



Lifting of the corporate veil

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Abstract

A company has been given the status of separate legal identity which could be used to hide the unlawful acts done by the individual running the company. The impact of the doctrine of lifting the corporate veil is to clear the differences of action done by the company and its members for their own benefits. This doctrine is like a watchdog to keep a check on the member of the company, so that no one takes the unlawful advantage behind the curtain by utilising the company name as the banner and hiding tool. This research paper deals with the public policy and lifting of corporate veil, wherein it has been discussed under what provision the corporate veil could be lifted and what happens if the corporate misuses the public policy and how the public policy helps in determining that the separate identity of the corporate is being mis utilised.

Keywords: corporate veil, legal identity, individual running

Introduction

In the current scenario lots of starts ups are coming up each year which is phenomenal but thing to notice is the jeopardy that it could create. Since, the company law provides the provision which clearly states that the corporation is a separate legal entity and it stands different from its members. If not done rightly, it might bring the shadow of suspicion on the company. The public policy is something which is in the benefit of the public if any action taken by the company which proposed to be for the public and actually it turns to be against it, there comes the principal of lifting the corporate veil in exposing the unlawful acts. It was clearly decided in the case of Solomon v Solomon & Co Ltd that piercing the veil of incorporation is situation where shareholders and other members of the company are held liable for the debt of the company because the members are the ones who do actions on behalf of the company.

The basic concept of lifting of the corporate veil means keeping aside the individual corporate personality that has been granted to the company by the section 8 of the Companies Act. The meaning of word person is living human but law considers the artificial person like companies, registered society and other corporations as the living person. This was well explained in the case of Pharmaceutical Society v. London and provincial Supply Association Ltd, that law includes both the natural and artificial person.

If the established company was set up with an intent to do unlawful activities which is not permitted under the provisions of the companies act or in any way it is harming the interest of public then the only remedy the company has got is to do away with its certificate of incorporation or to consider the status of the company as null.

The companies Act 2013 contains various provisions as to support and safeguard the interest of the public. Some provisions which safeguard it are mentioned as below

- **Section 2(60):** This is in regard with the officer who would be held liable for the act, mainly these people

consist of key managerial personnel.

- **Section 7(6):** This keeps in check if the company had been incorporated and found on a later date that it was done by representing false data or material information were kept hidden than in that case the promoters or the first director of that company would be held liable and would be punished.
- **Section 34:** This helps in punishing in case the prospectus contains any misrepresentation of data or information.
- **Section 36:** This leads to the punishment of directors in case they hid the material information from the investor or public or misrepresented the information.

The policy of limited liability is preferred by the individuals as they invest their excess funds or capital into it and derive the benefit out of it. In the case of Rainham Chemical Works Limited v Belvedere Fish Guano Company, it was held that companies act states people may substitute the limited liability with the unlimited liability just to promote the higher the higher the return.

A great example where this doctrine could be demonstrated well could be observed in the case of Lee v Lee's Air Farming Ltd., where the facts were as follows – Appellant's husband was the director and major shareholder with the controlling rights in it. He also worked as a chief pilot in his own company. There was this incident of airplane crash when he was flying it and which caused his death. The concern that arose at that point was whether to allot him as the worker so that his nominees could receive the workman compensation amount or the controlling director. The council on that case was clear about this and stated that both company and the deceased are two different individual identity. Thus, his nominee received the workman compensation as he was held to be the employee of the company.

Literature review

1. Bello and Nrichel, (2014). In this article the author has analysed the topic of piercing the corporate veil under the long practice observed by the corporates for about centuries. It has been focussed in this article that veil acts like a protective shield for the members of the company and puts them in a safer position. If there is no veil of the corporation then the company will be prone to corporate assault and its members might face the direct proceedings against them. But the corporate veil turns to be useful and protective for its employee as the proceedings does not take place directly against them. Third party cannot sue the company and its members just like that. This paper reflects the importance of corporate veil as the strength for the corporate body.
2. Brenda Hannigan, (2013), This paper has analysed one of the landmark cases regarding the separate legal entity and piercing the corporate veil, i.e. Salomon v Salomon^[1]. Author has cleared the confusion regarding the lifting of the corporate veil. It has set the standards as to when and under what circumstance veil needs to be lifted to get the clear picture of events. This article emphasises more towards the exception to the Salomon principle which allows the lifting of corporate veil, in order to find the person actually responsible for the activities done on behalf of the company.
3. Francis X. Welch, (1931), Here the author discusses about the what is more prominent and what stands before in case of corporation and law. It is a debatable topic like what has come first whether the egg or chicken. The author has put in a swift way analysing the following aspect. The article has even touched the views of many scholars and German jurist as to their views on separate legal entity existence and natural person and its association. Article has mentioned about the situation when will the corporate fiction would be disregarded. It also emphasises on law being the guardian of the corporate fiction.
4. David H. Barber, (1981),. This article has mainly focussed on the principle of separate legal entity. It even talks about the liability involved of its shareholders and other members of the organisation. It has made some points clear regarding, when the holding company is held liable for the action of its subsidiary organisation. The author has highlighted the various aspects of subsidiary and holding company relationship. The condition which makes the court to lift the protective veil of the corporate to expose its reality.

Objective of the paper

The paper focuses on lifting of the corporate veil and short aspect of public policy affecting the piercing of corporate veil, which will help in understanding the concept of the paper topic and its provisions.

- To throw some light on understanding the concept of lifting the corporate veil.
- To deal with the case study.
- To study the various provision related to lifting the corporate veil.

Issue

- Does the public policy go in hand in hand with the lifting of the corporate veil?

- Whether the provisions relating to lifting the corporate veil under the companies act 2013, when compared with 1956 act is sufficient or not.
- What are the grounds under which the veil is lifted?

Methodology

Doctrinal Research Method has been used for the present research article. Doctrinal research has been chosen as most of the information has been sought from the available literature, case laws, books and law journals for the preparation of the research article.

Research and Analysis

- The association between public policy and lifting the corporate veil is extremely dubious and tough to establish. This is because of the fact that public policy is highly undefined Principal that is invoked to justify enactment of statutes and delegated legislation. In the case of state of Rajasthan & others v. Gotan Lime Stone Khanji Udyog Pvt. Ltd & Ors, the transfer of shares was held to be dishonest. The court observed carefully the entire fact and transaction related to the case and disregarded the corporate veil. But when viewed in its entirety the events turned out to be illegal where in it was found that the transaction of transferring the shareholding of mining lease led to violation of Rule 15 of the Rajasthan Minor Mineral Concession Rules, 1986, because the lease was transferred without the proper permission from the required authorities. In this case court also implemented the public policy as the basis to pierce the corporate veil. The mining rights and controlling stake was within the hand of the state government, this was supposed to be regulated in consonance with the public interest. The court had clearly held that GLKU was established with the intent to get away with the mandatory statute requirement permission from the government for the transfer of lease to the third party. This action of GLKU reflects that company was established with the clear motive of making profit at the cost of public interest. In this case bench need not have looked into the violation of public policy to lift the corporate veil because there was prima facie violation of the impugned rules. Public interest has not been defined by any statutory regulation or judicial pronouncement. The invocation of the theory of the public interest often contradicts the legal assumption that the courts should usually be hesitant to pierce the corporate veil.

The test set out in *Prest v. Petrodel*, which was accepted by the supreme court in *Balwant Rai Saluja v. Air India*, may have been a more cautious approach. Here, by moving its entire shareholding to UTCL, GLKU intentionally evaded a legal restriction by disguising the lease transfer consideration as the shareholding price in order to suppress the fact that it had not obtained the required consent from the competent authority for the transfer of mining lease to UTCL.

In my opinion I consider the usage of public policy for lifting the corporate veil as a vague concept. Thus, in the rarest of rare cases, courts can rely exclusively on the public interest where other conclusive grounds cannot be counted on and its prima facie clear that the corporate structure of a corporation is used to commit fraud or escape liability.

- In the case of *Salomon v. Salomon*, the theory laid down by the house of Lords is that the same law is followed by the courts and piercing the corporate veil is the exception to this law. In various instances the honourable high courts and supreme court have allowed to lift the corporate veil on the basis of Doctrine of piercing the corporate veil. There is some difference between the companies act 2013 and the previous act of 1956 act. There are many enriched provisions are introduced in Article of Association regarding the lifting of the corporate veil. The constitution of India provides importance to the company as it has its own separate legal identity. Article 21 constitution of India states that right to life and personal liberty should be allowed to every person except in accordance with the provisions laid by the law. As per the Article of the company and company act, the company enjoys the privilege of right to life and personal liberty. In the case of *Chiranjitlal Chaudhary v. Union of India* where the Supreme court gave the judgement as fundamental rights are not only granted to the individual natural person but it extends to the artificial person as company. Thus, a corporation has its own rights and can sue and be sued, deal with property like selling and buying.
- The court lifts the corporate veil only when it tries to look deep into the aspect as to who is really responsible for the event. When the court disregards the company's separate legal identity from that of its members and managers, its then when veil is pierced. It is difficult to assess what are the factors which leads to the breakdown of the corporation's insulation. It largely depends upon the court's discretion based upon the existing situation in society and economy. It can be stated that adherence would not be to the Solomon Principal pertinaciously where it would lead to unequal outcome.

Corporate veil could be lifted under two categories i.e.

1. Judicial Interpretation.
2. Statutory Provisions.

The lifting of corporate veil under Judicial Interpretation

1. Protection of Revenue: In the case of *Sir Dinshaw Maneckjee Petit Re*, in this case the assessee was making huge sum of money through dividend and interest. He transferred his shares to four companies in exchange for their shares. Then the interest and dividend received by the company was then given to sir Dinshaw in the form of loan. It was stated that this was all done to avoid the tax and company was nothing but assessee himself. Thus, the court pierced the veil to get a clear insight of the story.
2. Fraud: The courts have always kept their eyes open for the right judgement and when it comes to piercing the corporate veil, the courts have done that properly. The courts do not let people use the Principal of Solomon to be used in wrong manner or to commit fraud. Two prominent cases to support this are as follows:

Gilford Motor Company Ltd. V Horne, in this case Mr. Horne was the employee of the *Gilford Motor Co.* where

under his employment contract it was specifically mentioned that he won't be allowed to solicit the customers of the company. In order to avoid this situation Mr. Horne incorporated a company in the name of his wife and solicited the customer of *Gilford Motor Co. Ltd.* When the company got informed of this, they brought an action against him. The court clearly stated that it was nothing but a clear case of fraud, by hiding the business with different name and regarded the company to be mere sham.

Jones v. Lipman, in this particular case a man had a contract to sell his land and afterwards he turned his thoughts of selling away his land and to avoid the order of specific performance, the property was transferred in the name of a company. It was rightly stated by the court that he was trying to hide behind the eye of equity. The court held that specific performance to be awarded to both Mr. Lipman and the company.

3. Enemy character: This is about the enemy company whose revenue supports the enemy country. In the case of *Daimler company Ltd. Continental Tyre & Rubber Co.*, a tyre company was established in London by a German company whose major stakeholders were German. A war had started between the England and Germany thus, it was decided that trade debt needs to be dismissed on the basis of war as those amounts will help its enemy country.
4. Sham or cloak: This is the situation where the directors, shareholders paint a shady picture in order to get away of any contractual obligations, this is when court lifts the corporate veil. In the case of *Delhi Development Authority v. Skipper Construction Company Pvt. Ltd.* it was held by the honourable supreme court that it has considered all those companies as sham or cloak because the court found that all the companies were owned and controlled by the director and his family and in reality, there was only one person in charge of them.
5. Economic Offence: In *Santanu Ray v. Union of India*, it was decided that the court has the power to pierce the corporate veil in the situation wherever it feels there is any economic offence done by a company. In this particular case it was held that the company had violated section 11(a) of the central excises and salt act, 1944. The court held that veil could be pierced by the authority to identify who all were involved with the tax evasion or concealment of information.
6. Welfare Legislation: when an enterprises objective is to avoid doing some welfare to is employee like in terms of bonus than the courts will lift the veil. This could be seen in many cases where the court has pierced the veil to only find companies manipulating the funds just to avoid the welfare of the employees. In the case of workmen employed in *Associated rubber Industry Ltd. v. Associated Rubber Industry Ltd.* the holding firm had earned dividends on subsidiary equity assets. This dividend was added to the company profit, in order to avoid giving incentives to the employees the holding company created a wholly owned subsidiary and transferred all the dividends earned to it. The court pierced the veil to find that the newly incorporated subsidiary had no assets of its own or profit, every profit and revenue was coming from the holding company. This was done in order to avoid the bonus payments and other incentives to the workmen.
7. Contempt of court: In *Jyoti Ltd. v. Kanwaljit Kaur*

Bhasin the court clearly held that it is important and essential to lift the corporate veil in order to punish if there is any contempt of court. There are not many incidents regarding this but any won't be entertained or excused. Here the general rule of separate identity cannot be set up. In the case of U.K. Mehra v. Union of India there was an interim order passed by the court stating that it is for specific company to not enter in an joint venture in India. Those who have entered through wholly owned subsidiary, the court held that it's not contempt of court and it won't be called as joint venture.

8. **Mere Agency:** In the case of Smith Stone & Knight Ltd. V Birmingham corporation, in this the appellant (SSK company of the appellant) had sold his land to BWC, which was the subsidiary of SSK. When the respondent asked to but the land it was stated by the appellant company that they no more have this land and it's owned by other company. It was observed by the court and found that the particular transaction was done by the appellants agent for the advantage of its principal. The court declared parent company to be involved in this fraud. The court even stated five tests in this case which are as follows:
 - Holding company derives the benefit out of the subsidiary company.
 - Holding company appoints the person for the management of subsidiary company.
 - The management instruction is passed by the holding company to the subsidiary company as to what to be done and when to be done.
 - Whatever revenue the subsidiary company is making is ought to be coming from the holding company.
 - Holding company is supreme in case of holding and subsidiary company format as it has the total control over the company.

However, in case of Adams v. Cape Industries Plc the court was unable to pierce the corporate veil because the company's activities were not matching with any of the test that was established in the previous case i.e., Smith stone v. Birmingham corporation. The company was doing good and in fact was generating revenue and profits for the holding company.

In the case of Royal Industries Ltd. V. Kraft Foods Inc, the court held that Agency theory cannot be used as the mean to pierce the corporate veil. It has to be in a way where the subsidiary company meets all the requirement. If it is so, then court pierces the corporate veil.

9. **Acting against the public policy:** the court had extended the principle of piercing the corporate veil to provide the justice in the case of PNB Finance v. Shital Prasad Jain. But this judgement of court is considered to of vague nature as to subject matter of lifting the corporate veil. The scope of public policy is very wide, thus becomes difficult to understand at times. Exception to the general principle of separate legal identity cannot be the means to nullify the effect of the principle in the entirety.

In the case of Re Polly Peck International Plc. The court stated that when there are several claims which are interlinked with each other in association with same debt, then in that case court will enquire for the legal substance in

that particular transaction rather than looking for economic value into it. The court cannot ignore the separate legal entity characteristic of a company by just receiving some facts and cannot pierce the veil in the mentioned transaction.

10. **Negligent activities:** In some cases, it happens that the holding company turns out to be working very normally even after doing the enquiry but the subsidiary company happens to be doing so malpractice, so in this case as well the holding company would be held responsible for the wrong doing of the subsidiary company. This is when the court feels like lifting the corporate veil to see the clear picture as to what is happening. This could be supported by the case of Chandler v. Cape Plc; the holding company was held liable for the action done by the subsidiary company by the English court. The negligent activity regarding employee's health and safety was observed by the court. In this case there was a employee who worked in the defendants subsidiary company. The employee was exposed to certain harmful substance at his work place which led employee to acquire certain disease. The employee realised it on a later date when the symptoms were quite visible. But then the problem that came up was that the subsidiary company in which he used to work as an employee had shutdown. Then he claimed his compensation from the holding company that due to the negligence of the ceased subsidiary company he has got the disease. The court declared that under particular circumstances it could be said that duty of care was present or not. Below those points are mentioned:
 - When both the holding and subsidiary company deal in similar kind of business.
 - When holding company has more knowledge and skills regarding the aspect of health and safety.
 - When the holding company was aware of the skills and prevailing system in subsidiary.
 - When there was the possibility of foreseeing the events by the holding company but no action was taken by the holding company.

The lifting of corporate veil under the Statutory Provisions.

1. **Non-compliance of requirements:** Under section 464 of the company law, it states that all the benefits of corporation could be nullified if found that incorporation is not following the necessary conditions.
2. **Misrepresentation in the prospectus:** Section 34, states that any type of misrepresentation made in the prospectus would cause the approving authority to incur liability towards all of those who have subscribed for shares.
3. **Failure to return application Money:** If the minimum subscription amount is not achieved by the company within 120 days after the date from whenever the prospectus was issued. This would cause company to refund the entire sum within another 10 days. If anything goes wrong the company and its management would be held liable to a penalty for every single default, every single day for about the amount of Rs. 1000 and can increase up to Rs. 1,00,000 or whichever is low.
4. **Prohibition on repeating the name of the company:** There is this restriction where the directors or the directors of the insolvent company cannot use or rather

repeat the company name for five years. Under the section 216 of the insolvency act restriction for reuse of company name is specified in clear words that if any contravention of section 216 is found, then the directors would be held liable personally for all the debts of the company performing in contravention. The remedy to resolve this problem is stated under section 217 to pierce the corporate veil to have a clear picture of the scene.

5. Tax Evasion: If the Federal Board of Inland Revenue is of the thought that certain disposition has been made to neglect the tax amount under the Income Tax act, then the court would lift veil.
6. Section 339 of the company act; Fraudulent Conduct: while the company is going to shut down and it is discovered that the company was operating its business with the intention of defrauding its creditors then the liability would be incurred by the company if the same is proved.
7. Actual ownership of the company: To find out the person behind the wrongful activity or unlawful one, Company act has a provision under the section 216 i.e. to find out who is the actual owner of the company responsible for the act of the company behind the veil. This helps the court to lift the veil of the corporates.
8. Ultra vires act: The memorandum of association of any company is for the outside members of the organisation which provides the details about the company. This even provides for the limitation of the company. Anything which is not allowed or mentioned under the Association is considered to be ultra vires. For such actions which are not authorised liability is set on the directors. In the case of *Weeks v. Propert*, in this a loan amount was under the scrutiny and turned out to be ultra vires, which lead to liability falling upon the directors.

This doctrine was evolved in the case of *Ashbury Railway Carriage & Iron Company Ltd. V. Hector Riche*, the company had entered into an agreement for something which is not mentioned in MoA of the company. Thus, this action was held to be ultra vires.

Conclusion and suggestion

This research paper has focussed to keep a balance between public interest and the principle of separate legal entity. The conditions under which courts can lift the veil to set a clear picture of the events. There is no single principle which goes in line with the order of the court. The courts do not pierce the corporate veil just to remove limited liability but courts lift only if they find any wrongful activity committed by the company. Piercing the corporate veil does not constitute a rebuttal of the values of the economic body, but a manifestation of lack of faith in shareholder barons and their professional management. This is demonstrated in the corporate debacles of the directors of Enron and WorldCom, where shareholders were kept accountable for corporate offences.

The principle of lifting the corporate veil is not necessary for any conduct of bright line assessment. For years, courts have faced the difficulty to achieve the growth and stability to refine their evaluation of these assumptions. Each new behaviour, however, brings into the equation a different set of facts and conditions. It is appropriate to make a separate

decision as to whether the complainant has adduced ample proof of control and oppression, inappropriate motive or use and subsequent harm. The decision whether to lift the veil can be endorsed. It can be based on the expert's independent opinion. Testimony of the expert would be of great use when it comes to the trier of fact in deciding whether the corporation was sufficiently capitalised for its intended intent. Finally, what matters is whether to disregard the separate entity principle will be based upon several balancing factors or some of the factors but which may not be adequate to lift the corporate veil.

It has been observed, after going through several decisions passed by the court that it has exercised wide discretion in order to determine about a specific event whether to lift the veil or not in order to impose the liability on the participants. Being conscious of the fact that the primary purpose of the corporate law should be to create certainty and stability but this has led to unpredicted events and instability which has led to the piercing of the corporate veil.

Now after going through so many cases and circumstances under which court has pierced the corporate veil one thing has become very clear that incorporation is not the ultimate means to avoid the personal liability. Therefore, the existence of the principle of separate legal entity would be entertained only till the time the corporation is following the policies. At times it has happened that courts have collected the evidence and have transferred the liability on to shareholders. Therefore, it has been found that courts have at different times given references to several principles. They have used it frequently without having much knowledge on it and thus it displays the courts wide discretion on whether to pierce the veil of the corporate or not and it depends case wise.

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