

“Pandora's Papers: An Analysis of Shell Companies and Financial Frauds”

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ABSTRACT

The increase in number of shell corporation has contributed to a large number of crimes which was elucidated upon through the Pandora Papers. These documents unveiled by the International Consortium of Investigative Journalists (ICIJ) in October 2021, constitute a monumental leak of financial documents which then exposed a vast network of offshore wealth and covert financial dealings. India, particularly affected by these revelations, doubled down and intensified its efforts to combat tax evasions and financial misconduct. A background study on the subject reveals disparities in the regulatory frameworks and enforcement mechanisms. Addressing loopholes in the legal system is crucial to effectively combatting financial crimes perpetrated through shell corporations. This research emphasized on the need for robust regulatory measures, transparency, and other legislative amendments to safeguard the integrity of global economic system. Through this research, an actionable set of suggestions are developed which are applicable in light of the current socio-economic atmosphere.

Keywords: Pandora Papers, Shell Corporations, Financial Crimes, Companies Act 2013, Indian Economy.

1. INTRODUCTION

The wide-spread emergence and development of shell corporations around the globe have catalyzed and aided the evolution of a variety of financial crimes, including tax evasion, money laundering and other fraudulent activities. This is due to the protection and the resultant encouragement that the offenders receive from the safety offered by the shell companies. Through this paper, the researchers have aimed to comprehensively analyze the concept of shell

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companies. To achieve a thorough understanding of it, the study begins with research into the background and evolution of shell corporations, and delving particularly into the recent publication of the Pandora papers, which stands as a testament to the several significant transformations that occurred in the global economy within a short period⁴. Shell corporations are characterized by their minimal assets, operations, and business activities, as they operate primarily on paper, thereby serving to conceal assets and facilitate illegal activities and the resultant financial transactions under its guise.

As this research is primarily conducted on the Pandora Papers, it further moves to introducing what these documents signify from the global economic perspective⁵. This massive leak unveiled the intricate offshore wealth of several prominent individuals, public officials, and wealthy elites worldwide and is expanded extensively as follows⁶. Unlike previous such instances like the Panama and Paradise Papers, the Pandora Papers implicate this in a much more elaborate manner, implicating 14 different offshore service providers involved in facilitating money laundering and tax evasion, who all cater to affluent individuals and businesses seeking to establish shell corporation in nation that has the suitable legislations providing for these loopholes⁷. Through the research, this paper aims to discussed the repercussions of the release of the Pandora Papers, and the deep significance of it. The research also delves into its results from a legislative point of view, particularly in India. After establishing the required preliminary knowledge and perspective knowledge needed for the analysis, the primary objective behind this analysis was to analyze the Indian laws that empower Indian citizens to indulge in such activities, identifying the causative loopholes and finally provide suitable suggestions that can be adapted as a preventative measure.

The instant research is of great significance from the global economic perspective and calls for the analysis of various laws and statutes. But for the purpose of the research, the researchers have constrained majorly to Indian laws and referencing the occasional foreign laws as required. This paper employs a doctrinal research methodology streamlining to analytical study of various resources. These resources which the researchers use to obtain information from includes journal articles, laws and economic commentaries which jointly constitute to be secondary data and have been reviewed as literature. Availing the sources through diverse legal

⁴ Thomas and Alexander, *The Logics and Trajectories of Advanced Capitalism*, THE POL. AND ETHICS OF TRANSHUMANISM: TECHNO-HUMAN EVO. AND ADV. CAPITALISM 32, 32-70 (2024).

⁵ Maurer, Bill, *Money Laundering, Terrorist Financing, and Tax Evasion: The Consequences of International Policy Initiatives on Financial Centres in the Caribbean Region*, 97 NWIG 364, 364-365 (2023).

⁶ Risso, Melina, et al., *Setting the Stage for Money Laundering Frameworks Related to Environmental Crime*, FOLLOW THE MONEY: CONNEC. ANTI-MONEY LAUND. SYS. TO DISRUPT ENV. CRIME IN THE AMAZON 14, 14-19 (2023).

⁷ ICIJ, *Offshore Havens and Hidden Riches of World Leaders and Billionaires Exposed in Unprecedented Leak*, <https://www.icij.org/investigations/pandora-papers/global-investigation-tax-havens-offshore/> (last visited Aug. 31. 2024)

databases providing the same. To perform an effective study the researchers, interpret secondary and tertiary empirical data for furtherance of the same.

2. BACKGROUND OF SHELL CORPORATIONS

Even though it spans decades, the current history of tax fraud, money laundering, and the creation of tax havens has its origins in the years following World War II. Global economic systems experienced profound changes during the war, which paved the way for the emergence of offshore financial hubs and the spread of legislation about banking secrecy. These events laid the groundwork for money laundering and tax evasion to become systemic problems in the global banking system. The emergence of jurisdictions that provided advantageous regulatory frameworks, low tax rates, and stringent banking secrecy rules was one of the main drivers of the rise of offshore finance.

As offshore financial hubs, nations like Luxembourg⁸, the Cayman Islands, Switzerland⁹ and various other countries in South America drew affluent individuals to hide their assets from taxes and scrutiny in their countries¹⁰. Particularly, the Swiss banking system, which offered account holders a veil of anonymity and protected their financial information from prying eyes, came to be associated with banking secrecy. Advances in international trade, investment, and technology that made it easier to transfer money across borders coincided with the growth of offshore finance. Wealthy individuals or other bodies who amassed their wealth through illegal means started making use of banking secrecy rules and offshore countries to avoid paying taxes, laundering money illegally, and hiding the earnings of their illicit activities. Trusts, shell corporations, and offshore accounts have all become popular means of hiding the source and ownership of money, making it more challenging for tax officials and law enforcement to locate and retrieve assets¹¹. A commercial firm that primarily exists on paper and lacks significant assets, operations, or business activities is referred to as a shell corporation, also known as a shell company or shell entity. These organizations are frequently created to keep assets, assist with financial transactions, or carry out illegal acts under the cover of legality¹². A shell corporation is essentially a business that mimics a real company's formalities and legal framework, but it has no actual business or operational substance. The activities of shell firms are usually restricted to pass-through transactions or retaining assets on behalf of unknown

⁸ Anna Hermelinski-Ayache & Jean-Baptiste Lhuillier, *Luxembourg's Fight against Empty Shell Companies: Out-of-Court, but Never Far from Court*, 16 INSOLVENCY & RESTRUCTURING INT'L 32 (April 2022).

⁹ Nicholas Shaxson, *How to Crack down on Tax Havens: Start with the Banks*, 97 FOREIGN AFF. 94 (2018).

¹⁰ Angélico, Fabiano, and Lígia Zagato, *Definitions: Money-Laundering, Tax Havens and Shell Companies*, TRANSPARENCY INT'L. 16, 16-18 (2017).

¹¹ WHAT IS A SHELL CORPORATION? HOW IT'S USED, EXAMPLES AND LEGALITY, <https://www.investopedia.com/terms/s/shellcorporation.asp> (last visited 14.03.2024).

¹² Sharman and Jason, *Offshore and the New International Political Economy*, 17 REV. OF INTL. POLITICAL ECO. 1, 1-19 (2010).

beneficiaries. Typically, they have few or no staff, physical offices, or tangible assets. Shell companies are not intrinsically illegal, but they can be used for money laundering, tax evasion, fraud, and hiding the real owners of assets, among other illegal activities¹³. Shell corporations can be used to conceal the sources and recipients of illegal funds because of their opaque and secretive character. This makes them appealing to people or organizations seeking illicit financial activities while avoiding accountability and detection.

Financial misconduct thrived due to the offshore finance industry's pervasive culture of secrecy and opacity. Money launderers, tax evaders, and other bad actors took advantage of regulatory gaps and slack enforcement to commit crimes without being caught. The absence of accountability and transparency in offshore jurisdictions hindered attempts to stop financial crime, money laundering, and tax evasion by allowing illegal funds to move through the global financial system easily¹⁴.

3. PANDORA PAPERS: AN INTRODUCTION

The International Consortium of Investigative Journalists (ICIJ) revealed the Pandora Papers, a massive leak of financial documents that revealed a vast network of offshore wealth and covert financial dealings involving well-known people, public officials, and wealthy elites worldwide in October 2021. The breach, which included 11.9 million documents and 2.94 terabytes of data, provided insight into the sophisticated methods used to launder money, evade taxes, and carry out illegal financial transactions via trusts, offshore shell companies, and other elaborate arrangements. In the Panama Papers, the organization responsible for money laundering was a law firm called Mossack; in Paradise Paper, it was an associate trust. Still, in Pandora papers, there is not one specific organization but 14 different service providers¹⁵ involved in money laundering. Confidential documents belonging to 14 offshore service providers, who offer expert assistance to affluent people and businesses looking to establish shell corporations in tax haven nations- have been leaked¹⁶. Owners can hide their identities from the public due to the entities. The information leaked pertains to the beneficial owners of companies registered in various tax haven nations, including South Dakota, the British Virgin Islands¹⁷, the Seychelles, and Panama. It also includes details about the officials, directors, and stockholders. Moreover, these kinds of organizations frequently invest in and buy assets like

¹³ DEFINING THE SHELL COMPANIES IN INDIA, <https://indiaforensic.com/certifications/defining-shell-companies/> (last visited 12.03.2024).

¹⁴ Sharman, J. C., *Shopping for Anonymous Shell Companies: An Audit Study of Anonymity and Crime in the International Financial System*, 24 THE JOURNAL OF ECO. PERSPECTIVES 127, 127-140 (2010)

¹⁵ Supra Note 7.

¹⁶ Sagnik Sarkar, *Tax Haven: Analysing Tax Avoidance in respect of Panama and Pandora Papers*, 3 IJLR 597, 597-613 (2023).

¹⁷ Sagar Kumar, *A Critique on Pandora Papers under the Realm of Tax Haven*, 4 INDIAN J.L. & LEGAL RSCH. 1 (2022).

real estate and aircraft. The Pandora Papers probe also exposes the close cooperation between banks and legal firms and offshore service providers in the creation of intricate corporate frameworks, despite legal prohibitions against engaging in fraudulent business practices. The way Pandora papers operate is as follows: considering Mr. A has a significant amount of unreported income that, if revealed, he must pay hefty taxes in his native nation. Thus, Mr. A establishes a shell business in a tax haven nation, Panama, or the British Virgin Islands. After that, Mr. A uses a service provider to move his wealth into that shell business, and he names a nominee or beneficial owner to serve as the company's director or shareholder. Now that the sum of money cannot be linked to Mr. A, he has successfully concealed his income. Now, Mr. A purchase a London property through a shell business to justify their fortune. As a result, Mr. A was allowed to transfer the funds into a valid tax jurisdiction, and they are no longer associated with Mr. A. The disclosures in the Pandora Papers caused a global uproar, calls for accountability, and a re-examination of offshore tax havens and financial secrecy. One of the major revelations from the Pandora Papers was the extent to which prominent people, politicians, and world leaders used offshore companies to hide their wealth from public view and evade taxes. Numerous political elites, including heads of state, government employees, and members of royal families, were linked to dubious financial dealings and offshore investments, according to the leak. The documents revealed, for instance, how powerful individuals such as King Abdullah II of Jordan¹⁸, the ruling family of Qatar, and President Uhuru Kenyatta of Kenya accumulated enormous amounts of offshore wealth using intricate networks of shell corporations and trusts. In a similar vein, the leak implicated public servants from across the world, exposing their hidden wealth, undeclared assets, and possible conflicts of interest¹⁹. In addition to political figures, the Pandora Papers exposed the involvement of wealthy individuals or other bodies who amassed their wealth through illegal means, in offshore financial operations designed to reduce tax obligations and increase financial confidentiality. The leak made public how well-known individuals, including as sports figures, musicians, and business moguls, used offshore companies to buy boats, fancy homes, and other high-value possessions while dodging taxes in their native nations. The papers included the names of prominent individuals, including Hollywood actors, Russian billionaire Roman Abramovich, and Indian cricket icon Sachin Tendulkar, raising concerns about their financial and moral behaviour. The role that banks, legal firms, and other financial intermediaries played in enabling financial malfeasance and offshore tax evasion was also exposed by the Pandora Papers. The leak made public how large financial institutions and professional service providers worked together with customers to construct intricate offshore structures, hide assets, and take advantage of legal loopholes to avoid paying taxes and conceal riches from

¹⁸ The Impact of Pandora Papers, 9 CT. UNCOURT 23 (2022).

¹⁹ Supra Note 16.

government officials²⁰. Concerns over involvement in money laundering, corruption, and other financial crimes were raised by some of the records, which demonstrated how banks and legal companies knowingly supported illegal financial activity. The global fallout from the Pandora Papers led to innumerable inquiries, protests, and demands for change. The disclosures sparked calls for increased responsibility, openness, and regulatory monitoring of offshore financial operations in numerous nations. Calls for legislative changes, tighter enforcement tactics, and international collaboration to address offshore tax havens and financial secrecy put pressure on governments to crack down on tax evasion, money laundering, and financial wrongdoing.

4. IMPACT OF PANDORA PAPERS IN INDIA

The disclosure of the involvement of multiple persons and businesses in offshore financial operations by the Pandora Papers had a significant impact on India. The examination of well-known politicians and those close to them involved in offshore financial operations was one of the main effects of the Pandora Papers on India. The disclosure exposed the use of offshore companies by Indian lawmakers, including state and national parliamentarians, to launder money, avoid paying taxes, and hide assets. The revelations aroused concerns over possible conflicts of interest, corruption, and power abuse among elected officials, prompting calls for regulatory action and investigations. A well-known former cricket player and national hero, Sachin Tendulkar, was one of the prominent cases featured in the leak. Tendulkar's relationship to an offshore company based in the British Virgin Islands was made public by the leak, which sparked concerns about his financial activities and the motivations behind these kinds of offshore investments. Additionally, the Indian government has decided to investigate the Pandora leak. In a press release, the government said that they would launch their own inquiry and would use relevant information regarding significant entities that they had acquired from other countries. The discovery attracted public controversy and scrutiny even though Tendulkar explained that the organization was set up for legitimate commercial purposes and fully notified the Indian tax authorities. Anil Ambani, a notable industrialist, and the chairman of the Reliance Anil Dhirubhai Ambani Group (ADAG), was the subject of another well-known lawsuit²¹. Ambani's connections to offshore companies in tax havens including the British Virgin Islands and Seychelles were made public by the Pandora Papers, indicating attempts to hide wealth and avoid paying taxes. The aforementioned disclosures have contributed to the pre-existing controversy about Ambani's commercial conglomerate, encompassing financial defaults, litigation, and corporate governance concerns. The disclosure heightened vigilance on Ambani's fiscal matters and sparked questions about his adherence to legal and regulatory

²⁰ Supra Note 10.

²¹ PANDORA PAPERS: HERE ARE THE BIGGEST REVELATIONS SO FAR, <https://www.indiatoday.in/business/story/pandora-papers-investigation-icij-biggest-revelations-so-far-1860842-2021-10-05> (last visited 15.03.2024).

requirements²². The Pandora Papers also made the Bollywood actor Jackie Shroff's participation in offshore financial operations public made public by the Pandora Papers. Shroff's financial practices and the motivations behind his offshore investments were questioned after he was connected to an offshore organization incorporated in the Cayman Islands. Despite Shroff's insistence that the company was founded for legal reasons and fully declared to Indian tax authorities, the disclosure aroused public suspicions about celebrities using offshore organizations to manage their riches.

India has taken several steps to improve transparency, fight tax evasion, strengthen regulatory control in response to the Pandora Papers' disclosures and stop illicit financial activity. The creation of specialized task forces and agencies tasked with looking into offshore financial activities and taking tough measures against tax evasion and money laundering is one notable move made by the Indian government. The job of identifying and closely examining people and organizations engaged in offshore financial activities has fallen to some agencies, including the Income Tax Department, the Enforcement Directorate (ED), the Securities and Exchange Board of India (SEBI), the Central Bureau of Investigation (CBI), the Financial Intelligence Unit (FIU), and the Serious Fraud Investigation Office (SFIO). India additionally stepped up its efforts to strengthen information sharing and international collaboration with other countries to track and trace illicit financial flows and bring those guilty of tax evasion and financial crimes to justice. In addition, the government has enacted new rules and regulations to improve corporate governance practices, strengthen anti-money laundering legislation, and boost financial sector transparency. To give authorities the ability to investigate and prosecute offenders involved in offshore financial activities, these reforms include modifications to the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, the Prevention of Money Laundering Act, 2002, and other essential statutes.

5. SHELL COMPANIES IN INDIA

The definition of what precisely a shell company is, is not provided for anywhere in the Companies Act, 2013, or any other legislation currently in force in India. A reference can be made to the Organization for Economic Co-operation and Development, which categorizes a shell company or a shell corporation to be one that does not conduce any economic activity in the economy in which it is incorporated²³. Under Indian laws, the Companies Act, 2013 deals

²² PANDORA PAPERS: FROM SACHIN TENDULKAR TO ANIL AMBANI, HERE'S WHAT ED'S PROBE ON OWNERS OF OFFSHORE FIRMS REVEALS, <https://www.livemint.com/news/india/pandora-papers-from-sachin-tendulkar-to-anil-ambani-heres-what-eds-probe-on-owners-of-offshore-firms-reveals-11707105110532.html> (last visited 15.03.2024).

²³ GOVERNMENT OF INDIA MINISTRY OF CORPORATE AFFAIRS, https://www.mca.gov.in/Ministry/pdf/ru359_07022018.pdf (last visited 12.03.2024).

with the regulation of corporate entities. Section 455²⁴ provides for dormant companies, which are defined as those companies which have no significant accounting transactions. For the sake of this paper, it can be described as a corporation without active business transactions or assets.

It is essential to note that not all shell companies are of a mala fide nature. Some corporations create legitimate subsidiaries to conduct business transactions, such as those to acquire estates or take over other businesses. Sometimes, some companies would attempt to enter a new field of business but would want it to remain unlinked with their original brand²⁵. Such was the case with Adidas Originals, which was incorporated by Adidas to enter the apparel section. Some companies may also incorporate shell companies to move undetected in the stock market. Unfortunately, the ability of shell companies to cloak their ownership has paved the way for a plethora of financial frauds being committed under the guise of these companies.

In a paper by Prateek Goswami and Vartika Shrivastava, the activities of a shell company that rendered it illegal were analyzed. In the paper titled “An Analysis of the Stygian World of Shell Companies and the Way Ahead,” the authors gave detailed explanations of the various types of financial frauds, namely tax evasion, money laundering, and Ponzi schemes²⁶. The authors also explained the repercussions in India due to the Panama Paper leaks. This ambiguity allows for the owners and other stakeholders to park their assets which they desire to acquire under the radar of the taxing authority. In the case of the Panama Paper Leaks, a Panama based company provided shell companies for a sum starting as low as USD1000²⁷. While several Indian celebrities and public figures were named, a government inquiry concluded that 352 out of the reported 500 Indians named in the leak could not be tried due to insufficient evidence.

6. EXPLOITATION OF LEGAL LOOPHOLES TO COMMIT FINANCIAL CRIMES

6.1. Legal Provisions and Subsequent Loopholes

Under the present legal system, under section 248(1)(c) of the Companies Act²⁸, a company can be struck from the Registrar if, for a consecutive period of the previous two financial years, they have had no business transactions and has not applied to a dormant company. Shell companies, in general, are poorly regulated. Some places in the world have such porous laws that they become tax havens to facilitate financial criminal activities. Once a shell company is

²⁴ Companies Act, 2013, §455, No.18, Acts of Parliament, 2013 (India).

²⁵ Harshita Yadav, An Analysis of Recent Corporate Frauds in India and USA and Their Nexus with Corporate Governance, 5 INT'L J.L. MGMT. & HUMAN. 337 (2022).

²⁶ Prateek Goswami & Vartika Shrivastava, An Analysis of the Stygian World of Shell Companies and the Way Ahead, 21 SUPREMO AMICUS [277] (2020).

²⁷ Id.

²⁸ Companies Act, 2013, § 248(1)(c), No.18, Acts of Parliament, 2013 (India).

established, the origins and movements of funds need not be disclosed, which allows for the obscurity required to commit fraud and misappropriation of funds. Owning a shell company itself is not illegal, but the lack of transparency provided by these companies provides a viable platform for financial crimes, especially money laundering²⁹. Under the Prevention of Money Laundering Act, 2002, shell companies can be held liable under section 3³⁰.

The Companies (Restriction on Number of Layers) Rule, 2017, restricts the number of layers a company may have. The layering rule initially referred to under section 186 of the Companies Act, 2013, places a limiting cap on the maximum number of layering a company may have to ensure transparency³¹. There are a few exceptions present, such as exceptions to wholly-owned subsidiaries. In line with the intent of the legislation, these wholly-owned subsidiaries must be in the first layer, that is, directly controlled by the parent company. However, since the true purpose of the legislation is to prevent multiple layering, this exception is counter-productive. Another major exception to the layering rule, which functions as a gaping sieve for criminal activities, is the exception given to companies having subsidiaries in foreign states. In such cases, the number of layers will be decided by the laws of the foreign nation. However, the extent of liability in case this rule is broken is unclear. To understand this concept better, the authors have referred to the article “Restriction on Layering of Companies: Should We Go Back to the Drawing Board?” authored by Prerana Priyanshu and Jishan Dediwal. The article breaks down the complicated rules into comprehensive examples to allow for the readers to understand the intent of the legislature. The authors of this paper, with due credit, would deem it appropriate to cite an example from the aforementioned article to illustrate the workings of this rules. Company A in India has a holding in Company B. Both are incorporated in India. Company B has a subsidiary, Company C, in another State. In this State, the cap on the vertical layering is two. Company C has a subsidiary, Company D, which further has a subsidiary, Company E, in the same state. Therefore, both Company A and Company C have exhausted their permitted number of layers. Now, if Company C acquires Company F as another subsidiary, resultantly Company C has more than the permissible number of layers. In such circumstances, it is unclear what the liability is for the parent Company A in India.

Illegal activities carried out by such shell companies can be tried under various laws, such as under section 420 of the Indian Penal Code³², which criminalizes cheating. The Benami Transactions Act prevents shell companies from holding assets of their parent corporations.

²⁹ RESTRICTION ON LAYERING OF COMPANIES: SHOULD WE GO BACK TO THE DRAWING BOARD?,

<https://www.scconline.com/blog/post/2023/05/27/restriction-on-layering-of-companies-should-we-go-back-to-the-drawing-board/> (last visited 13.03.2024).

³⁰ Prevention of Money Laundering Act, 2002, § 3, No. 15, Acts of Parliament, 2002 (India).

³¹ Companies Act, 2013, § 186, No.18, Acts of Parliament, 2013 (India).

³² Indian Penal Code, 1860, § 420, No. 45, Acts of Parliament, 1860 (India.)

Such practices are generally done to evade tax liability on the part of the larger corporation. The Prevention of Money Laundering Act criminalizes the practice of “cleansing” black money. In 2017, the Government of India attempted to crack down on shell companies by forming a Task Force on Shell Companies. The Task Force was headed by the Revenue Secretary and the Secretary of the Ministry of Corporate Affairs. In a promising state of affairs, between the years of 2018-2021, the Task Force identified and struck from the records a total of 2,38,223 companies for being shell companies³³.

6.2. Need to Lift the Corporate Veil on Shell Companies

As stated earlier, shell companies thrive in crevices of law that mask their fraudulent activities under the guise of legality. The peculiarity of corporations is their unique identity, isolated from their owners. Corporates have separate legal identities, and in general, liability, such as contractual liability, is laid on the company, not its owners. In some cases, however, the company serves as a front for criminal activities. In such cases, it is pertinent to “lift the corporate veil” on such corporations and hold the persons behind the operation of the company and the commission of the crime liable for the same. At present, in the case of shell companies, it is pertinent to know who the “ultimate beneficiary” is, as shell companies can obscure ownership of themselves.

In 2017, SEBI released guidelines with parameters to detect mala fide shell companies, which enables law authorities to lift the corporate veil on these shell companies. The first indicator is the actual physical existence of the company. Some companies will only be on paper, with no actual registered office. According to a SEBI study, some shell companies are created to manipulate stock prices. In such cases, shell companies rarely have physical locations. The second parameter includes monitoring the preferential allotment of shares. Generally, shell companies that have been formed to evade tax have funds and other significant amounts of investments in their name. Under the guise of dormancy, these companies help the parent company to avoid tax. In some cases, these companies will be listed on the Stock Exchange. In such cases, legal authorities must be vigilant, especially if stock prices fluctuate for no apparent reason. The final tell of a shell company is the lack of real-world activities or transactions.³⁴

Other than these parameters, there are other indicators that could raise suspicion of a company being a front for illegal activities. An unnecessarily complex corporate structure could be an indication of the effort to hide ownership. Some companies purposely complicate their layering with intricate networks to ensure that actual ownership cannot be traced back to the parent

³³ GOVERNMENT IDENTIFIED 2,38,223 COMPANIES AS SHELL COMPANIES BETWEEN 2018-2021, <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1739583> (last visited 14.03.2024).

³⁴ LIFTING THE CORPORATE VEIL ON SHELL AND SHADOW COMPANIES – AN INDIAN OVERVIEW, CNLU LJ (7) [2017-18] 96.

company³⁵. An absence of a standard workforce is also a clear indication of a lack of business continuity. Some shell companies do not have or even attempt to have the required number of employees as needed by a company in their field. In some cases, there might be a small number of employees engaged in financial fraud. Some shell companies may make suspicious transactions, which must immediately be flagged and scrutinized. If some of these transactions involve offshore dealings with tax-haven countries like the Cayman Islands, the British Virgin Islands, and various other South American countries³⁶ it must be thoroughly investigated³⁷. It is, however, pertinent to note that these indicators might not necessarily prove that the company is a shell company. Each suspicious case must be researched and investigated thoroughly before arriving at a conclusion.

7. SUGGESTIONS AND CONCLUSION

Two significant loopholes in the legal system are pertaining to the obscurity in the layering of companies. The layering rule has two exceptions: wholly-owned subsidiaries and foreign-owned subsidiaries. As elaborated earlier, whole owned subsidiaries in the first layer are not accounted for while computing the number of layers. The aim of the Companies (Restriction on Number of Layers) Rule, 2017, is to ensure transparency in ownership. With this objective in mind, the exclusion of wholly-owned subsidiaries is in accordance with the legislative intent. It is to be noted that the Rules itself is not clear on how to calculate the layer to be exempted. A mere reading of the provision does not specify that the wholly-owned subsidiaries must form the first layer of the investment company's vertical ladder³⁸. Rule 2(1) of the Rules provides for this exception. However, such a conclusion can be reached by interpretation of the Rules. The proviso to the clause mentions "one layer" but does not specify the position of the layer. Since it is to be in accordance with the Rule it is intended to supplement, it can be concluded that only the first layer is to be included³⁹.

The second exception, however, is quite contradictory to the aim of the Rules. It allows for foreign companies being acquired by Indian companies to have more than two layers of

³⁵ SHELL COMPANY MONEY LAUNDERING: RED FLAGS & PREVENTIVE STRATEGIES, <https://signdesk.com/in/aml/shell-company-money-laundering#:~:text=Creating%20and%20implementing%20an%20AML,financial%20fraud%20through%20shell%20companies> (last visited 12.03.2023).

³⁶ Supra Note 4.

³⁷ Id.

³⁸ THE LAYERING RESTRICTIONS & WOS EXEMPTION – NEED FOR REGULATORY CLARITY, <https://corporate.cyrilamarchandblogs.com/2023/05/the-layering-restrictions-wos-exemption-need-for-regulatory-clarity/> (last visited 15.03.2024).

³⁹ LAYERING OF SUBSIDIARIES – AMBIGUITIES IN REGULATORY FRAMEWORK, <https://www.azbpartners.com/bank/layering-of-subsiaries-ambiguities-in-regulatory-framework/#:~:text=Exemptions%20to%20such%20restriction%20include,as%20per%20the%20laws%20of> (last visited 13.03.2024).

subsidiaries. Additionally, some companies, like those in the banking sector, are exempted from the two-layer rule. Therefore, if the foreign acquired subsidiary companies have further subsidiary companies that fall under such exemptions, it is unclear if they are to be included in the computation of the layers⁴⁰. It is suggested that it is required by the government establish the “ultimate beneficiary” of each offshore holding of Indian citizens. The status of those Indian citizens with such offshore companies must also be regularly monitored. The government has claimed the more than 250 Indian Citizens have been named in the Pandora Paper Leaks⁴¹.

A criticism of these rules is the overreach of the government in the corporate sector. A well-researched article published in THE LIVEMINT highlights the fallacies in the government Rules. The authors Sharad Abhyankar and Soumyadri Chattopadhyaya point out that there is an apparent discrepancy between the intent and the result. While the Government aims at solving fraudulent practices, its Rules unfortunately fall short of achieving the same. Critics of these rules contend that the structuring of companies depends on the entrepreneur and the field of business itself. A blanket restriction of two layers severely hampers what is otherwise a standard global practice. In all, creating a network of companies mitigates risk, ensures the flow of capital, and encourages market competition.

Additionally, there is no limit to the number of companies in each layer. Therefore, criminals may establish a complex network of shell companies within the same strata to facilitate fake or fraudulent transactions to legitimize black money. Shell companies incorporated in these layers may inflate costs, make fake receipts, etc., while working with other companies in their level to “cleanse” their money. Inasmuch, the Rules have only presented what has already been tackled by law, with no new tools to crack down on shell companies. It is submitted, therefore, that the government must focus on ensuring transparency in transactions rather than restricting business structures. Embarrassingly, the Government as of 2023 had no record of offshore shell company holdings of its citizens, while in the same vein, it claimed to have a Task Force that prosecutes illegal activities of shell companies⁴². The “hows” of conducting a business need not be of concern to the Government if the company complies with all the legal provisions. The Government’s combat is against the crimes of money laundering and tax evasion, and such rules will not negate the prevalence of the same⁴³.

⁴⁰ REGULATORY OVERREACH ON HOLDING STRUCTURES, <https://www.livemint.com/Opinion/BDEZ14YHCYy4MyK4ZLYrNO/Regulatory-overreach-on-holding-structures.html> (last visited 15.03.2024).

⁴¹ Union Govt 'Has No Data' on Indians' Offshore Shell Companies – But Task Force Running Since 2017, <https://thewire.in/government/union-govt-says-it-has-no-data-on-offshore-shell-companies-owned-by-indians> (last visited 17.03.2024).

⁴² Id.

⁴³ Supra Note 18.

Efforts to address financial crimes associates with shell companies require a multifaceted approach including lifting the corporate veil to hold individuals accountable, implementing stringent regulatory measures and leveraging technology to detect and prevent illicit financial activities. However, the effectiveness of regulatory reforms depends on overcoming legal and institutional barriers thereby ensuring coordination among the various stakeholders involved. In conclusion, the Pandora Papers served as a wake-up call for governments, regulatory authorities, and international organization to redouble their efforts in combatting financial crimes, enhancing transparency, and strengthening the integrity of the global financial system. Only through concerted action and cooperation these pervasive challenges can be addressed, thus safeguarding the integrity of financial markets, and promoting inclusive and sustainable economic growth.