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THE LEGAL STATUS AND LIABILITY OF SHELL COMPANIES AFTER THE MCA CRACKDOWN

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ABSTRACT

The Ministry of Corporate Affairs has intensified enforcement against shell companies, striking off over 1.85 lakh entities since 2022-23. Yet this crackdown operates without statutory definition of "shell company" in the Companies Act, 2013, creating legal uncertainty and disproportionate outcomes. This paper examines whether legislative amendment is necessary to define shell companies and establish graded liability for directors and promoters. Through doctrinal analysis of Sections 248, 164, and 447, the study identifies critical gaps: definitional vacuum enabling arbitrary enforcement, binary liability mechanisms that treat inadvertent non-compliance identically to criminal fraud, and promoter impunity through nominee director structures. Comparative analysis of the UK's Economic Crime and Corporate Transparency Act 2023 and the US Corporate Transparency Act 2021 reveals alternative frameworks combining institutional "failure to prevent" liability with beneficial ownership transparency. The paper proposes a statutory definition incorporating operational inactivity, asset insignificance, and related-party transaction dominance, coupled with a three-tier liability regime distinguishing administrative penalties, director disqualification with promoter recovery, and criminal prosecution with beneficial owner accountability. Implementation mechanisms include risk-based classification algorithms, beneficial ownership registries, and NCLT appellate procedures. The framework balances deterrence against money laundering with proportionality, aligning India with global anti-avoidance standards while preserving legitimate corporate structuring flexibility.

Keywords: shell companies, MCA enforcement, corporate liability, beneficial ownership, Companies Act 2013

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I. Introduction

The Ministry of Corporate Affairs has dramatically escalated its enforcement drive against shell companies, striking off 1,85,350 entities between 2022-23 and 2024-25, including 40,949 companies removed in the last financial year alone.[1] This enforcement intensification reached new prominence in December 2024 when the Serious Fraud Investigation Office arrested directors linked to Chinese-funded shell companies allegedly facilitating money laundering and regulatory evasion.[2] Yet this aggressive crackdown operates within a curious legal vacuum: the term "shell company" appears nowhere in the Companies Act, 2013 or its subordinate legislation.[3]

The MCA relies instead on descriptive characteristics such as "non-functional," "nominal operations," and "lack of commercial substance" to identify target entities.[4] While a 2017 inter-ministerial task force proposed working definitions, these remain administratively invoked rather than statutorily codified.[5] This definitional absence creates profound uncertainty. Legitimate special purpose vehicles, holding companies with active subsidiaries, and temporarily dormant entities risk being swept into enforcement actions designed to combat money laundering conduits and benami structures.

Compounding this definitional lacuna is the binary nature of existing liability mechanisms. Section 248 of the Companies Act authorizes strike-off for non-operational companies, while Section 164(2) imposes automatic five-year disqualification on directors of such entities.[6] Between administrative strike-off and criminal prosecution under Section 447 for fraud, the statute offers limited gradations.[7] A director of a failed startup that ceased operations faces identical consequences to one knowingly operating a round-tripping vehicle for proceeds of crime. Promoters and beneficial owners, meanwhile, often escape accountability entirely despite orchestrating shell structures through layers of dummy directors.

[1] Lok Sabha Unstarred Question No. 87, Ministry of Corporate Affairs (30 November 2024) https://sansad.in/getFile/loksabhaquestions/annex/186/AU87_9upoGr.pdf accessed 3 February 2026.
[2] 'MCA Crackdown on Chinese Shell Companies in India' (TaxTMI, 31 December 2024) https://www.taxtmi.com/news?id=25775 accessed 3 February 2026.
[3] 'Government Actions on Non-Functional & Shell Companies' (TaxGuru, 25 March 2025) https://taxguru.in/company-law/government-actions-non-functional-shell-companies.html accessed 3 February 2026.
[4] ibid.
[5] 'Shell Companies, Uses, Abuse, Example, Regulation in India' (Vajira Mandravi, 10 October 2025) https://vajiramandravi.com/current-affairs/shell-companies/ accessed 3 February 2026.
[6] Companies Act 2013, ss 248, 164(2).
[7] Companies Act 2013, s 447.

ISSN: 2582-6433

This research examines whether the Companies Act should be amended to statutorily define "shell company" and establish a graded liability regime distinguishing inadvertent non-compliance from willful misuse and criminal fraud. Through doctrinal analysis of existing provisions, comparative study of the UK's Economic Crime and Corporate Transparency Act 2023 and the US Corporate Transparency Act 2021, and case studies from recent MCA enforcement actions, this paper argues that statutory clarity coupled with proportionate liability would enhance legal certainty, enable risk-based enforcement, and align India with global anti-avoidance standards while preserving legitimate corporate structuring flexibility.

II. THE DEFINITIONAL LACUNA IN INDIAN LAW

Current Regulatory Approach

The absence of a statutory definition has not deterred the MCA from aggressive enforcement. Instead, regulators employ a characteristics-based approach derived from administrative practice and international precedents. The 2017 inter-ministerial task force described shell companies as entities with "no significant accounting transactions" that serve primarily as vehicles for round-tripping funds, layering transactions, or holding benami assets.[8] The MCA's operational framework identifies red flags including minimal paid-up capital, lack of physical infrastructure, common registered office addresses shared by hundreds of entities, and predominant related-party transactions without commercial rationale.[9]

Enforcement mechanisms operate without definitional anchoring. Section 248 empowers the Registrar to strike off companies that fail to commence business within one year of incorporation or remain non-operational for two consecutive financial years.[10] The 2022 amendment to Rule 25B of the Companies (Incorporation) Rules introduced mandatory physical verification of registered offices, authorizing removal where companies cannot be traced.[11] This provision proved particularly disruptive for foreign subsidiaries utilizing registered office services, as physical presence requirements conflicted with minimal footprint structures.[12] Additionally, SEBI restricts trading in shares of companies displaying shell

[8] 'Shell Companies, Uses, Abuse, Example, Regulation in India' (Vajira Mandravi, 10 October 2025) https://vajiramandravi.com/current-affairs/shell-companies/ accessed 3 February 2026.
[9] ibid.
[10] Companies Act 2013, s 248(1).
[11] 'Crackdown on Shell Companies: MCA Amends the Companies Incorporation Rules to Provide for Physical Verification of Registered Offices' (Cyril Amarchand Mangaldas, 28 August 2022) https://corporate.cyrilamarchandblogs.com/2022/08/crackdown-on-shell-companies-mca-amends-the-companies-incorporation-rules-to-p accessed 3 February 2026.
[12] ibid.

ISSN: 2582-6433

characteristics, creating securities law consequences beyond corporate law strike-off.[13]

Problems with Definitional Absence

This enforcement-without-definition approach generates systemic problems. First, over-inclusiveness captures legitimate corporate structures. Special purpose vehicles established for project financing, holding companies with no direct operations but active subsidiaries, and companies dormant due to market downturns face potential strike-off despite valid commercial purposes.[14] The Rule 25B physical verification requirement has been criticized for failing to distinguish between entities deliberately evading detection and those legitimately operating through professional registered office providers.[15]

Second, under-inclusiveness allows sophisticated shell structures to escape scrutiny. Entities conducting nominal transactions sufficient to avoid "non-operational" classification, maintaining minimal assets just above de minimis thresholds, or layering operations through multiple jurisdictions exploit definitional gaps. The MCA's characteristic-based assessment lacks statutory precision to capture these arrangements.

Third, the absence creates judicial inconsistency. Without settled statutory language, courts interpreting Section 248 applications and Section 164(2) disqualifications reach varying conclusions on what constitutes sufficient "operations" to avoid shell categorization. Company law tribunals have no uniform standard for evaluating whether an entity's activities demonstrate commercial substance versus nominal compliance.

Fourth, compliance ambiguity undermines legitimate business planning. Multinational enterprises structuring Indian subsidiaries, venture capital funds establishing holding structures, and companies undergoing genuine restructuring cannot determine ex ante whether their arrangements will trigger enforcement action. This uncertainty contradicts the principle that regulatory boundaries should be ascertainable.[16]

[13] 'Shell Companies, Uses, Abuse, Example, Regulation in India' (n 8).
[14] 'Crackdown on Shell Companies' (n 11).
[15] ibid.
[16] 'Legal Implications of Shell Companies in India' (Enterslice, 12 December 2021) https://enterslice.com/learning/shell-companies/ accessed 3 February 2026.

ISSN: 2582-6433

Comparative Definitions as Models

International jurisdictions provide instructive definitional frameworks. The United States Securities and Exchange Commission defines a shell company under 17 CFR §230.405 as an entity with no or nominal operations and either no or nominal assets, or assets consisting solely of cash and cash equivalents.[17] This dual-element test (operational vacuum plus asset insignificance) creates objective criteria while the "cash equivalents" specification targets entities holding funds temporarily for layering purposes.[18]

The United Kingdom adopts a different approach under the Economic Crime and Corporate Transparency Act 2023. Rather than defining shells by operational characteristics, UK law focuses on beneficial ownership opacity and institutional accountability for fraud prevention.[19] The ECCTA creates corporate criminal liability for "failure to prevent fraud" by associated persons, shifting focus from entity classification to control person responsibility.[20] Companies House received enhanced powers to verify director identities, remove fraudulent filings, and share data with law enforcement, addressing shell company misuse through transparency mandates rather than definitional exercises.[21]

These comparative models demonstrate alternative regulatory philosophies. The US approach provides bright-line criteria enabling self-assessment and consistent enforcement. The UK model prioritizes attribution of liability to controllers regardless of corporate form. Both frameworks, however, rest on explicit statutory foundations absent in Indian law. Adopting elements from each would require legislative clarity on what constitutes a shell company, what conduct triggers enhanced scrutiny, and what liability attaches to various actors within such structures.

[17] 'Shell Companies, Uses, Abuse, Example, Regulation in India' (n 8).
[18] ibid.
[19] 'New UK Transparency Laws Will Target Money Launderers and Fraudsters' (ICIJ, 2 November 2023) https://www.icij.org/investigations/fincen-files/new-uk-transparency-laws-will-target-money-launderers-and-fraudsters-but-advocates-want-more/ accessed 3 February 2026.
[20] 'New UK "Failure to Prevent" Fraud Corporate Criminal Offence Takes Effect' (A&O Shearman, 25 October 2023) https://www.aoshearman.com/en/insights/ao-shearman-on-investigations/new-uk-failure-to-prevent-fraud-corporate-criminal-offence-takes-effect accessed 3 February 2026.
[21] 'New UK Transparency Laws' (n 19).

ISSN: 2582-6433

III. EXISTING LIABILITY FRAMEWORK: GAPS AND INCONSISTENCIES

Current Director Liability Provisions

Disqualification under Section 164(2)

The Companies Act imposes automatic disqualification on directors of companies that fail to file financial statements or annual returns for three consecutive financial years. Section 164(2)(a) read with Section 167 triggers removal from office and a five-year debarment from appointment to any company.[22] During the 2017-19 enforcement drive, the MCA identified 1,06,578 directors associated with struck-off shell companies facing potential disqualification.[23] This provision operates as a binary mechanism: once the three-year threshold is crossed, disqualification becomes automatic regardless of the director's degree of culpability, the reasons for non-filing, or whether the company engaged in fraudulent activities or simply ceased operations due to business failure.

The disqualification regime does not extend to promoters or beneficial owners who structure shell companies through nominee directors. The 2017 crackdown revealed widespread use of dummy directors, often individuals from economically vulnerable backgrounds recruited to lend their names while actual control remained with undisclosed principals.[24] These shadow controllers face no automatic consequences under Section 164(2), creating perverse incentives for control-without-accountability structures.

Continuing Liability under Section 250

Section 250 provides that the dissolution of a company does not affect the liability of directors, managers, or officers as if the company had not been dissolved.[25] This statutory fiction theoretically enables creditors and authorities to pursue individuals post-strike-off. However, practical enforcement proves difficult. The provision establishes continuing liability without specifying recovery mechanisms, limitation periods, or priority among competing claims. Where shell companies facilitated money laundering or tax evasion, identifying and attaching the proceeds from former directors requires coordination between the Registrar of Companies, Enforcement Directorate, and Income Tax Department with no clear statutory protocol.

[22] Companies Act 2013, ss 164(2)(a), 167.
[23] 'Disqualification of Directors and Shell Companies by MCA' (MyAdvo, 11 September 2019) https://www.myadvo.in/blog/disqualification-of-directors-and-shell-companies/ accessed 3 February 2026.
[24] ibid.
[25] Companies Act 2013, s 250.

ISSN: 2582-6433

Criminal Provisions

Section 447 criminalizes fraud involving false statements, asset misappropriation, or acts resulting in wrongful gain to any person.[26] Conviction carries imprisonment from six months to ten years plus fines. However, prosecution requires proving specific intent and identifying particular fraudulent acts, a high evidentiary bar that renders Section 447 unsuitable for addressing the typical shell company scenario where the entity's very structure and lack of genuine operations constitute the misconduct rather than discrete criminal acts.

Section 339 addresses fraudulent trading, imposing liability where business is conducted with intent to defraud creditors. Yet this provision applies only in the context of winding-up proceedings, excluding the strike-off route under Section 248 that the MCA primarily employs against shell companies. This procedural gap means fraudulent trading liability rarely attaches to shell company operators removed through administrative strike-off.

Inadequacies of Current Framework

The existing liability architecture suffers from four fundamental deficiencies. First, it lacks gradation. A director of a startup that raised minimal capital, attempted operations for 18 months, and then became dormant due to market conditions faces identical five-year disqualification as a director knowingly operating a layering vehicle for hawala transactions.[27] The framework recognizes no middle ground between administrative strike-off with collateral disqualification and criminal prosecution under Section 447.

Second, promoter impunity persists. The December 2024 SFIO action against Chinese-funded shell companies resulted in arrests of dummy directors but no announced framework for pursuing the beneficial owners who orchestrated the structures.[28] Section 164(2) disqualifies only persons formally appointed as directors, not those exercising de facto control. Without beneficial ownership disclosure mandates backed by meaningful sanctions, the corporate veil shields those most culpable.

Third, procedural delays undermine deterrence. Section 252 permits restoration of struck-off companies within 20 years of dissolution upon application to the National Company Law

[26] Companies Act 2013, s 447.
[27] 'Disqualification of Directors and Shell Companies by MCA' (n 23).
[28] 'MCA Crackdown on Chinese Shell Companies in India' (TaxTMI, 31 December 2024) https://www.taxtmi.com/news?id=25775 accessed 3 February 2026.

ISSN: 2582-6433

Tribunal.[29] This extraordinary window allows shell company operators to maintain dormant structures indefinitely, reviving them opportunistically when beneficial. The lack of temporal finality contradicts the policy objective of removing non-functional entities from the register.

Fourth, cross-border enforcement challenges proliferate. The Jillian Consultants case exemplifies jurisdictional limitations where foreign nationals serve as directors of Indian shell companies.[30] Extradition for corporate law violations proves impractical, and attachment of assets held abroad requires letters rogatory and mutual legal assistance treaties. The Companies Act contains no extraterritorial application provisions addressing controllers operating from foreign jurisdictions.

Case Study Analysis

The Maharashtra shell company network demonstrates systemic inadequacies. In FY 2022-23, the MCA struck off 8,329 companies in the state, many sharing common registered office addresses and displaying interlocking directorships.[31] Despite these red flags suggesting coordinated misuse, no prosecutions were publicly reported. The entities were simply removed from the register, their directors disqualified, but the networks that created and monetized these structures remained intact and capable of forming replacement entities.

The SFIO's December 2024 action against Chinese-linked shell companies achieved arrests but highlighted the framework's limitations.[32] Charging dummy directors under existing provisions fails to address the transnational beneficial owners or establish deterrent penalties proportionate to the alleged money laundering facilitated. Without statutory clarity on graded liability and beneficial owner accountability, enforcement remains reactive and symbolic rather than systematically preventive.

[29] 'Slaying the Slain: The Law About Strike-Off of Companies' (Vinod Kothari, 18 September 2017) https://vinodkothari.com/2017/09/slaying-the-slain-the-law-about-strike-off-of-companies/ accessed 3 February 2026.
[30] 'MCA Crackdown on Chinese Shell Companies' (n 28).
[31] 'MCA Strikes Off 40949 Companies Under Companies Act 2013' (SAG Infotech, 22 July 2025) https://blog.saginfotech.com/mca-strikes-off-40949-companies-companies-act-2013-three-years accessed 3 February 2026.
[32] 'MCA Crackdown on Chinese Shell Companies' (n 28).

ISSN: 2582-6433

IV. COMPARATIVE ANALYSIS: UK AND US MODELS

United Kingdom: The ECCTA 2023 Framework

Substantive Reforms

The Economic Crime and Corporate Transparency Act 2023 introduced a transformative "failure to prevent fraud" offence under Section 199, effective from September 2025.[33] This provision creates corporate criminal liability where an "associated person" commits a fraud offence intending to benefit the organization or any person to whom services are provided on the organization's behalf.[34] The offence applies to large organizations defined as those with 250 or more employees, turnover exceeding £36 million, or total assets exceeding £18 million.[35]

Critically, the offence operates on strict liability principles. A company may be convicted even where senior management had no knowledge of the fraud, provided an associated person committed the predicate offence.[36] The only statutory defense requires the organization to prove it had "reasonable procedures" in place to prevent persons associated with it from committing fraud.[37] This burden-shifting mechanism compels corporations to implement robust compliance architectures or face criminal liability for employee and agent misconduct.

The scope encompasses a wide range of fraudulent conduct. Official guidance identifies applications including greenwashing (false environmental claims), false statements to Companies House, fraudulent trading, and abuse of corporate structures to facilitate tax evasion.[38] Parent companies bear liability for subsidiary fraud where the subsidiary performs services on the parent's behalf, closing a significant enforcement gap in multinational structures.[39]

Liability Attribution Model

The ECCTA framework holds institutional actors accountable without requiring prosecution of individual fraudsters. Prosecutors may proceed against the corporate entity alone, a strategic

[33] 'UK "Failure to Prevent Fraud" Offence Comes into Force' (Wikborg Rein, 4 September 2025) https://www.wr.no/en/news/uk-failure-to-prevent-fraud-offence-comes-into-force accessed 3 February 2026.
[34] 'New UK "Failure to Prevent" Fraud Corporate Criminal Offence Takes Effect' (A&O Shearman, 25 October 2023) https://www.aoshearman.com/en/insights/ao-shearman-on-investigations/new-uk-failure-to-prevent-fraud-corporate-criminal-offence-takes-effect accessed 3 February 2026.
[35] ibid.
[36] ibid.
[37] ibid.
[38] ibid.
[39] ibid.

ISSN: 2582-6433

advantage where identifying the specific employee or agent responsible proves difficult.[40] Convicted organizations face unlimited fines calibrated to the harm caused and the organization's means.[41]

In August 2025, the first prosecution under analogous "failure to prevent tax evasion" provisions under the Criminal Finances Act 2017 resulted in charges against a corporate services provider, demonstrating enforcement authorities' willingness to deploy institutional liability mechanisms.[42] This precedent signals that failure to prevent offences constitute viable prosecutorial tools rather than merely symbolic deterrents.

Enhanced Transparency Measures

Beyond criminal liability, the ECCTA empowered Companies House with unprecedented verification and enforcement capabilities. The registrar may now verify director identities proactively, remove fraudulent or misleading filings, annotate the register with warnings, and share data with law enforcement agencies and regulatory bodies.[43] These reforms address systemic problems revealed by investigations such as the ICIJ's FinCEN Files, which identified £4.5 billion in suspicious transactions involving British shell companies over a two-year period.[44]

The verification powers enable Companies House to reject incorporation applications or strike off entities displaying shell characteristics at the formation stage, shifting from reactive enforcement to preventive gatekeeping. Enhanced information-sharing protocols facilitate coordinated action by Companies House, HMRC, the National Crime Agency, and the Serious Fraud Office against networks exploiting corporate vehicles for money laundering or sanctions evasion.

Relevance to India

The UK model offers three adaptable insights for Indian reform. First, the "failure to prevent"

[40] ibid.
[41] ibid.
[42] 'First Business Charged Under UK Corporate Criminal Offences of Failure to Prevent Tax Evasion' (Osborne Clarke, 14 August 2025) https://www.osborneclarke.com/insights/first-business-charged-under-uk-corporate-criminal-offences-failure-prevent-tax-evasion accessed 3 February 2026.
[43] 'New UK Transparency Laws Will Target Money Launderers and Fraudsters' (ICIJ, 2 November 2023) https://www.icij.org/investigations/fincen-files/new-uk-transparency-laws-will-target-money-launderers-and-fraudsters-but-advocates-want-more/ accessed 3 February 2026.
[44] ibid.

ISSN: 2582-6433

principle shifts compliance responsibility to corporate entities themselves, incentivizing investment in fraud detection and prevention systems. Second, the graded approach distinguishes large organizations facing strict liability from small and medium enterprises subject to lighter-touch regulation, balancing deterrence with proportionality. Third, institutional liability addresses the attribution gap where beneficial owners hide behind nominee directors, as UK law pierces the corporate veil to hold controlling entities accountable for subsidiary misconduct.

United States: Corporate Transparency Act 2021

Beneficial Ownership Reporting

The Corporate Transparency Act, effective January 2021, requires reporting companies to disclose beneficial ownership information to the Financial Crimes Enforcement Network.[45] This mandate responds to evidence that 70 percent of grand corruption cases involve the use of US-incorporated entities, exploiting the opacity previously afforded by state incorporation regimes requiring no beneficial ownership disclosure.[46] Most US states historically demanded no information regarding LLC members or managers, enabling anonymous corporate vehicles.[47]

Reporting companies must identify individuals who exercise substantial control or own at least 25 percent of ownership interests, providing names, dates of birth, addresses, and identification document details. The regime also requires disclosure of "company applicants," the individuals who directly file formation documents or direct such filing, creating an accountability trail from the incorporation stage.[48]

Penalty Structure

The CTA establishes a graded penalty framework distinguishing negligent non-compliance from willful violations. Civil penalties reach $500 per day of continued non-compliance, capped at $10,000.[49] Criminal liability attaches to willful provision of false information or

[45] 'Federal Corporate Transparency Act Requires Companies to Disclose Beneficial Owner' (Porter Wright, 1 March 2021) https://www.porterwright.com/media/federal-corporate-transparency-act-requires-companies-to-disclose-beneficial-owner/ accessed 3 February 2026.
[46] Financial Crimes Enforcement Network, 'The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies' (US Department of the Treasury, 2006) https://www.fincen.gov/system/files/shared/LLCAssessment_FINAL.pdf accessed 3 February 2026.
[47] ibid.
[48] 'Federal Corporate Transparency Act' (n 45).
[49] ibid.

ISSN: 2582-6433

willful failure to report, carrying maximum imprisonment of two years.[50] This tiered structure enables proportionate enforcement: inadvertent reporting delays trigger modest civil penalties while deliberate falsification faces criminal sanction.

The "willfulness" requirement provides a culpability threshold absent from UK strict liability offences. Prosecutors must prove the defendant acted with knowledge that conduct was unlawful or with reckless disregard for legal obligations. This mens rea element protects inadvertent violators while targeting those deliberately exploiting opacity.

Indian Adaptation Potential

The US transparency model offers three transferable elements. First, beneficial ownership registries reduce anonymity without requiring complex institutional liability theories. The MCA proposed such a registry in 2018 consultations but never implemented it; the CTA demonstrates feasibility.[51] Second, the clear penalty gradation between civil and criminal violations provides the proportionality lacking in current Indian law. Third, applicant disclosure requirements impose accountability on incorporators and professional intermediaries who facilitate shell company formation, addressing the lawyer-accountant enabler problem.

Synthesis: Lessons for India

The UK and US frameworks embody distinct regulatory philosophies suited to different aspects of shell company misuse. The UK's ECCTA model prioritizes institutional liability and fraud prevention obligations, appropriate for large listed companies and corporate groups where compliance infrastructure is feasible. The US CTA emphasizes transparency and beneficial ownership disclosure with clear penalty gradations, a scalable approach applicable across diverse entity sizes.

Both jurisdictions transitioned from reactive strike-off procedures to proactive prevention regimes backed by explicit statutory frameworks. The UK's verification powers at Companies House parallel the need for enhanced ROC capabilities in India. The US requirement to identify company applicants addresses the incorporation gateway that Indian law leaves largely unregulated beyond minimum documentation. Adapting elements from both models would

[50] ibid.
[51] 'New UK Transparency Laws' (n 43).

ISSN: 2582-6433

position Indian corporate law to address shell company misuse through a combination of transparency mandates, institutional accountability, and proportionate sanctions calibrated to culpability.

V. PROPOSED FRAMEWORK: STATUTORY DEFINITION AND GRADED LIABILITY

Recommended Statutory Definition

A coherent enforcement regime requires statutory clarity. The Companies Act should define a "shell company" as an entity satisfying both operational and asset-based criteria, adapted from the US SEC framework with modifications for Indian commercial realities. The proposed definition would designate as a shell company any entity that:

1. Has conducted no operations or only nominal operations for at least two consecutive financial years; AND
2. Satisfies any of the following conditions:
    - Holds no assets or nominal assets below a prescribed threshold of ₹5 lakhs excluding cash and bank balances;
    - Holds assets consisting primarily (exceeding 90 percent of total assets) of cash, bank deposits, or marketable securities without identifiable business purpose disclosed in board resolutions;
    - Conducts transactions predominantly (exceeding 75 percent by value) with related parties as defined under Section 2(76), evidencing circular fund flows or layering arrangements.

This multi-factor test balances objectivity with flexibility. The operational element addresses entities formed but never activated or those that ceased meaningful business. The asset-based criteria capture conduit vehicles holding transitory funds. The related-party transaction threshold targets round-tripping structures where funds circulate within controlled networks without genuine commercial exchange.

Safe Harbor Exclusions

To prevent over-inclusive application, the definition must explicitly exclude:

- Companies holding valid dormant company status under Section 455, having properly notified the Registrar and complied with applicable conditions;

ISSN: 2582-6433

- Special purpose vehicles established for bona fide project financing, infrastructure development, or securitization where the SPV structure and limited operations serve disclosed commercial purposes;
- Holding companies where one or more subsidiaries conduct active business operations, provided consolidated financial statements demonstrate group commercial substance;
- Companies undergoing corporate insolvency resolution process or liquidation under the Insolvency and Bankruptcy Code, 2016;
- Newly incorporated companies within 18 months of registration, allowing reasonable time to commence operations.

These carve-outs preserve legitimate corporate structuring while focusing enforcement on entities genuinely lacking commercial substance.

Graded Liability Regime

Tier 1: Administrative Non-Compliance

This tier addresses inadvertent or technical violations. It applies where a company becomes dormant without filing for Section 455 status, experiences temporary cessation due to market disruption, or fails administrative compliance requirements without fraud indicators.

Liability consequences include monetary penalties of ₹50,000 to ₹2 lakhs imposed jointly on directors, with the company required to regularize status by filing for dormant classification or demonstrating resumed operations. No disqualification attaches, and the company remains on the register. This tier recognizes that operational cessation often results from business failure rather than misconduct, warranting remedial rather than punitive responses.

Tier 2: Persistent Non-Compliance

Tier 2 targets willful neglect. It applies where companies fail to file financial statements or annual returns for three consecutive years, evade Section 455 dormancy obligations despite lacking operations, refuse cooperation with ROC physical verification under Rule 25B, or maintain shell status for extended periods without legitimate justification.

Consequences escalate significantly. The company faces strike-off under Section 248 plus monetary penalties of ₹5 to ₹10 lakhs recoverable jointly and severally from directors and promoters. Directors incur two-year disqualification under Section 164(2) and continuing

ISSN: 2582-6433

liability under Section 250 for company obligations. Promoters holding beneficial ownership exceeding 10 percent face joint liability for company debts up to the amount of paid-up capital.

Restoration under Section 252 remains available but with a reduced window of 10 years (shortened from the current 20 years) to impose temporal finality. This tier balances accountability with the recognition that persistent non-compliance, while serious, may not involve criminal intent warranting prosecution.

Tier 3: Fraud and Money Laundering

The highest tier addresses criminal misuse. It applies where shell companies facilitate round-tripping of funds, layering transactions to obscure proceeds of crime, tax evasion through bogus expenses or accommodation entries, or violations of the Prevention of Money Laundering Act, 2002.

Liability reaches maximum severity. The company faces immediate strike-off, disgorgement of proceeds, and attachment of assets. Directors face prosecution under Section 447 carrying imprisonment from six months to ten years, plus lifetime disqualification from holding directorships. Promoters and beneficial owners become subject to PMLA prosecution, asset attachment, and potential application of a "failure to prevent" liability principle adapted from UK law. Where a controlling entity (parent company, promoter group entity, or principal beneficial owner) fails to implement reasonable procedures to prevent use of the shell company for fraud or money laundering, that controlling entity incurs criminal liability.

No restoration is permitted for Tier 3 entities. The permanent removal signals zero tolerance for criminal exploitation of corporate vehicles.

Implementation Mechanisms

Effective operation requires robust institutional support. The MCA should deploy risk-based classification algorithms analyzing red flags including common registered office addresses, sudden capital movements (large deposits followed by rapid withdrawals), networks of interlocking directorships, nominee director patterns (multiple directorships in unrelated industries), and GST registration mismatches.

Procedural safeguards must accompany enhanced powers. Before imposing Tier 2 or Tier 3

ISSN: 2582-6433

classification, the Registrar must issue a show-cause notice providing 90 days for the company to explain its status or regularize operations. Adverse determinations should be appealable to the National Company Law Tribunal within 60 days, with the tribunal empowered to review factual findings and tier classification.

Finally, beneficial ownership disclosure requires mandatory implementation. Companies filing AOC-4 (financial statements) and MGT-7 (annual returns) should attach a schedule identifying all individuals holding more than 10 percent voting rights or exercising control through other means, including details sufficient to verify identity. Non-disclosure or false disclosure should trigger Tier 2 or Tier 3 liability depending on whether the omission appears inadvertent or deliberate.

VI. ADDRESSING COUNTERARGUMENTS

Concern 1: Over-Regulation of Legitimate Structures

Critics may contend that statutory definitions and graded liability will impose excessive compliance burdens on legitimate special purpose vehicles, holding companies, and restructuring entities. This concern merits consideration but proves ultimately unpersuasive. The proposed framework incorporates explicit safe harbor provisions excluding dormant companies under Section 455, bona fide SPVs with disclosed purposes, and holding companies with operational subsidiaries from shell classification.[52] These carve-outs preserve structural flexibility while targeting entities genuinely lacking commercial substance.

Moreover, the current enforcement regime already impacts legitimate structures through the definitional vacuum. The 2022 Rule 25B physical verification requirement disrupted foreign subsidiaries utilizing registered office services despite valid business models.[53] Statutory clarity would reduce rather than increase compliance uncertainty by providing ascertainable criteria for self-assessment. The Tier 1 administrative category further accommodates inadvertent non-compliance through remedial rather than punitive responses, recognizing that temporary operational cessation often results from market conditions rather than misconduct.

[52] Companies Act 2013, s 455.
[53] 'Crackdown on Shell Companies: MCA Amends the Companies Incorporation Rules to Provide for Physical Verification of Registered Offices' (Cyril Amarchand Mangaldas, 28 August 2022) https://corporate.cyrilamarchandblogs.com/2022/08/crackdown-on-shell-companies-mca-amends-the-companies-incorporation-rules-to-p accessed 3 February 2026.

ISSN: 2582-6433

Concern 2: Administrative Burden on MCA and ROCs

Enhanced verification, risk-based classification, and beneficial ownership disclosure impose additional workload on already resource-constrained regulators. However, risk-based enforcement concentrates intensive scrutiny on high-risk entities displaying red flag indicators, while low-risk compliant companies face minimal additional requirements beyond existing annual filing obligations. Technology-enabled algorithms can automate initial screening based on objective criteria such as common addresses, interlocking directorships, and transaction patterns.

The UK experience demonstrates feasibility. Companies House absorbed expanded verification and strike-off powers under ECCTA while maintaining registration processing timelines.[54] Investment in technology infrastructure and inter-agency data sharing with the Enforcement Directorate, SEBI, and Income Tax Department would enhance rather than burden enforcement capacity by enabling coordinated action against networks exploiting corporate vehicles.

Concern 3: Chilling Effect on FDI and Corporate Restructuring

Foreign investors and multinational enterprises may perceive enhanced enforcement as hostile to legitimate cross-border structures. This concern inverts causation. The current arbitrary enforcement environment, where shell classification lacks statutory definition and depends on administrative discretion, creates greater investment uncertainty than a clear rules-based framework.

The proposed definition's "identifiable business purpose" exception protects genuine holding companies, treasury centers, and intellectual property vehicles common in multinational tax planning, provided purposes are disclosed and documented. Enhanced certainty regarding what constitutes impermissible shell structures facilitates rather than impedes compliant structuring. Furthermore, aligning Indian corporate law with OECD and FATF standards by implementing beneficial ownership transparency and anti-avoidance provisions reduces the risk of grey-listing or sanctions that would genuinely harm India's investment climate.[55] Regulatory clarity attracts investment by demonstrating commitment to rule of law and proportionate

[54] 'New UK Transparency Laws Will Target Money Launderers and Fraudsters' (ICIJ, 2 November 2023) https://www.icij.org/investigations/fincen-files/new-uk-transparency-laws-will-target-money-launderers-and-fraudsters-but-advocates-want-more/ accessed 3 February 2026.
[55] ibid.

ISSN: 2582-6433

enforcement.

VII. Conclusion

The existing legal framework's twin deficits create systemic enforcement failures. The absence of a statutory definition for "shell company" produces arbitrary enforcement capturing legitimate dormant entities while allowing sophisticated layering structures to escape scrutiny.[56] The binary liability approach, offering only administrative strike-off or criminal prosecution, fails to distinguish startup failures from deliberate money laundering conduits.[57] With 1,85,350 entities removed since 2022-23 yet persistent regulatory arbitrage and shadow promoter networks remaining intact, reactive measures prove inadequate.[58]

Legislative reform should proceed along three dimensions. First, the Companies Act requires amendment to incorporate a statutory definition combining operational inactivity, asset insignificance, and related-party transaction dominance with explicit safe harbors for dormant companies, SPVs, and holding companies with operational subsidiaries. Second, a three-tier liability regime should distinguish administrative non-compliance warranting penalties and remediation, persistent neglect justifying disqualification and recovery from directors and promoters, and criminal fraud demanding prosecution plus beneficial owner liability. Third, institutional reforms including a beneficial ownership registry, enhanced ROC verification powers modeled on UK Companies House, NCLT appellate mechanisms, and formalized MCA-ED-SFIO coordination protocols must support the substantive framework.

Adopting the UK's "failure to prevent" principle for Tier 3 offences addresses the attribution gap enabling shadow controllers to evade accountability through nominee directors.[59] Implementing US-style transparency mandates with graded civil and criminal penalties

[56] 'Government Actions on Non-Functional & Shell Companies' (TaxGuru, 25 March 2025) https://taxguru.in/company-law/government-actions-non-functional-shell-companies.html accessed 3 February 2026.
[57] 'Disqualification of Directors and Shell Companies by MCA' (MyAdvo, 11 September 2019) https://www.myadvo.in/blog/disqualification-of-directors-and-shell-companies/ accessed 3 February 2026.
[58] Lok Sabha Unstarred Question No. 87, Ministry of Corporate Affairs (30 November 2024) https://sansad.in/getFile/loksabhaquestions/annex/186/AU87_9upoGr.pdf accessed 3 February 2026.
[59] 'New UK "Failure to Prevent" Fraud Corporate Criminal Offence Takes Effect' (A&O Shearman, 25 October 2023) https://www.aoshearman.com/en/insights/ao-shearman-on-investigations/new-uk-failure-to-prevent-fraud-corporate-criminal-offence-takes-effect accessed 3 February 2026.

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balances deterrence with proportionality.[60] These comparative borrowings would position Indian corporate governance as globally competitive while preserving entrepreneurial flexibility. The proposed framework recognizes that not all non-functional companies constitute vehicles for illicit finance, but all effective anti-money laundering and tax compliance regimes require robust detection, proportionate sanctions, and beneficial owner accountability. Statutory clarity coupled with risk-based enforcement would enhance rather than burden India's investment climate by replacing arbitrary discretion with ascertainable legal standards.

[60] 'Federal Corporate Transparency Act Requires Companies to Disclose Beneficial Owner' (Porter Wright, 1 March 2021) https://www.porterwright.com/media/federal-corporate-transparency-act-requires-companies-to-disclose-beneficial-owner/ accessed 3 February 2026.