

Decoding shell companies

The Centre has initiated action against more than two lakh shell companies as part of Operation Clean Money. Separately, the market regulator Securities and Exchange Board of India has identified 331 companies and initiated action against them. Here is all you need to know about shell companies.

What are shell companies?

The Companies Act, 2013 has not defined what a 'shell company' is and as to what kind of activities would lead to a company being termed a 'shell'.

Shell companies are typically corporate entities which do not have any active business operations or significant assets in their possession. The government views them with suspicion as some of them could be used for money laundering, tax evasion and other illegal activities.

Is there a law governing shell companies?

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 and can indirectly be used to target shell companies — Benami Transaction (Prohibition) Amendment Act 2016; The Prevention of Money Laundering Act 2002 and The Companies Act, 2013.

Is it easy to strike off a shell company from the records?

According to Anant Merathia, a Chennai-based corporate lawyer, companies can be removed from the rolls of the Ministry of Corporate Affairs by two means: strike off by Registrar of Companies (RoC) — (Section 248 (1) of the Companies Act, 2013) and voluntary strike off — (Section 248 (2) of the Companies Act, 2013). Voluntary closure can be done with the approval of the board and shareholders and the firm should have nil liabilities.

What scenarios can lead to a company's name being struck off by the RoC?

The strike off happens in case of companies which have failed to commence business within a year of incorporation.

Also, in case of companies that are not carrying on any business or operation for a period of two immediately preceding financial years and have not made any application within such period for obtaining the status of a 'dormant company' under Section 455 of the Companies Act can be struck off by the RoC unless cause is shown to the contrary.

The RoC issues a show-cause notice to such companies and their directors seeking their response within 30 days. If the response is not satisfactory, the company's name would be removed from the register.

What is a dormant company?

According to Mr. Merathia, as per Section 455 of the Companies Act, 2013, a company that does not have significant financial activity or has been inactive can apply to the RoC and obtain the status of a dormant company.

The company shall be a dormant company on the rolls of the RoC until it follows all the provisions

of Section 455. If it fails to do so, the RoC shall have powers to strike of their names from the Register of Companies.

What is the difference between dormant and shell companies?

A dormant company gets its title in two ways: it has chosen to get a 'dormant' status from the RoC by way of an application and is in compliance of the requirements of Section 455.

Further, in case a company has not filed financial statements or annual returns for two financial years consecutively, the RoC shall issue notice and include it in the register of 'dormant' companies. But a shell company is one which is typically suspected of illegal activities.

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