders for shell companies from clients, lodging the official paperwork, and paying the government fee necessary to create a company. They also offer various auxiliary services, ranging from virtual office facilities to filling important corporate roles as nominee directors, secretaries, or shareholders. CSPs may be sole traders forming companies on a bespoke basis, or wholesalers responsible for the formation and on-going support of tens of thousands of companies through a network of dozens of associated retailers. These firms may be law or accounting firms creating shell companies on an incidental basis, or specialized concerns that do little else. As described below, CSPs are the crucial point at which regulators may intervene to impose a duty to collect customer identity documents.

The international standard governing shell companies is clear-cut. It states: "Countries should take measures to prevent the misuse of legal persons [i.e., companies] for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities." This rule has been set down by the Financial Action Task Force (FATF), the world's standard-setter and enforcer of anti-money laundering standards. The FATF was founded in 1990 and has been dominated by developed states, more recently augmented by powerful transitional and developing countries like Russia,China, India and Brazil. Over 180 countries have committed to FATF standards, which have also been endorsed by the UN, G20, World Bank and many other bodies.

In principle, there are three ways to establish the beneficial owner of shell companies: through strong law enforcement powers, company registries, or Corporate Service Providers, though we argue that only the last provides a realistic solution.

The first potential option is for law enforcement agencies to have strong investigative powers to track down shell company owners. The difficulty here, however, is that police powers are limited by national jurisdictions, whereas the misuse of shell companies is all too often an international problem. The shell company may be incorporated in a different jurisdiction, or the beneficial owner may be a foreign resident, or the provider may be located in a different jurisdiction, or all three. Furthermore, if the provider who formed the company did not collect any information on the owner (as our results show is common), no amount of police pressure will summon up the missing information. As one provider replied to one of our earlier solicitations: "Regarding confidentiality, no information is taken, so none can be given. It is that simple!"

The second option might seem the most promising: having government company registries collect and file information on the real owners. If companies are creatures of law, they cannot exist without some documentation lodged with some form of company registry. From here it might seem an easy step to simply require these registries to demand and hold owners' proof of identity. Company registries, however, largely have a passive, archival function of collecting a very limited range of information. Though some registries hold more information on companies than others, currently to our knowledge only one, that in Jersey, holds the information on the beneficial owner. Few if any registries have the capacity or desire to change this state of affairs.

By elimination, this leaves **the third option**, requiring CSPs to collect and hold identity documentation on customers forming shell companies according to the "Know Your Customer" principle. In practice, this is the only way to reliably establish the real owner of shell companies. This solution depends on licensing and regulating providers (something which many countries, including the United States, do not do), imposing a legal duty on them to collect proof of identification from customers, and auditing providers to make sure they do in fact collect this information, with penalties for non-compliance. Because law enforcement powers are largely limited by national boundaries, and because company registries do not collect beneficial ownership information, in practice, if CSPs do not establish the real owner of shell companies, no one else will. This is why CSPs are at the heart of our study.

The major advantage of ensuring the ability to "look through" shell companies by regulating those that sell them is that it actually works. As discussed in the results section below, several countries that regulate CSPs had near-perfect records of asking for identity documents from our fictitious customers.

Shell companies play in laundering the proceeds of international crime

Shell corporations – often formed in offshore jurisdictions, but equally available in the United States – are used because they conceal the identity of the true or real owners (in legal terms, "beneficial" owners) of the companies and the source and control of their assets.

The use of shell companies by money launderers, tax evaders, and corrupt foreign officials has been well documented by US law enforcement, Congressional oversight committees, and multiple international bodies, such as the Financial Action Task Force, or FATF – the leading intergovernmental standard-setting body to combat money laundering, terrorist financing, and related threats to the integrity of the financial system.

For that reason alone, it would not be surprising if the use of shell corporations were part of the focus of the investigation into possible collusion between Russians and Trump campaign officials being conducted by Congress and Special Counsel Robert Mueller. But, there are more specific reasons why that might be the case

First, it has been alleged that Paul Manafort bought luxury apartments in New York City using shell corporations that obscured the source and

origin of the funds in a manner that might implicate federal and state money laundering laws. (Manafort has denied wrongdoing in the purchases, saying in a statement to WNYC, “My personal investments in real estate are all ordinary business transactions. It is common practice in New York City and elsewhere to use an LLC to purchase real estate. These transactions were executed in a transparent fashion and my identity was disclosed.”)

Second, the so-called “eighth man” present at the June 9, 2016, meeting in Trump Tower between Donald Trump Jr., Trump campaign officials and individuals they thought represented the Russian government was recently identified as Ike Kaveladze. Previously, Kaveladze had been reported to have opened 236 bank accounts in the United States for shell corporations formed in Delaware on behalf of mostly Russian brokers.

Indeed, in a 2000 report commissioned by the Senate Permanent Subcommittee on Investigations into the methods Russians and other foreign nationals used to launder large amounts of money through US financial institutions, the Government Accountability Officetraced the movement of $1.4 billion in wire-transfer transactions into these 236 accounts. (Kaveladze was not mentioned by name in the report. In an interview at the time of the GAO report, he said he had engaged in no wrongdoing; he was not charged with any crimes. He described the GAO investigation as a “witch hunt.”)

Third is the presence of Natalia Veselnitskaya at the June 9 Trump Tower meeting. Veselnitskaya is a Russian lawyer who represented Cyprus-based Prevezon Holdings, a defendant in a civil forfeiture action involving the alleged laundering of the proceeds of a $230 million Russian fraud scheme through myriad shell corporations in Eastern Europe – money that ultimately was invested, in part, in real estate in New York.

http://edition.cnn.com/2017/09/08/opinions/shell-companies-russia-probe-north-korea-opinion-zeldin-cassella/index.html

VIKTOR BOUT

A notorious arms dealer Viktor Bout, the alleged model for the movie “Lord of War,” who sold weapons to butchers and terrorists from Africa to the Balkans. Bout didn’t move his arms here, but this Soviet arms merchant moved his blood money through companies established in Florida, Texas and Delaware. A loophole in our financial system allowed for this secrecy, and it took years to uncover the full money trail.

Delaware is well-known for its incorporation businesses, but it’s no worse

than any other state in this regard. With about $100 and 20 minutes, you can go to a U.S. state's website and form a company without disclosing the name of the person who will own or control it. Professional incorporation agents set up hundreds or even thousands of these companies and then sell them, in some cases to those looking to move money surreptitiously. Criminals have learned that American companies have an easier time obtaining bank accounts, and so they incorporate here in large numbers. The result is that our financial investigators often come across U.S. shell companies in their money hunts – and that may be where the trail ends.

Anonymity isn't sold by a back-alley check casher or hawaladar in these cases; it's provided in the open by state incorporation offices. This gives U.S. shell companies the dubious distinction of being the only money laundering method where secrecy is provided by a government entity.

Stopping terrorist financing and money laundering are bipartisan issues, and Congress's support for the work of my office is broad and deep. But when legislators have tried over the years to pass laws similar to the one recently proposed by Treasury, interested stakeholders have defeated the bills every time. This is simply unacceptable.

In the meantime, to mitigate the threat, the Treasury Department issued a rule that will require U.S. banks opening accounts for a company to obtain and verify the identity of the company's beneficial owner. That will help with companies that choose to bank here, but it won't stop criminals who use U.S. front and shell companies to open bank accounts abroad. And the burden for disclosing the true owners of companies should fall primarily on those incorporating the companies in the first place. To set this right will take an act of Congress.

In most respects, the U.S. is the envy of the world when it comes to our anti-money laundering system. By fixing our shell company problem, Congress would close a loophole that has allowed billions of dollars to flow with anonymity and safeguard the reputation of the United States as the best and safest place to do business on Earth.

Anglo-Leasing and Finance Ltd., U.K. shell company

(Report on The Puppet Masters by The International Bank for Reconstruction and Development / The World Bank, 2011)

In 2002, the government of Kenya invited bids to replace its passport printing system. Despite receiving a bid for €6 million from a French firm, the Kenyan government signed a contract for five times that amount

(€31.89 million) with Anglo-Leasing and Finance Ltd., an unknown U.K. shell company, whose registered address was a post office box in Liverpool. The Kenyan government's decision was taken despite the fact that AngloLeasing proposed to subcontract the actual work to the French company. Material leaked to the press by whistle-blowers suggested that corrupt senior politicians planned to pocket the excess funds from the deal. Attempts to investigate these allegations were frustrated, however, when it proved impossible to find out who really controlled Anglo-Leasing.

FREQUENTLY ASKED QUESTIONS

Ques 1. Who is a Beneficial Owner?

Ans. In terms of section 90 of Companies (Amendment) Bill, 2017, every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of section 2, over the company is referred to as "significant beneficial owner".

Ques 2. How is the Declaration of Beneficial Interest filed as per Companies Act, 2013?

Ans. As per Section 89 of the Companies Act, 2013, read with the Companies (Management and Administration) Rules, 2014, every person who holds or acquires a beneficial interest in share of a company shall make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars in the **Form No. MGT.5** within thirty days after acquiring such beneficial interest in the shares of the company.

Ques 3. What is black money?

Ans. The White paper on Black Money defines Black money as "assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession". Significant amount of black money is generated through legally permissible economic activities, which are not accounted for and disclosed or reported to the public authorities as per the law or regulations. The fundamental reason for the generation of black money is to evade payment of taxes by reducing profits.

Ques 4. What is unexplained investment?

Ans. Section 69C of Income Tax Act provides that where in any financial year, an assessee has incurred any expenditure and he offers no

explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year.

Ques 5. Is there any special provision/regulation that deals with fraud and shell companies in India?

Ans. The Companies Act, 2013 has specific provisions relating to fraud prevention and reporting. It explicitly defines fraud, includes severe penalties for violation, places greater accountability on Senior Management/ the Board to ensure that sufficient care is taken to prevent and detect fraud (and other irregularities), provides statutory recognition to the Serious Fraud Investigative Office, introduces provisions relating to class action lawsuits, makes the establishment of a vigil mechanism mandatory for listed companies; to name a few.

In India, there is no specific law relating to "shell companies." However, some laws help, to an extent, in curbing illegal activities such as money laundering – Benami Transaction (Prohibition) Amendment Act 2016; The Prevention of Money Laundering Act 2002; The Companies Act, 2013; Prevention of Corruption Act, 1988; SEBI (Listing and Disclosure Requirements) Regulations, 2015; Indian Penal Code, 1860, Income-tax, 1961 [Sections 68, 69, 69A, 69C, 56(2)(vii), 271(1)(c), 269SS, 269SC].

Ques 6.What are the different vehicles used for incorporating shell companies?

Ans. Following are the different vehicles used for incorporating shell companies:-

a. Companies
b. Limited Liability Partnerships
c. Trust
d. Foundations
e. Operational Entities
f. Fictitious entities

Ques 7. What is money laundering?

Ans. In terms of the Prevention of Money Laundering Act, 2002, the term 'Money-laundering' means Whosoever directly or indirectly attempts

to indulge or assist other person or actually involved in any activity connected with the proceeds of crime and projecting it as untainted property.

Quest 8. What is 'Tax Evasion'?

Ans. In general terms, Tax evasion is an **illegal practice** where a person, organization or corporation intentionally avoids paying his true tax liability. The provisions are detailed under Chapter XXII of the Income-tax Act, 1961. Those caught evading taxes are generally subject to criminal charges and substantial penalties.

Quest 9. What is corruption?

Ans. As per OECD Glossary, "active or passive misuse of the powers of Public officials (appointed or elected) for private financial or other benefits" is corruption.

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