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MISUSE OF DORMANT COMPANIES IN INDIA: A CRITICAL LEGAL ANALYSIS OF REGULATORY GAPS AND JUDICIAL OVERSIGHT (2013–2025)

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ABSTRACT

The regulatory framework of dormant companies as stated in Section 455 of the Companies Act, [1007]2013 contains a structural weakness that encourages corporate malfeasance, even though it is intended to ensure that inactive businesses have the freedom to operate. The paper addresses systemic frailties inherent in the dormant system of the company regime, in the form of the statutory framework, enforcement mechanisms and judicial interpretation, by showing how the advanced players use the loopholes in the regulations to engage in illegal financial transactions. This work shows that the information asymmetry created by the self-declaration model underlying Section 455, although it lessens the compliance burden on legitimate dormant entities, is critically damaging, allowing shell companies to operate under the cloak of regulatory dormancy. Over 233,000 companies were struck off by the Ministry of Corporate Affairs between 2019 and 2025, but such reactive enforcement steps cannot curb the already existing networks of layered corporate forms that help to launder money, evade taxation and conceal beneficial ownership. The dichotomy of active and dormant firms is not a sufficient way of describing the range of corporate inactivity, as it is possible that corporations can be dormant entities that act as passive intermediaries in sophisticated financial plans. Cases in courts, especially those of the Supreme Court in McDowell and Co. Ltd. v. Commercial Tax Officer and Vodafone International Holdings v. The Union of India, create a set of conflicting doctrinal premises authorizing substance- over form analysis at the same time as evidentiary standards are high in veiling the corporate veil. This conflict of doctrine, together with the formalism of procedure taken by the National Company Law Tribunal and National Company Law Appellate Tribunal, contributes to the inefficiency of regulation in identifying and preventing the difference between an active and a dormant company abuse.

The study suggests comprehensive changes such as the obligatory non-government audit of dormant status applications, graduated dormant status, centralized corporate intelligence systems where inter-agency data could be integrated in real-time, and more deterrence with commensurate punishment. The recommendations are also to change the reactive and procedure-oriented dormant regime of companies in India to a proactive, intelligence-based regime that keeps the business legitimate flexibility and provides regulatory accountability and market integrity.

Keywords

Dormant Companies, Section 455 (Companies Act, 2013), Shell Layering, Beneficial Ownership, Regulatory Framework, Corporate Governance

[1007] Companies Act, No. 18 of 2013, § 455 (India).

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Research Methodology

The research adopts a **doctrinal** and policy-oriented methodology grounded in primary and secondary legal sources. It systematically analyses Section 455 of the Companies Act, 2013, relevant Rules, MCA notifications, strike-off data (2019–2025), and the statutory scheme on beneficial ownership disclosure. Parliamentary debates, the Statement of Objects and Reasons of the Companies Bill, 2011, and subsequent MCA rule-making are examined to trace the legislative intent behind the dormant company framework and its evolution.

Judicial precedents of the Supreme Court (including McDowell and Co. Ltd. v. Commercial Tax Officer and Vodafone International Holdings v. Union of India) and key NCLT/NCLAT decisions (such as Sanmati Agrizone Pvt. Ltd. v. RoC and Active Telematics cases) are critically analysed to understand how doctrines like substance over form and corporate-veil lifting are applied in practice to dormant and shell structures. The study also uses descriptive and inferential analysis of MCA enforcement actions, especially large-scale strike-off campaigns and director disqualification data, to evaluate the gap between formal powers and actual enforcement outcomes.

A comparative method is employed by examining the UK's Persons of Significant Control (PSC) regime and Singapore's ACRA–IRAS model to identify best-practice standards on beneficial ownership transparency, activity-neutral disclosure, and inter-agency intelligence sharing. Insights from academic commentary, empirical studies on shell companies, and policy papers are integrated to expose structural weaknesses in India's self-declaration model and to inform the reform proposals advanced in the paper.

1. Introduction

Section 455 of the Companies Act, 2013[1008] has brought about the concept of dormant status as a facilitative tool which was made to sustain the legal life of a company in the event if it is inactive, holding of assets, or in incubation and with the compliance requirement being minimal as the risk to its operations is low. Practically, but not officially, the absence of substantial barriers to entry, the self-declaration aspect and the lack of a strong ex ante verification has created gaps in the regulations. These loopholes can be used to abuse dormant companies by engaging in shell layering, related-party concealment and evading creditor, tax, and securities regulation.[1009] The consequence is a structural incompatibility between the procedural form of inactivity and the substantive reality of the ongoing commercial maltreatment, which destroys investor confidence, market integrity and overstrains the already scarce resources of regulating authorities and the courts to respond effectively and in a time-sensitive manner. Although these efforts are made in regard to mass strike-offs and random increase of compliance, the framework has been reactive and enforcement has focused on eliminating compliance after the fact instead of proactively supervising in a risk-based manner.

Despite the amendments and e-governance practices, which have enhanced digitisation and filing, there is still no systematic cross-verification with tax, anti-money laundering and securities information, which affects the early detection of misconduct. Although judicial interventions have increased minimum compliance expectations but have not helped in forming a doctrinal distinction between actual inactivity and sham dormancy and rather have resorted to making enforcement overly technical without necessarily dealing with the underlying economic realities.

[1008] Companies Act, No. 18 of 2013, § 455 (India).

[1009] KNN India, MCA Strikes Off 2.33 Lakh Dormant Firms in Massive Corporate Clean-Up, *KNN India* (Sept. 21, 2025), https://knnindia.co.in/news/newsdetails/sectors/others/mca-strikes-off-233-lakh-dormant-firms-in-massive-corporate-clean-up

The latent company regime is also structurally weak due to its reliance on procedural claims and institutional bias in favour of the periodical clean-up drives as opposed to continuous monitoring. This is a weakness that is especially troublesome when inactive provisions that were initially drawn to legitimate commercial purposes are used by firms as a juridical cover against investigation.[1010] This framework is especially abused by shell companies that rely on the self-declaration model which relies on representations that cannot be properly verified. Moreover, the narrow definition of significant accounting transactions in the law enables companies to do little authorised activities and represent themselves as dormant to mask business. This, together with less rigorous compliance requirements compared to the active companies, creates less regulatory coverage and the possibility of abuse.

The interventions in the courts have tended to be technical, more so than investigating the facts of the matter, which further restricts the efficiency of the law in uncovering fraud. Even though the Registrar of Companies has the authority to strike off dormant companies when they have failed to act or comply within a long period, these measures are normally reactive clean-up exercises as opposed to being part of a regular surveillance system. This allows the inactive businesses to serve as effective legal shields in their role of perpetuating financial offenses, tax evasion, money laundering, and fraud.

This study seeks to dismantle the provisions of dormancy in company Act of 2013 as stipulated in Section 455 of the Companies Act, 2013, exploring its statutory intent, application, interpretation and enforcement in India. This will include an analysis of the legislative context, the debate in parliament, the Statement of Objects and Reasons of the 2011 Bill, and further rule-making by the Ministry of Corporate Affairs so as to see how the legislators aimed to create a balance between corporate flexibility and regulatory protection. Judicial tendencies are also a necessary element since rulings of the Supreme Court, National Company Law Tribunal, and Appellate Tribunal are concerned with limits of lawful inactivity and give an idea about the conflict between formal adherence and actual corporate fact. The successes and the drawbacks of regulatory responses can be identified through enforcement practices, especially strike-off campaigns, inspections, and digitised verification between 2019 and 2025. There is official information on strike-offs, government policy statements and internal memoranda which give a glimpse of the obstacles to director accountability and the veil of secrecy around the beneficial ownership.

Locating this analysis within the global framework, the study compares it with the United Kingdom and Singapore. The Persons of Significant Control framework in the UK and the one in Singapore both focus on transparency based on public ownership registries and dual-agency oversight and audit triggers, respectively (to force established companies to scrutinize dormant companies). These comparative methods give examples of best practices that might be used in future reform in India. The reform suggestions in the study include: India should have threshold free beneficial ownership disclosure, time limit dormancy with mandatory disclosure audit, permanent portal of data sharing between corporate, tax, and financial crime regulators, and an active role of tribunal in examining dormancy claims. The study brings together statutory interpretation and judicial analysis, enforcement history, and international benchmarking so as to create a comprehensive argument as to why India should change its dormant company system, which is more of a reactive, procedural way of doing business, to a more proactive, intelligence-oriented system that maintains business flexibility and ensures transparency and regulatory accountability.

[1010] Vyshnavi Epari, *Shell Companies and Corporate Frauds: Legal Loopholes and Regulatory Response in India*, *IOSR Journal of Business and Management*, July 2025, Vol. 27, Issue 7, Ser. 2, pp. 42–49, https://www.iosrjournals.org/iosr-jbm/papers/Vol27-issue7/Ser-2/E2707024249.pdf

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2. Legal Framework and Regulatory Development

2.1 Section 455: Design and Intent

Section 455 of the Companies Act, 2013, forms the legislative framework on which the regulation of dormant companies in India is to be made, which is an unregulated area of corporate law in which companies operate without an established system of governance and regulation. Under this provision, two main routes to obtaining dormant status are available to companies: firstly, a company that is organised with the purpose to realize some commercial projects or owning only some assets that were not involved in any business activity or any transaction that can be considered as significant during two successive financial years. The integration of the suo-moto powers of the Registrar of Companies (ROC) to designate firms as dormant is an indication of statutory identification of the role of regulation over the dormant corporate bodies and underscores a desire to have tighter control and to particularise the role of governance even when the business activity is absent.

The procedure whereby an organisation will formally or officially achieve dormant status under the statute requires a specific level of procedural rigour. The special resolutions should be approved by the board and the shareholders, allowing the designation of the Form MSC-1 to be submitted to the ROC, with the corresponding declarations justifying the inactivity of the company and its right to do so.[1011] Later, inactive businesses are subject to low compliance standards, especially by conducting board meetings at least twice a year and submitting annual statements using Form MSC-3. This organisation is trying to find a compromise between regulatory transparency and operational versatility, so that companies can still enjoy the legal personhood, without having to bear the liabilities normally linked to active commercial entities.

It is also worth noting that the definition of significant accounting transactions in the act restricts it to exclude normal payments like registration fees, costs of compliance with statutes, share allotments in compliance and small office maintenance expenses. Although such exclusion comes in handy in preserving the dormant status of acknowledging unavoidable minimum activities, it also introduces a regulatory gap to be exploited. Advanced players can use this latitude to make active operations appear inert, hiding illegal business operations under the cover of legal compliance with technical requirements.[1012]

This regulatory scheme is a subject of academic commentary due to its inherent weaknesses based on the self-declaration model and non-compulsory due diligence. According to scholars, these aspects spread information asymmetries as they preempt company claims against objective verification, which thus facilitates regulatory arbitrage. The lack of a mandatory requirement of exhaustive background checks or independent audits at the beginning or continuation of dormant status enables companies to avoid inspection, which can be used to commit financial misconduct, including layering, diversion of funds, and ownership trail obfuscation.

The regulatory blind areas have been reported in a number of empirical and doctrinal studies, which focus on the fact that the existing procedural protections in Section 455 are inadequate to inhibit the abuse of dormancy status. The lack of an obligatory inter-agency check between the Ministry of Corporate Affairs, the Income Tax Department, and financial intelligence fails only worsens the situation as the dormant enterprises are not recalculated by a complex system of control measures over the long term. This legislative laxity and a lack of

[1011] CS Divesh Goyal, *Annual Compliance of Dormant Company*, *CS Divesh Goyal* (Apr. 23, 2024), https://www.csdiveshgoyal.com/Blog/172/AnnualComplianceofDormantCompany.aspx.

[1012] Shivani & Dr. Anupa Singh, *An Analytical Study on Corporate Governance Practices in India*, *MGMT. J.* Vol. 6, Issue 2, 2024, at 24, https://www.managementjournals.net/assets/archives/2024/vol6issue2/6033.pd

capacity to enforce the law contributes to the continued existence of shell companies and veils to financial transparency that degrade the integrity of markets and investor confidence.

To summarize, although Section 455 has provided a requisite legal framework that facilitates corporate dormancy in India, its structure is that of a regulatory tradeoff where it entails the administrative ease and business-flexibility, as opposed to high-level control. Recalibration is needed to turn the company regulation that has been ineffective in terms of preventing misuse because of its existence in the form of a mainly procedural schema. This must involve the establishment of mandatory due diligence procedures, enhanced cross-agency integration of data and the statutory definition of dormancy to seal the holes that have facilitated the concealment of active business operations under the guise of dormancy.

2.2 Regulatory Amendments and Current Development

The Ministry of Corporate Affairs (MCA) introduced some radical changes between 2023 and 2025 to enhance the supervision of dormant companies. Compulsory filing of the financial statements and resolutions of the board by means of digital platforms has improved the process of submissions, automated the process of verification at the Registrar of Companies (ROC) and improved the process of anomaly detection.[1013] The Companies (Management and Administration) Second Amendment Rules, 2023, placed more severe beneficial-ownership disclosure standards, as each dormant company will have to name an officer to report ultimate beneficial owners in statutory disclosures. Furthermore, the ROC has acquired the instance of suo moto power to label non-compliant entities as dormant, backed by digital checks that compare real-time registry, transaction, and ownership data.[1014]

Although these amendments help make data more accurate and more accessible, practitioners warn that they do not completely resolve the complicated ownership chains or lack of resources to enforce them. Unless there is interoperative inter-agency coordination, effective forensic-audit, and harsher penalties, improved disclosures may remain merely a show of form instead of triggers of substantive change. However, such regulatory improvements represent a critical transition to at least something beyond self-proclamation to a more open, more responsible system, which sets the stage to take the wheel and prevent the spread of shell companies.

2.3 Evidence of Enforcement MCA Strike Offs

Between 2019 and mid-2025, the mass strike-off operations of the MCA abolished more than 233,000 companies -8.3% of the registry of India- most of which were registered under Section 248 due to their inability to start business or to make returns. The highest level of FY 2022-23 (82,125 strike-offs) emphasised the regulatory importance after the pandemic.[1015] Under Rule 25B, targets fictitious-address companies, verified physically, but strike-off is an ad hoc process: before the avenue is closed down, entities often finalise illicit schemes. Voluntary strike-offs in Section 248(2) included 37,212 exits between May 2023 and June 2025, which means that the regime also supports orderly wind-downs.

Strike-offs, despite their impressive figures, deal only with technical defaults. There are very few disqualified directors and criminal actions against the underlying fraud, money laundering, or tax evasion are not common. More than 2 lakh directors had been associated with struck-off companies, but a small part faced the Section 164 disqualification. The absence of

[1013] Nishith Desai Associates, *Government Strengthens Beneficial Interest Disclosure Regime*, *Companies Act Series* (Nov. 13, 2023), https://www.nishithdesai.com/fileadmin/user_upload/Html/Hotline/Companies_Act_Series_Nov1323-M.htm.

[1014] Companies (Significant Beneficial Owners) Amendment Rules, (India).

[1015] MCA Strikes Off 40,949 Companies Under Companies Act, 2013, SAG INFOTECH BLOG (July 22, 2025), https://blog.saginfotech.com/mca-strikes-off-40949-companies-companies-act-2013-three-years

network-level probes and cross-entity asset tracing also maintains a whack-a-mole cycle since operators add new shells after being hit. Inter-agency co-operation, such as SEBI inspection of 331 shell companies, RBI-led account freezes, and a few cases of the Enforcement Directorate, has been an isolated activity. By 2025, 2.8 million registered companies will have been active by only 64.8 percent, with more than 35 percent living in regulatory limbo, which demonstrates ongoing oversight issues.[1016]

2.4 Disclosure of Beneficial Ownership: Ahead and behind

The beneficial-ownership regime in India has a 2018 SBO Rules-enabled system of disclosure of beneficial interest of 10% and above, which is lower than the international 25-percent limit.[1017] The divergent but supplementary declaration in sections 89 and 90 is between MGT-4 and MGT-5, which reflects a registered and a beneficial ownership, and SBO Rules which have a significant control, but by an indirect method. The 2023 amendment has turned beneficial-ownership reporting into an active compliance process by imposing on firms officers to engage in beneficial-ownership reporting and cooperate with regulators with parallel thresholds of 10% (companies/trusts) and 15% (partnerships), which creates regulatory fragmentation.[1018]

There are still difficulties in identifying Ultimate Beneficial Owners (UBOs) of the Ultimate Beneficial Owners to SBOs of the company law, particularly those that are foreign-investment entity structures which are bound by conflicting SEBI, RBI, and MCA requirements. The different exemptions to certain categories of investors also further weaken transparency. Most importantly, inactive businesses receive a lighter overview of controls, minimal paperwork, board meetings twice a year, and annual attestations, which generates disclosure asymmetry that allows highly complex layering by using numerous dormant entities. The dormant vehicles will be still dark pools of hiding under the absence of analytical tools to perform automated chain-analysis or standard oversight across jurisdictions.

Examples of successful international models include the PSC register of the UK and the dual ACRA-IRAS of Singapore, which show the advantages of activity-neutral disclosure, and complementary mechanisms, in one form or another. The regime in India should start changing the form-based filings to substance-based disclosures and consolidate a real time data disclosure, automated risk rating and concerted policing measures to seal the structure gaps and increase investor trust in the corporate environment.

3. Reframing Judicial Authority: Courts and Case Law in Contemporary Governance

3.1. Precedents of the Supreme court and Doctrine

Indian judicial review of inactive firms is based on the Supreme Court case laws that authorize the court to lift the corporate veil in instances where legal entities are utilized to commit fraud or avoid liabilities. Another landmark case that caused a drastic change was of McDowell and Co. Ltd. v. Commercial Tax Officer (1985) where the Court ruled that tax evasion by artificial means which are legal is not allowed. This ruling brought about the doctrine of the substance over form whereby courts would not solely consider only the technical complies of the arrangement but also examine the economic truth of the corporate arrangement.[1019] The decision discarded the old Westminster rule that allowed people to structure their affairs in such a way as to reduce taxes and permitted judicial intervention to frustrate colorable

[1016] MCA Releases LLP and Company Strike-Off List for August 2025, GLOBAL JURIX (Sept. 1, 2024), http://www.globaljurix.com/law-news/MCA-releases-LLP-and-company-strike-off-list-for-august-2025.php
[1017] Companies (Significant Beneficial Owners) Rules, r. 3(1) (India).
[1018] Bomi F. Daruwala & Krishna Kishore, Unveiling the Complex Web of Corporate Ownership: A Detailed Examination of Significant Beneficial Ownership and Contemporary Trends, INDIAN BUS. L. REV., Vol. 2, Issue 1, at 1.
[1019] Existence and Relevance of the McDowell Rule, MANUPATRA, http://docs.manupatra.in/newsline/articles/Upload/2D6AB81F-1568-496A-B9C4-D182E4CA9A11.pdf

devices and fraudulent techniques in order to evade regulatory purposes.

Nevertheless, the next ruling of the Supreme Court in Vodafone international holdings v. Union of India a subtle balancing was presented. Although the Court acknowledged the validity of tax planning and defense of bona fide commercial arrangement, the Court established a high evidentiary standard when setting aside corporate structures. The corpus that corporate set-ups should be given respect unless these structures are provable to be sham implies that the officials issuing the regulations should give concrete proof of a fraudulent intention, rather than a questionable design[1020]. Although the method is protective of the true business conduct, it has unwillingly done so by providing safe haven to advanced abuse, particularly in dormant business where inaction may conceal elaborate concealment mechanisms.

The conflict between the two precedents, the one being the substance-over-form doctrine of McDowell and the other being the respect of the corporate form of Vodafone, has defined the judicial environment. Courts have the authority to interfere in cases of proved fraud, although the burden of proving that there was a sham arrangement usually puts a strain on the effectiveness of regulation. This is especially difficult in the cases of dormant companies, where no active business activity is present and the corporate arrangements are created with a premeditated plan which prevents proving intent or finding any documentary facts that prove abuse. Cases that have been decided more recently still show such a doctrinal twist. This has been the case of the tribunals like National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) which have predominantly followed a procedural approach whereby it is necessary to comply with the statutory requirements but not substantively investigate the economic reality of dormant entities. An example is when it was ruled in Sanmati Agrizone Pvt. Ltd. v. RoC (NCLAT, 2023) that the Registrar of Companies acted validly in liquidating a company due to years of no revenue, without investigating its activity.[1021] Equally, in Registrar of Companies v. Tribunal, Active Telematics Pvt. Ltd. (NCLT, 2020), the judge insisted on compliance filing rather than on the in-depth investigation of whether the dormant character was merely a cover of the active state of affairs.

This is a judicial formalism, which is efficient in administration but which has important implications. The elevated standard of evidence and attention to technical compliance opens the possibilities of elaborate actors to take advantage of regulatory loopholes, to hide their money or evade the regulations through dormant firms as an instrument of financial transparency or regulatory avoidance. The initiation of a tribunal inquiry is usually done suo moto and orders are generally aimed at restoration or strike-off as opposed to inquiries about any beneficial ownership or as a way to instruct thorough audits. This leads to the fact that systemic misuse practices are not addressed, and deterrent jurisprudence is still at an early stage.

To conclude, the doctrinal basis of the Supreme Court gives the power and the restrictions of judicial control of dormant enterprises. Although the corporate veil may be lifted by courts where fraud is established, the natural difficulty of presenting evidence and the procedural nature of tribunals imply that dormant abuse of companies may continue to thrive though official legal observance. In dealing with these challenges there must be strong legal principles and also reform in enforcement and adjudication so that substance gains on form in the administration of dormant entities.

[1020] Vodafone International Holdings B.V. v. Union of India, (2012) 6 SCC 613 (India).

[1021] Comp. App. (AT) No. 27 of 2022. Sanmati Agrizone Pvt. Ltd. v. RoC

3.2 Tribunal Methods of Dormant Company Supervision and Enforcement Patterns

Dormant-company ruling supervision Since the Companies Act, 2013, the NCLT and its appellate tribunal, the National Company Law Tribunal (NCLT), and its restorational counterpart, the National Company Law Tribunal (NCLAT) have decided on strike-off and restoration cases (Section 248 and Section 252 of the Companies Act, 2013 respectively). Nevertheless, these two tribunals have mostly been committed to a procedural, more form-focused approach, which is formalism in the judiciary, which compromises their ability to identify and discourage more advanced abuse.

In Sanmati Agrizone Pvt. Ltd. v. RoC (NCLAT, 2023), the tribunal upheld strike-off only due to audited statements that indicated zero revenues in two consecutive years, but it did not investigate the possibility of dormancy masked shell operations.[1022]This bias during the procedure produces three negative outcomes. To start with, it encourages surface-level compliance nominal filings cover up illicit activity. Secondly, the use of documentary evidence does not take into account fraud schemes without traces. And, third, it cripples the growth of a jurisprudence responsive to content rather than form.

Even though tribunals have a power of suo moto inquiry under Section 206, they rarely exercise it in dormant-company cases awaiting references to RoCs or private petitions. Even where there are red flags of rapid strike-offs or opaque ownership tribunals insist on express evidence of a fraudulent motive and circumstantial evidence is not enough. The resultant burden of evidence frustrates regulators and liquidators. Orders have a narrow scope of concerns, either concerning strike-off or restoration, and order beneficial-ownership investigations or forensic audits are not mandatory.[1023] Such a reactive paradigm does not break down underlying networks of shell entities, operators merely add new dormant, continuing to abuse them. In order to change the situation with tribunal oversight, a paradigm shift in terms of substance-based adjudication should be made. NCLT and NCLAT ought to use available powers to subpoena records, trace assets and demand disclosure of ownership in strike-off and restoration proceedings. Tribunals may use presumptive economic-activity inquiries (induced by zero-revenue features or by veil of incorporation) and to discourage re-registration of shells may include third-party audits or asset escrow.

Developing expert skills in financial forensics and corporate intelligence in the judicial system is also critical. This would even increase the rigour of the investigations by training tribunal members to identify indicators of shell-company and providing them with analytical tools. Specialized benches of dormant-company cases would help to streamline the decisions and develop institutional knowledge of the habits of complex abuse. NCLT and NCLAT can become more than mere procedural registration agencies, and successfully combat the misuse of dormant companies by making their practices in line with the substance-over-form doctrine of McDowell and Co. and admitting strong circumstantial evidence.

Critical Analysis Systemic Vulnerabilities and Reform Imperatives

4.1 Weaknesses in the Existing Framework Structure

The dormant regime of company, which is instilled in Section 455 of the Companies Act, 2013, is based on a self-declaration model that places a burden on companies to prove that they are non-operational. Although this practice lowers compliance costs incurred by bona fide dormant entities, it also introduces underlying information asymmetries which is manipulated by more sophisticated participants to continue shell activity or cover illicit financial

[1022] Comp. App. (AT) No. 27 of 2022. Sanmati Agrizone Pvt. Ltd. v. RoC
[1023] Anaya Nandish Shah & Pulkit Rajmohan Agarwal, *Fairness and RoC's Compliance: Natural Justice under Section 248*, *CBCL NLIU* (Aug. 10, 2023), https://cbcl.nliu.ac.in/company-law/fairness-and-rocs-compliance-natural-justice-under-section-248/

transactions.[1024] During the application phase, the companies that want to obtain dormant status should receive board and shareholder resolutions and submit Form MSC-1, with no third-party confirmation of the inactivity required. As a result of this, entities which have continued undercover operations are able to obtain dormant status without any substantive review. This loophole discredits the statutory purpose of having real strategic dormancy whereby fraudulent dormancy claims pass without being challenged.

These weaknesses are further aggravated by the binary nature of the concept of dormancy that the regime applies to companies, dividing them into two groups: active and dormant. The present-day corporate frameworks tend to be multi-tiered with some of the entities representing passive links in the intricate networks of transactions. An example is that, a group can have multiple technically inactive holding companies to store intellectual property or even undetectable cross-border fund flows, and sister entities will conduct commercial operations. These subtle differences are not reflected in the current framework, which does not include such subtle categories as transactional dormancy or economic dormancy. The law deems inactive status homogenous and therefore disregards the fact that there are dormant entities which have active roles as intermediary layers that thwart proper oversight and allow abuse.[1025]

Furthermore, implementation framework in India is still divided into various agencies. The corporate registry is carried out by the Ministry of Corporate Affairs (MCA), tax authorities by monitoring financial compliance and enforcement agencies through the Enforcement Directorate and Financial Intelligence Unit to examine illicit finance. Practically, these bodies work in silos and there is little real-time sharing and integration of risk data or coordinated risk evaluations. An inactive business in a cross-border layering scheme would only be detected when corporate registry information, tax returns and suspicious transactions reports are not analyzed together. This fragmentation of jurisdiction can enable advanced actors to take advantage of the intervening mandates, incorporating shell entities in one jurisdiction, sending money through another, and avoiding regulators by moving between jurisdictions.

4.2 Schemes of Beneficial Ownership Opacity and Layering

Even with the major improvements to the beneficial ownership disclosure regime in India, there is still lack of structural disclosures, especially in the case of dormant companies. The Significant Beneficial Ownership Rules set 10% level, above which people, owning either directly or indirectly 10 percent or higher of the shares, voting rights, or dividend rights, must disclose this information. Though less than the 25% standard that is used internationally, it also allows advanced types of actors to achieve engineering ownership right under the disclosure level, which allows the de facto control without the creation of reporting requirements.[1026] These fringe holdings in many instances become focussed through family trusts, nominee facilities or circular shareholding between group entities effectively avoiding the 10 percent trigger yet retaining decisive power.

Regardless of the fact that beneficial owners are registered by the dormant, the regime does not have the instruments to follow the ownership by various layers of dormant entities. The common layering approach may incorporate a chain of five or six inactive businesses incorporated in various states in

[1024] Shalini Jain, Naman Desai, Viswanath Pingali & Arindam Tripathy, Choosing Beyond Compliance Over Dormancy: Corporate Response to India's Mandatory CSR Expenditure Law, *Management and Organization Review*, June 11, 2023, at 594, https://www.cambridge.org/core/journals/management-and-organization-review/article/choosing-beyond-compliance-over-dormancy-corporate-response-to-indias-mandatory-csr-expenditure-law/022D9ECF9A1291D141156E2B6C9EDF1A

[1025] Sanjay Sanghvi & Sahil Sheth, Lifting the Corporate Veil on Tax Planning, *Int'l Tax Rev.* (Mar. 15, 2023), https://www.internationaltaxreview.com/article/2bembb6nu4njz9ljg5wjk/lifting-the-corporate-veil-on-tax-planning

[1026] Financial Intelligence Unit – India, *Home | Financial Intelligence Unit | Ministry of Finance | GoI*, *FIU-INDIA* (Jan. 19, 2025), https://fiuindia.gov.in

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India or even offshore. Independent SBO disclosures are made by each of the layers, each of which is not above 10 percent in cases of direct ownership, although the top-level individual retains the effective control. This haphazard disclosure presents a maze, which regulatory authorities, who do not have automated analysis of ownership chains, fail to navigate. Therefore, ultimate beneficial owners are still hidden and screening process becomes a paper form exercise, which lacks substantive checks.

The layering schemes also take advantage of exemptions that the particular type of foreign investors have. Government owned or government-related, the public sector pension funds, and specified multilateral institutions are relieved of SBO disclosures under the Companies (Management and Administration) Second Amendment Rules, 2023. Although these carve-outs are meant to facilitate compliance by bona fide investors, they unintentionally offer some avenue of hiding complex fund structures. Investments can be made through umbrella entities that qualify as exemptions and would put the underlying natural persons beyond the jurisdiction of law since the money trail would be that of the umbrella entity which is domiciled in a jurisdiction considered to be that of the friendly jurisdiction.

There is no intense re-verification of SBO status of dormant companies, which are not fully scrutinized after being accorded status. As opposed to active companies, which are expected to disclose it every time the company has a change in the shareholding, dormants have minimal compliance: biannual board meetings, annual status confirmations, and updated addresses. This type of regulatory asymmetry allows dynamic layering: inactive entities can interpose among active firms and ultimate investors, and update formal share registers very infrequently, as substantive control transfers unnoticed. This has the net effect of creating endemic opaque ownership, which undercuts the core transparency goals of the disclosure regime.

4.3 Enforcement constraints and Deterrence failures

India response in terms of enforcement in relation to dormant misuse by companies although numerically significant in terms of strike-off actions continues to be mostly retrospective and poor in terms of deterrence. More than 233,000 satisfied companies were eliminated off the corporate registry between 2019 and 2024. These mass strike-off exercises were mostly, however, directed against entities which had fulfilled their shell functions, having possession of unexplainable assets, or having served some illegal purpose, and were now unnecessary to their authors.[1027] It is regulatory action, therefore, that in many cases comes after the circuits of misuse of companies have been followed, and before the main beneficiaries have gained their profits. Reactive character of enforcement implies that when a company is struck off, the purpose of it to engage in illegitimate purposes is used up, and the deletion does not bring much besides temporary cleansing of the registry.

The Companies Act has civil penalties in the case of false life converts exclusion or omission of returns, which are relatively small, with a scale ranging between INR 10,000 and INR 50,000 per default. These sums are nothing compared to possible criminal gains due to money-laundering or tax evasion plans which inactive entities can accommodate. This means that the projected penalty cost is a small percentage of illegal profits and this does not provide much economic deterrence.[1028] The misuse of the dormant company is criminally prosecutable, but not very common, under Sections 447 and 448 of the Act. To establish intentional fraud, a large amount of evidentiary development must be demonstrated by the courts. There are also resource limitations in the enforcement agencies that make it more difficult to pursue complex cases of financial

[1027] Resolutions and Agreements to be Filed, *CA2013.COM* (Sept. 3, 2025), https://ca2013.com/resolutions-and-agreements-to-be-filed/
[1028] Violating Sections 92 and 137 of the Companies Act, 2013, *Ebizfiling* (June 21, 2023), https://ebizfiling.com/blog/penalties-for-violating-sections-92-and-137-of-the-companies-act-2013/

crime and most of the violations are not prosecuted.

The enforcement is also directed to individual firms and not networks of related firms. Advanced actors just reinvent old dormant companies under new names or jurisdictions after being struck off, and a whack-a-mole game. The creation of new strike-offs will restart the regulatory clock, where new bodies will have the same benefits of self-declaration and limited regulation. This small-scale approach to single-entity strike-offs does not deal with the systemic abuse trends that cut across several related companies. The lack of network-level investigation and tracing of assets through corporate webs ensures enforcement is only taken to surface registry measures.

Furthermore, law enforcement agencies rarely work in real time. Tax authorities can see any suspicious dormant organizations by mismatching the tax returns, but do not have direct access to the corporate registry analytics of MCA. Anti-money laundering statutes Enforcers are investigating suspects may find shell conduits, but find it hard to organize registry efforts on strike off or restoration. This leads to isolated corporate intelligence operations, redundant work, and lost chances to break up layered abuse networks due to the lack of a centralized corporate intelligence platform.

Reform Imperatives

The response to these systemic weaknesses requires a multi-parameter approach that goes beyond the incremental rules changes and entails substantive checking and harmonized implementation in each phase. To start with, the dormant status application process needs to include the mandatory independent review, i.e. certified statements made by practicing chartered accountants or authorized company service providers. Such professionals must certify that there are no significant transactions and they must provide bank statements and ledgers to prove such a situation, an external control against fraudulent dormancy claims is also introduced.

Second, binary dormancy framework should develop to be a graduated scale that acknowledges levels of inactivity. The criteria of economic dormancy might make companies with small volumes of transactions to go through regular risk reviews, which involve the automated identification of suspicious fund flows or beneficiary ownership changes. Companies with flagged patterns would have better compliance, e.g. quarterly reporting, and focus of audits until their risk profile normalizes.

Thirdly, it must have a centralized corporate intelligence platform. Regulators are able to create real-time risk profiles of entities by combining MCA registry data with tax filings and financial intelligence reports and bank transaction warnings. More sophisticated analytics and machine learning would be able to identify layering patterns, threshold manipulations, and a high strike-off cycle and make proactive inquiries pursuant to Section 206. Task forces across agencies relying on this common platform would facilitate the investigations, which means that suspected networks, instead of individual companies, incur optimal examination.

Fourth, the beneficial ownership regime should increase thresholds and checking. Reducing the SBO to 5 percent in relation to dormant businesses and making individuals verify their digital identity with Aadhaar or linking it with a passport would reduce marginal holdings abuse. Chain analysis, i.e., the connection of disclosures within entity networks, must be automated, and the lack of this should be used to initiate automatic investigations. The exemptions of foreign investors should be reviewed, with only Multilateral institutions having open public ownership gaining relief, and have the umbrella funds of the private sector be fully subject to the SBO reporting.

Lastly, the enforcement needs to refocus its deterrent architecture. The fines must be proportional to the size of the illicit transactions

and disgorgement of profits and considerable punitive fines should be imposed depending on the economic outcome. The criminal prosecution process needs to be simplified with special financial crime courts, with less emphasis on evidentiary duty to include strong circumstantial evidence when ascertained to be seriously risking fraud. Conditions to be incorporated into restoration orders ought to include the need to conduct forensic audits, escrows and lock-in of beneficial ownership so as to discourage mere re-incorporation of stripped-off shells.

The political commitment and resource allocation are needed in order to implement these reforms. The regulatory bodies require increased legal staff, forensic auditors, and data scientists. The judicial capacity building such as training of the members of NCLT and NCLAT to detect financial crimes will be essential in the application of substance-based principles of adjudication. Taken together, these steps can help to change the stagnant company regime in India to a powerful tool of corporate governance that would ensure economic integrity and investor confidence.

5. Reform Proposals and Policy Proposals

5.1 The improved legal framework

The Section 455 of the Indian company laws that are dormant in nature need significant amendments in order to avoid misuse of the same in a sophisticated manner. Any inactive businesses ought to reveal beneficial ownership, irrespective of shareholding limits, and a public register of beneficial ownership like that of the UK. Dormant status must have an expiry period of 3 years after which it may be renewed with audited financial statements and ownership proven. The definition of dormancy ought to be broadened to encompass "economic dormancy" to include entities that though technically within compliance, are vehicles of a complex transaction. Misuse should be more penalized and this should be in terms of disqualifying directors and criminal prosecution. Random audits and coordinated audits by the RoC, tax authorities and enforcement agencies should be made statutory to disorganize layering and shell operations.

5.2 Institutional Reform and Co-ordination

Institutional changes are the key in ensuring that reform is coordinated. MCA, tax, SEBI, RBI and enforcement databases need to be connected in a single corporate intelligence system with real-time analytics being used to identify suspicious dormant companies. Joint investigations, tracing assets, and enforcement should be authorized to be done by multi-agency task forces. Staff in the regulatory departments should be better trained in the detection of financial crimes and beneficial ownership tracing, with the aid of centers of excellence and advanced analytical tools. Rapid procedures of dormant companies investigations would guarantee prompt settlement of transparent violations of rules and voluntary compliance schemes could encourage transparency and best practices using authentic dormant companies.

5.3 Quasi-Judicial and Judicial Reforms

Criminal procedures should stop fulfilling a procedural and start a substantive role. In cases of strike-off or restoration NCLT and NCLAT should be given powers to direct extensive beneficial ownership investigations and financial audit. Increased suo moto authority would give tribunals the ability to look into at-risk dormant businesses automatically identified by registry analytics. Regulators and practitioners should be led by specialised jurisprudence and directions of practice in identifying and handling patterns of abuse. Tribunal members, in terms of financial crime and corporate intelligence training, would enhance the adjudicatory capacity to ensure that decisions can be made using strong evidence. Such a review of the case at the appellate level should focus more on substance than form, in line with the substance-over-form doctrine established by India and to avoid the

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dormant going concerns protecting the illegal operations.