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COMBATING MONEY LAUNDERING THROUGH NGOS AND SHELL COMPANIES: ROLE OF INDIAN BANKING LAWS

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ABSTRACT

One of the most complex and continuous threats to the financial integrity of India is money laundering via Non-Governmental Organisations (NGOs) and shell companies. Although a strong statutory framework with the Prevention of Money laundering Act, 2002 (PMLA) as its backbone was established, the regulatory effectiveness is still compromised by the existence of gaps in enforcement, manifested in low rates of conviction, insufficient beneficial ownership disclosure, and lack of inter-agency coordination. This paper critically discusses the means by which NGOs and shell companies are used to launder money, the responsibilities of Indian banks as reporting entities, the difficulties in enforcing the rules, and uses three high-profile enforcement actions, the Vijay Mallya loan fraud, the K. Ponmudi disproportionate assets case, and the V. Senthil Balaji job scam, to demonstrate systemic weaknesses The paper ends with suggestions on a more robust risk-based strategy, incorporation of RegTech tools, and enhancement of data connectivity between the DARPAN portal and the Financial Intelligence Unit (FIU-IND) to bring the anti-money laundering system in India into compliance with Financial Action Task Force (FATF) standards.

Keywords: Money Laundering, PMLA, NGOs, Shell Companies, Indian Banking Law, FATF, Know Your Customer, Suspicious Transaction Reports, FIU-IND.

I. INTRODUCTION

Money laundering - the disguising of the criminal sources of criminal derived proceeds so that they can be re-introduced into the legitimate economy has been estimated to make up between two and five per cent of world GDP each year. In India, legislation that is aimed at responding to this threat is mainly represented by the *Prevention of Money Laundering Act, 2002,*[766] which defines banks and financial institutions as Reporting Entities and places upon them a broad set of responsibilities, including customer due diligence and the submission of Suspicious Transaction Reports (STRs) to the Financial Intelligence Unit-India (FIU-IND).[767]

Despite these legislative efforts, money laundering has remained vibrant using two vehicles that can particularly be exploited Non-Governmental Organisations (NGOs) and shell companies. The charitable nature of their work sends NGOs considerable tax breaks, the ability to receive foreign donations via the *Foreign*

[766] Prevention of Money Laundering Act, No. 15 of 2003, Acts of Parliament, 2002 (India) [hereinafter PMLA].

[767] Financial Action Task Force, Mutual Evaluation Report: India (2024), https://www.fatf-gafi.org/en/publications/Mutualevaluations/mer-india-2024.html.

Contribution (Regulation) Act, 2010,[768] and level of public trust that makes them vulnerable to abuse in the form of laundering money and funding illicit activities. Shell companies, however, provide the veil of legal corporate existence with no material economic activity, allowing their operators to transfer funds across numerous layers of transactions without any identities.

High-profile enforcement cases such as the Enforcement Directorate investigation of a ₹9,000 crore bank loan default by Vijay Mallya organized using a network of offshore shell companies; the prosecution of Tamil Nadu Minister K. Ponmudi because of disproportionate assets related to money laundering; the arrest of former Tamil Nadu Minister V. Senthil Balaji due to a job sc All of these instances demonstrate the structural lack of effectiveness in the anti-money laundering (AML) framework of India and serve as a helpful prism in the context of assessing suggested reforms.[769]

The paper follows the laundering mechanics via the NGOs and shell companies, the regulatory framework, and obligations of banks as reporting entities, the challenges of enforcement by the three case studies, a comparison of lessons learned in other jurisdictions, and the conclusion with recommended reforms.

II. THE MECHANICS OF MONEY LAUNDERING THROUGH NGOS AND SHELL COMPANIES

A. The Classical Three-Stage Model

Money laundering follows three classical steps, namely, placement, layering and integration.[770] When cash is acquired illegally through placement, it goes into the financial system. Layering refers to the disguise of the money trail with complicated and usually trans-national transactions. The last step is to integrate, in which the laundered money is reintroduced into the legitimate economy as seemingly legal wealth. Both NGOs and shell companies play pivotal roles at different stages of this cycle, often in conjunction with each other.

B. Money Laundering Through NGOs

Under Recommendation 8 by the Financial action Taskforce specifically names Non-Profit Organisations as organisations prone to abuse of money laundering and terrorist financing.[771] About the Indian situation, the NGOs under the FCRA have the advantage of foreign contributions, which can be anonymised and directed through foreign sources. This aspect renders them desirable channels of the placement phase: criminal funds may be channelled into an NGO in the form of a foreign contribution, masquerading as a charitable gift, which effectively launder the cash using the legitimate operations of the organisation.

One typical scheme is to form fictitious NGOs or seize dormant ones, and then overcharge the books of charitable expenditure, create lists of beneficiaries, and drain the accounts by overbilled vendor invoices or salaries to fictitious employees. The Ministry of Home Affairs has, in several annual FCRA reports, noted the widespread cancellation of NGO registrations for financial irregularities,[772] underscoring the pervasiveness of this problem. The requirement of the PMLA that banks implement enhanced due diligence on high-risk entities often results in the NGO-related accounts going unflagged, despite the fact that the charitable organisations are legally considered to be potentially high-risk customers.

[768] Foreign Contribution (Regulation) Act, No. 42 of 2010, Acts of Parliament, 2010 (India) [hereinafter FCRA 2010].
[769] ECIR/MBZO/01/2017 (Enforcement Directorate, proceedings ongoing) [hereinafter Mallya Case].
[770] supra note 6, at 98 (explaining the three-stage process of placement, layering, and integration as classically defined in the context of Indian financial crimes).
[771] Recommendation 8: Non-Profit Organisations, in FATF Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation 16 (2012, updated 2023).
[772] Annual Report on FCRA (2022–23) (noting that hundreds of NGO registrations were cancelled for violation of FCRA 2010 provisions relating to foreign contribution misuse).

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C. Money Laundering Through Shell Companies

Shell companies are legal persons who are typified by the fact that they do not engage in substantive economic activity: they do not have employees, no physical office, or real commercial activity.[773] Their main use in the laundering process is in the layering stage where money is being transferred using a set of inter-company transactions that further obscure the money trail. Such companies are commonly domiciled in several different jurisdictions, including offshore havens with low regulation, such as the British Virgin Islands, Cayman Islands, and the Isle of Man, which makes it incredibly difficult to trace beneficial ownership in a domestic regulator.

Unless banks are careful of shell company abuse using loan-back schemes a criminal can deposit illicit funds offshore through a shell company, which then takes a loan back at arm-length, and the repayments are pulled out of domestic income to justify them. The Mallya case offers a lesson-learned case-study-the Enforcement Directorate discovered that the money stolen by Kingfisher Airlines in the form of loans had been channeled through more than forty offshore shell companies before becoming repatriated.[774]

III. THE REGULATORY FRAMEWORK

The anti-money laundering structure in India is a multi-layered system. Topping it is the PMLA that outlaws money laundering under Section 3 and provides a sentence of three to seven years of imprisonment, which can be raised to ten years in case of drug-related crimes, under Section 4.[775] Banks and other financial institutions are named by the PMLA as Reporting Entities, and are held responsible to maintain records, conduct customer due diligence, and file STRs under Chapter IV.[776]

The Master Direction of KYC Directions by RBI, 2016 (revised 2023) offers the working scheme of customer identification and verification. FIU-IND is the main storage of STRs and Cash Transaction Reports whereas the Enforcement Directorate is in charge of investigating and prosecuting money laundering crimes.[777]

The PMLA has been significantly amended over the years—most notably in 2012, 2015, 2018, and 2019—to expand the schedule of predicate offences, extend the powers of provisional attachment under Section 5,[778] and incorporate requirements for beneficial ownership disclosure under Section 12A.[779] Notwithstanding these legislative developments, the FATF's 2024 Mutual Evaluation Report rated India as only 'partially compliant' on Recommendation 24 relating to beneficial ownership transparency,[780] indicating that the regulatory architecture, though comprehensive on paper, suffers from significant gaps in implementation.

IV. THE ROLE AND OBLIGATIONS OF BANKS

In the AML architecture of India, banks play the first line role. They are required to: (i) deal with Customer Due Diligence (CDD) including identification of beneficial owners; (ii) keep records of transactions at least five years; (iii) submit STRs to FIU-IND within seven working days of having a reasonable suspicion that a transaction is suspicious; and (iv) perform enhanced due diligence on high-risk

[773] *§ 2(1)(y) (defining 'shell company' indirectly through the concept of 'beneficial owner' and 'proceeds of crime' traceable through layered corporate structures).*

[774] *, supra note 10 (documenting the use of over 40 offshore entities in Isle of Man, British Virgin Islands, and Cayman Islands for layering funds).*

[775] *, Report on Currency and Finance: Fiscal-Monetary Co-ordination 78 (2022–23) (noting challenges in beneficial ownership verification across layered corporate structures).*

[776] *§ 12A (inserted by Finance Act 2019) (requiring maintenance of records relating to beneficial ownership).*

[777] , supra note 5, para 16 (requiring enhanced due diligence for high-risk customers including politically exposed persons and complex corporate structures).

[778] , Annual Report 2022–23 6 (Ministry of Finance 2023) (reporting receipt of over 7 lakh suspicious transaction reports but noting challenges in analytical capacity).

[779] , supra note 15 (tracing cash transactions through multiple shell-like intermediaries in the Uniform Recruitment Board job scam worth approximately ₹1,000 crore).

[780] , Press Release: Action under PMLA in Job Scam Case (July 14, 2023), https://enforcementdirectorate.gov.in (last visited Apr. 5, 2026).

customers, such as politically exposed persons and complex corporate entities.[781]

The definition of beneficial ownership is especially important when it comes to shell companies. As amended in 2023, the *Prevention of Money Laundering (Maintenance of Records) Rules, 2005*,[782] as amended in 2023, require banks to identify the natural person who ultimately owns or controls a customer entity. But the stratified corporate forms of shell company structures make this requirement all but impossible to fulfil, because banks can perform CDD on the direct applicant entity with no inquiry into the underlying holding companies that might hide the ultimate beneficial owner.[783]

The Senthil Balaji case depicts how such a process failed with regard to transaction monitoring. An investigation by the Enforcement Directorate showed that the funds of the job recruitment scam, which totalled around ₹1,000 crore, were laundered after being passed on using several middlemen and then incorporated into property and other assets.[784] It is believed that the banks the transactions were processed over did not raise any red flags on the suspicious nature of the cash deposit and withdrawal pattern which casts a big doubt on the effectiveness of their AML compliance programmes.

The annual reports of FIU-IND reveal an ever-growing number of STR report filings - more than seven lakh reports were only filed in 2022-23 alone[785]—but conversion rates of these reports into effective prosecutions are dismal, indicating systemic failures not only in bank reporting but also in the analytical and investigative resources of downstream enforcement departments.

V. ENFORCEMENT CHALLENGES: ILLUSTRATIVE CASE STUDIES

A. Enforcement Directorate v. Vijay Mallya – The Shell Company Paradigm

The Vijay Mallya case is the perfect example of the misuse of shell companies to commit bank loan fraud and money laundering in India. Kingfisher Airlines provided loans of about 9,000 crore to seventeen Indian state-owned banks between 2004 and 2012, in form of a consortium. The PMLA investigation by the Enforcement Directorate revealed that much of this money was instead diverted out of the purported use of meeting the operating costs of the airline and channeled through a system of over forty shell companies that had been incorporated in various offshore jurisdictions, such as the Isle of Man, the British Virgin Islands, and the Cayman Islands.[786]

The shell entities carried out a layering scheme in which the money was sent back to the foreign subsidiaries in the form of intercompany loans or management fees and then diverted through a series of offshore entities back into the shell entities and made to appear to have been received as international business receipts.

The lending consortium had significant lapses in its due diligence procedures that were revealed in the case. In spite of the publicly announced financial hardship of Kingfisher Airlines, banks still approved new loans and reorganized facilities without questioning how the money was actually spent, or questioning how corporate structures were used to conduct control by Mallya. The Enforcement Directorate finally confiscated property worth over 14,000 crore and Mallya was proclaimed as a fugitive economic offender under the Fugitive Economic Offenders Act, 2018. The case emphasizes the key role of end-use monitoring and beneficial

[781] Prevention of Money Laundering Act §§ 3–4 (India 2002) (prescribing punishment of three to seven years imprisonment, extendable to ten years for drug-related offences).

[782] *Prevention of Money Laundering Act* § 12 (India 2002) (imposing obligations on reporting entities including banks to maintain records and furnish information to the Financial Intelligence Unit).

[783] *Reserve Bank of India*, Master Direction – Know Your Customer (KYC) Direction, 2016 (Updated 2023), RBI/DBR/2015-16/18 (providing the regulatory basis for customer due diligence by Indian banks).

[784] *§ 5 (authorising provisional attachment of property believed to be proceeds of crime pending investigation).*

[785] *, supra note 2, at 44 (rating India as 'partially compliant' on Recommendation 24 relating to transparency and beneficial ownership of legal persons).*

[786] *, 2005 (as amended 2023), Rule 9 (requiring Customer Due Diligence measures including identification of beneficial owners).*

ownership checks in bank lending to highly complex corporate borrowers.

B. Enforcement Directorate v. K. Ponmudi – Political Exposure and AML Obligations

The K. Ponmudi case, a case filed in 2023, emerged as a result of a disproportionate assets inquiry by the Tamil Nadu Directorate of Vigilance and Anti-Corruption where Ponmudi who was a Higher Education Minister at the time, was found to have amassed assets beyond his known sources of income. The Enforcement Directorate registered an ECIR under the PMLA claiming that the disproportionate wealth was proceeds of crime.

The case also presents critical issues in the AML context in the context of handling Politically Exposed Persons (PEPs) by Indian banks. The KYC Directions that the RBI has issued, require banks to exercise greater due diligence when creating or sustaining relationships with PEPs, or those individuals placed with high-profile public roles. Research indicated that the records of the accounts in which Ponmudi amassed disproportionate assets ought to have received increased attention considering his PEP status, demonstrating how the normative scenario of increased due diligence and how reporting entities execute it in reality are not aligned with each other.

The Ponmudi case also brings to the fore how predicate offences are triggered by PMLA jurisdiction, showing how the corruption given by lapses in political accountability propagates directly into the money laundering ecosystem and how a wide range of scheduled offences in the PMLA schedule is geared to cover such behaviour.

C. Enforcement Directorate v. V. Senthil Balaji – Transaction Layering and Supervisory Failure

In June 2023, a major breakthrough in the enforcement of PMLA involved the arrest of V. Senthil Balaji, a former Tamil Nadu Minister for Electricity, who was alleged by the Enforcement Directorate to have received cash bribes, in exchange for guaranteed government employment, and the money subsequently laundered in shell-like intermediary entities and benami transactions.[787] sf[788]

The layering process that was used in the Balaji case was instructive. Bribe money in the form of cash was reportedly deposited in various bank accounts of associates and intermediaries, broken down into smaller amounts in order to avoid transaction reporting limits, and then moved through a chain of shell or dormant entities, back into real estate, gold, and other valuable assets. This is called a structuring process or smurfing which is a well-known layering method that is aimed at taking advantage of loopholes in the transaction monitoring systems.[789]

The Supreme Court, in *V. Senthil Balaji v. State of Tamil Nadu*, examined the legality of his arrest under Section 19 of the PMLA, affirming the ED's investigative powers while emphasising the importance of procedural safeguards. From a banking law perspective, the case reinforces the need for robust structuring-detection mechanisms within bank AML systems, since the fragmented pattern of cash transactions involved should have triggered STR obligations for the banks concerned.

VI. COMPARATIVE ANALYSIS

A relative study of anti-money laundering systems in Britain and the United States depicts that the PMLA in India, despite its overall congruity with the FATF guidelines in the context of legislation, is inefficient in its operations. Both *the Proceeds of Crime Act, 2002* of the UK and the *Bank Secrecy Act* of the US enjoy the benefits of centralised well-resourced financial intelligence units with advanced analytical capabilities, obligatory real-time beneficial ownership registries available to law

[787] V. Senthil Balaji v. State of Tamil Nadu, (2023) SCC OnLine SC 1244 (ruling on the legality of arrest under PMLA § 19).
[788] § 13 (empowering the Director, FIU-IND to impose fines on reporting entities for non-compliance with obligations under Chapter IV).
[789] supra note 6, at 201–08 (discussing enforcement gaps including low conviction rates attributable to procedural challenges and complex inter-agency coordination issues).

enforcement, and high conviction rates that accomplish credible deterrence.

The Indian system, however, has the drawback of the lack of a publicly accessible and centralised beneficial ownership register that compares to the People with Significant Control (PSC) register in the UK. The MCA21 portal of the Ministry of Corporate Affairs keeps positive ownership information, although it is not yet fully integrated with FIU-IND and the NGO DARPAN portal, which allows an investigator to quickly follow ownership trails.[790] Moreover, the 2024 assessment of the FATF revealed that India has a risk-based approach to AML supervision that has been inconsistently applied to the banking sector, with the smallest cooperative banks and payment banks having especially fragile AML compliance cultures. The rating on beneficial ownership transparency on the aspect of partial compliance by India is particularly worrisome in that shell company transparency is the key mechanism involved in both the Mallya and Balaji cases, and an opposite pattern as compared to jurisdictions like Singapore and Hong Kong where real-time corporate registry integration with financial intelligence units has been markedly more successful in disrupting shell company laundering.[791]

The FATF's assessment of India as only 'partially compliant' on beneficial ownership transparency[792]

VII. RECOMMENDATIONS

The following recommendations are advanced for strengthening India's AML framework with specific reference to NGOs, shell companies, and the banking sector.

To start with, the integration of NGO DARPAN portal and the FIU-IND database is urgently required. At the present time, a significant percentage of NGOs registered under FCRA are not cross-verified against DARPAN data, which has left a regulatory blind spot allowing the NGO accounts to be abused to place illegitimate funds. There would be a requirement to implement a real-time data-sharing system between the Ministry of Home Affairs FCRA portal and DARPAN, and the banks would be able to perform better CDD on their NGO customers.

Second, all Scheduled Commercial Banks should be required to adopt RegTech solutions, namely, transaction monitoring using Artificial Intelligence and useful ownership mapping using machine learning.[793] RBI has already started the conversation regarding RegTech frameworks; though, it is still implemented on a voluntary basis. As the layering methods in the Mallya, Ponmudi, and Balaji cases have been reported to be rather complicated, manual review processes are clearly ineffective.

Third, there is a need to operationalise the existing risk-based approach under the PMLA and RBI KYC Directions in a stricter way. Banks must be obliged to provide specific risk rating to NGO and shell company customers in the basis of objective factors such as amount of foreign contributions received, number of jurisdictions, propinquity to PEPs, frequency of high value cash transactions etc. and to impose enhanced due diligence that is commensurable with the risk rating.

Fourth, a more active implementation of penal provisions in Section 13 of the PMLA for non-compliance by reporting entities should be more vigorously enforced by FIU-IND. The existing enforcement history shows that administrative fines are not often levied on banks due to not filing STRs or for inadequate CDD, which forms a poor framework of incentives to comply.

Fifth, the suggestions of the Committee on Beneficial Ownership of the Ministry of

[790] (The Enforcement Directorate attached assets worth over ₹14,000 crore across multiple jurisdictions as part of the investigation).

[791] No. 17 of 2018, Acts of Parliament, 2018 (India) § 12 (enabling confiscation of properties of fugitive economic offenders).

[792] ECIR/CHZO/04/2023 (Enforcement Directorate 2023) [hereinafter Ponmudi Case].

[793] , *K. Ponmudi v. State, Crl. O.P. No. 9852 of 2023 (Madras H.C. 2023) (granting interim bail pending PMLA trial proceedings).*