pISSN: 2454-7107, eISSN: 2455-4189

Indian Journal of Law and Human Behavior
Volume 4 Number 2, July - December 2018
DOI: http://dx.doi.org/10.21088/ijlhb.2454.7107.4218.3

Original Article

Study of Doctrine of Corporate Veil and Effects of Piercing in to Corporate Veil

R. Dinesh Kumar

Author Affiliation
Student, Vels School of Law (VISTAS), Pallavaram, Chennai, Tamil Nadu 600117, India.

Corresponding Author
R. Dinesh Kumar
Student, Vels School of Law (VISTAS), Pallavaram, Chennai, Tamil Nadu 600117, India.

E-mail: rkddineshkumar997@gmail.com

Received on 31.07.2018
Accepted on 17.09.2018

Abstract

Corporate personality has been described as the "most pervading of the fundamental principles of company law". It constitutes the bedrock principle upon which company is regarded as an entity distinct from the shareholders, it gives an independent corporate existence.Lifting or piercing the veil is corporate laws most widely used doctrine to decide when a shareholder and members will be held liable for obligations of the corporation. Lifting the veil doctrine exists as a check on the principle that, in general, investor shareholders should not be held liable for the debts of their corporation beyond the value of their investment. The doctrine of corporate veil serves as a secured system in protecting inner functions, however it's not rigid it can be lifted when there is a proven allegation on the company and its functions. The corporate evil is said to be lifted when the court ignores the company and concerns itself directly with the members or the managers. This paper talks about characteristics of corporate personality and effects of lifting the corporate veil.

Keywords: Corporate Personality; Corporate Veil; Bedrock Principle; Pervading Anddoctrine.

Introduction

Corporate personality has been described as the 'most pervading of the fundamental principles of company law". In common law a company is a legal person or legal entity, separate form and capable of function beyond its members which means a company can hold its own rights and duties. Corporate personality constitutes the bedrock principle upon which company is regarded as an entity distinct from the shareholders constituting it.

When a company is incorporated under companies act 2013 it is treated as a separate legal entity distinct from its promoters, directors, members, and employees; and hence the concept of the corporate veil, separating those parties from the corporate body, has arisen. However, a company can be considered as a separate personality only when its certificate of incorporation is issued. The certificate of incorporation bring company into legal existence.

Corporate veil is one of characters of corporate personality. The issue of "lifting the corporate veil" has been considered by courts and commentators for many years and there are instances in which the courts have negated from the strict application of this doctrine. This doctrine has been established for business and corporate world. In India its established in various sections of companies act 2013.

In the doctrine of 'Lifting the Corporate Veil', the law goes behind the mask or veil of incorporation to determine the real person behind the mask for the purpose of holding them liable. The concept of lifting the corporate veil is not a recent one, its lifted to find the actual truth inside the company and protecting right and liability of shareholders.

But for clarity as to 'Lifting of the Corporate Veil', an understanding of the corporate personality of a company is required. Various grounds for piercing of the corporate veil and elements of lifting of corporate veil analyzed through the lens of leading case laws.

Objectives of the Study

- To know about corporate personality and its advantages.
- To study about doctrine of corporate veil and piercing of corporate veil.
- To know role of judiciary in piercing of corporate veil.

Hypothesis

Judiciary can lift the corporate veil to know inner functions of the company. Such powers are not limited and extent to any matters of company including fraud and tax related offences.

Corporate Personality and Advantages

The Term Company

The word company has no strict technical or legal meaning. The term company is mentioned under company act 2013 section 2 (20) means "company incorporated under this act or any previous company act" . In common law company is a legal person or legal entity separate from, and capable of surviving beyond the life of members thus, change in the members of the company will not affects functions of the company. In easy terms company can be said group of persons with common objectives and goals combinedly registered under any company act. The difference between company and partnership is that company as its own independent corporate existence but partnership has no such independent existence. Partnership is completely depending on its members for its existence and members of such partnership hold the liability. Partnership is nothing but collection of partners. A company must consider as separate legal persona which make its differentia from members of such company and to be a separate legal person which has capacity to hold property, to sue or to be sued, right to sell its shares and property and to get loan and money etc. Its due to its corporate personality.

Concept of Corporate Personality and Its Advantages

Independent Existence

The company gets its own corporate personality only when its registered or incorporated under any company act. Corporate personality make company distinct from it members who constitute it. As stated in section 9 of company act once the certificate of incorporation is issued the subscribers to the memorandum and other persons becomes body corporate capable of exercising all the functions of the incorporated company. Once the company is incorporated under section 7 of companies act, 2013 it capable of immediate functioning and acquires its own entity. Thus, the company acquires independent corporate existence and change in members does not affects the functions of the company.

The essential characteristic of a company is that it possesses a personality distinct from that of its members. This doctrine was first approved by the House of Lords in Soloman V Soloman & Co. Ltd. the facts of the case are as follows- One Mr. Soloman was the owner of a business which he turned in to a limited liability company. The other members of the company were his wife and children. The total number of issued shares were 20,007 of which Soloman took 20,001 shares and his family members took the remaining six. Soloman also took mortgage debenture to the amount of pound 1000 in part payment for the business. Later on the company became insolvent. The trial judge and the court of appeal held that the creditors had the prior claim to the assets since the company was a mere sham. The House of Lords reversed this, holding that the company was in law a person distinct from Soloman and that, therefore, Soloman was preferentially entitled to the assets as the secured creditors .

In Macaura v. Northern Assurance Co. Ltd . the House of Lords chose that back up plans were not at risk under an agreement of protection on property that was guaranteed by the offended party however claimed by an organization in which the offended party held all the completely paid offers. The House of Lords held that exclusive the organization as the different lawful proprietor of the property, and not the offended party, had the required insurable intrigue. The offended party, being an investor, did not have any lawful or advantageous enthusiasm for that property only due to his shareholding. In Lee v. Lee's Air Farming , the Privy Council held that Lee, as a different and particular element from the organization which he controlled, could be a worker of that organization with the goal that Lee's better half could assert remuneration for ailing spouse.

The decision of the Calcutta High Court in Kondoli Tea Co. Ltd, re. , seems to be the first on the subject. In this case certain persons transferred a tea estate to a company and claimed exemptions from Ad valorem duty on the ground that they themselves were the share-holders in the company and therefore it was nothing but a transfer from them to themselves under another name. Rejecting this, the Court observed that “the company was a separate person a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons”. In a number of other cases this principle has been recognized.

In Hobart Bridge Co. Ltd. v. FCT depending on the judgment by Lord Sumner in Gas Lighting Improvement Co. Ltd. v. IRC, Kitto. J compresses the position in the accompanying way:

"Between the financial specialist, who takes an interest as an investor, and the endeavor went ahead, the law forces someone else, genuine however manufactured, the organization itself, and the business carried on is the matter of that organization, and the capital utilized is its capital and not in either case the business or the capital of the investors”.

All the more as of late, the High Court in Industrial Equity v. Blackburn has held that the guideline works to keep a holding organization from treating a completely claimed auxiliary's benefits as its own. Along these lines, it can be seen that there has been, and still is, the most elevated specialist for the different new idea.

Nonetheless, thought must be given to the constraints of the different element guideline which totally precludes the viability from securing the corporate element as a legitimate individual separate from its originators, investors or administration. Judgements as ahead of schedule as the Salomon case have shown the acknowledgment of exemptions to the rule of partitioned substance by the courts. Acknowledgment of the different element is conceivable given there is "no misrepresentation and no organization and if the organization was a genuine one and not a fiction or myth."

As per Lord Denning in Littlewoods Mail Order Stores Ltd. v. IRC , joining does not completely "cast a cloak over the identity of a restricted organization through which the courts can't see. The courts can, and frequently do, pull off the veil. They hope to perceive what truly lies behind." "A company will be looked upon as a lawful substance when in doubt yet when the idea of lawful element is utilized to overcome open accommodation, legitimize wrong, ensure misrepresentation or protect wrongdoing the law will view the Corporation as relationship of individual.

The two huge reasons with reference to why special cases to the different element rule exist is that right off the bat, in spite of the fact that a company is a lawful individual, it can't generally "be dealt with like some other free individual." For instance, an organization is not equipped for carrying out a tort or a wrongdoing requiring verification of mens rea unless courts ignore the different element and decide the case.

Limited Liabilty

One of the main privilege of incorporating a company is limited liability. Limited liability is one of the advantages doing business under an established corporate form. The company, being a separate person, is the owner of its assets and bound by its own liabilities. Even when company went into dept the company itself made liable. Members of the company or owner of the company are not made liable because company is to consider as a fiction person. Sometimes the liability of the members is restricted to the nominal values of shares hold by them. As company has limited liability, the members are need not to contribute anything more than the nominal value of the shares. In a partnership, the liability of the partners are unlimited. Partners in a partnership are directly made liable for the dept occurred. Thus, limited liability becomes a greater advantages in running an company as mentioned by J. Buckley “ one of the primary and accepted motivations behind incorporation of company is to limit personal risk by obtaining the benefit of limited liability”.

Perpetual Sucession

An incorporated company never dies. Change in the members or management of the company does not affects the functions of the company. For instance, A and C are members of a company holding some shares of the company and shares may be transferred to some other persons. Therefore, becoming members of the company. However, it does not affect the functions and nature of the company. Members may come and go but the company can go on forever .

Thus, it also need to be understand that change in the membership or management including managing director does not affect or alter the liability of the company. Such change does not affect the continuity or its commercial or contractual relations and obligations .

Separate Property

Company as a legal person and capable of owning, enjoying and disposing of property in the company name and the company becomes owner of the assets and capital. A member or any one can't take interest over the property belong to company. The concept was well explained in macura v. northern assurance co ltd the facts are a person hold all shares of company except one. Company was running timber business. He insured timber in his own name. timber was destroyed by fire. The insurance company was not liable to pay as mentioned by the court that "No shareholder has right to any property or assets owned by the company, he has no legal or equitable interest".

Thus, incorporation helps company to maintain its property and distinguish from its members of such company. The property will be vested with company as a body corporate, change in members will not affect properties of the company.

Capacit to Sue and Financial Capacity

A company, being a body corporate, it has capacity to sue anyone and can be sued by anybody in its own name . The liability of the company can be sued only in the name of company but not on its members. The capacity to sue is not subjected to any restrictions it can act as a legal person in all legal matters including maters of criminal and defamation. This can be related to fiction theory of corporate personality which believes that company as fiction person and characteristics of the company are differ from members of company. Company as a legal person which is liable for its matters and can't be made liable for liability of its share holders and members of the company.

Company being a legal person it has capacity to borrow money from other institutions. It can lend money for its capacity from even by public subscriptions either by way of shares or debentures. The capacity of borrowing and giving securities is a exclusive privileges of the company. Capital is the important part of running company " no capital is the great misfortune were the development of company ceases or arrested".

Corpporate Veil and Its Effects

Its well-established principle that after incorporation a company becomes a legal person separate and distinct from its members. It has a corporate personality of its own with rights, duties and liabilities separate from those of its members and shareholders who constitute it. Thus, a veil of incorporation exists between the company and its members and due to this a company is not identified with its members. In order to protect themselves from the liabilities of the company, its members often take the shelter of the corporate veil. In a sense corporate veil one of biggest advantages in protecting internal functions of company. Sometimes this corporate veil is used as a vehicle of fraud or evasion of tax etc. To prevent unjust and fraudulent acts, it becomes necessary to lift the veil of the corporation or disregard the corporate personality to investigate the realities behind the legal façade and to hold the individual member of the company liable for its acts or liabilities.In many incidence court had removed the imaginary boundaries of the company for multiple reasons. "There are situation where the court will lift the veil of incorporation in order to examine the realities which lay behind".In State of U.P. V Renusagar Power Co., the court held that the concept of lifting the corporate veil is a changing concept. Its frontiers are unlimited. However, it depends primarily on the realities of the situation.

Grounds to Lift Veil of Corporate

Determination of the Enemy Character of A Company

In times of war the court is prepared to lift the corporate veil and determine the nature of shareholding as it did in the Daimler Co. Ltd. v. Continental Tyre and Rubber Co., where a company was incorporated in London for the purpose of selling German tyres manufactured by a German company. Its majority shareholders and all its directors were German. The English Courts held it to be an enemy company on lifting the veil and trading with this company was held to amount to trading with the enemy.

Revention of Fraud OR Improper Conduct

Where the medium of a company has been used for committing fraud or improper conduct, courts have lifted the veil and looked at the reality of the situation. The two classic cases of the fraud exception are Gilford Motor Company Ltd v. Horne and Jones v. Lipman . In the first case, Mr. Horne was an ex-employee of The Gilford motor company and his employment contract provided that he could not solicit the customers of the company. In order to defeat this he incorporated a limited company in his wife's name and solicited the customers of the company. The company brought an action against him. The Court of appeal was of the view that "the company was formed as a device, a stratagem, in order to mask the effective carrying on of business of Mr. Horne. "In this case it was clear that the main purpose of incorporating the new company was to perpetrate fraud." Thus the court of appeal regarded it as a mere sham to cloak his wrongdoings. In the second case of Jones v. Lipman a man contracted to sell his land and thereafter changed his mind in order to avoid an order of specific performance he transferred his property to a company. Russel J specifically referred to the judgments in Gilford v. Horne and held that the company here was "a mask which (Mr. Lipman) holds before his face in an attempt to avoid recognition by the eye of equity" he awarded specific performance both against Mr. Lipman and the company.

For Benefit of Revenue

The court has power to lift the individual character of the company. Such powers of is not subjected to any restrictions and even extent to revenue related matters of the company. Sometimes company uses its individual character to get illegal revenue benefits, where it become duty of court to interfere. In dinshawmaneckjee petit such incident has happened, in this case the assesses was a wealthy man enjoying huge benefit. He formed four individual company. He showed wrong income in his company to enjoy illegal tax exemption, where court went beyond Independent character of companies to find out any allegations.

Doctrine of Lifting of Corporate Veil Perspective in Taxation Cases

The doctrine of piercing or lifting of the veil of a Corporate Personality makes a change in the attitude of law as originally adopted towards the concept of separate legal personality or entity of the corporation. In Ansuman Singh v. State of U.P. , the court held that in suitable cases, the court will lift the corporate veil. It may happen that the corporate personality of the company is used to commit frauds or improper or illegal acts like tax evasion. Thus, the concept of piercing or lifting the corporate veil holds significance. A corporate veil may be pierced either through statutory provisions or by judicial interpretation. Piercing the corporate veil in taxation matters is an outcome of judicial decisions. The court has the power to disregard the corporate entity if used for tax evasion or to circumvent tax obligation.

The veil has also been lifted after finding that a corporation is merely an adjunct, business conduit or alter ego of another corporation or person. When the veil is pierced, the other entity, or the directors, officers, stockholders or members of the corporation, could be held solitarily and personally liable for corporate obligations .

In Vodafone International Holdings BV v. UOI Hutchinson International (non-resident company) held 100% shares of CGP Investments Holdings Ltd. (non-resident company) which in turn held 67% shares in the Indian company Hutchinson-Essar. The question which arose was, whether the income accruing to Hutchinson as a result of the transaction could be deemed to accrue or arise in India by virtue of Sec. 9 of the Income Tax Act. In Vodafone, the High Court answered all issues against Vodafone. However, final and concrete conclusions cannot be drawn as the judgment was not dealing with the taxability of the transaction.

In Santanu Ray v. UOI, it was held that in case of economic offences the court is entitled to lift the corporate veil and pay regard to the economic realities behind the legal façade. The court held that the veil of corporate entity could be lifted by the adjudicating authorities so as to determine as to which of the directors were concerned with the evasion of excise duty by reason of fraud, concealment or wilful misstatement or contravention of the provisions of the Act.

In the case of Richer Holding Ltd. (RHL),the issue before the High Court was whether RHL was obliged to withhold tax on the consideration paid for acquisition of 60% of the shares in a UK company that held a majority stake in an Indian Company. The High Court rejected the petition filed by RHL against the show cause notice by the Tax Authority since it was premature it was premature at this stage to arrive at a conclusion that there is no avoidance of tax obligations and RHL was not liable to tax on capital gains. The High Court also observed that it may be necessary for the Tax Authority to lift the Corporate Veil as well as examine the extent of powers the majority shareholder had in the interest/assets of the Indian Company to look into the real nature of the transaction.

Conclusion

Corporates play an indispensable role in shaping economy of the country. It ensures various business and infrastructural development by carryingbusiness and providing employment to people of the country etc. constitution of India ensures independent functions of company in the nation apart from this, company after incorporation gets its own corporate existence which give need to consider as separate legal persona which separate it from members and others who constitute it. It results in reduction in liability of members of the company. Its right to say companies are surrounded by an invisible wall or boundaries protecting the internal functions of the company and protecting its members from its liability. Such exception most of times lead multipleallegations of the companies in India such incidence is in increasing number, however court played great role in protecting the rights of shareholders of company and investors, by lifting individual corporate personality of company, its possible for court to decide actualliability of company. By widening the boundaries of lifting of corporate veil its made possible for judiciary to interfere and investigate various allegations of company such tax matters, shares and misappropriation of resources and members. Lifting the veil doctrine exists as a check on the principle that, in general, investor shareholders should not be held liable for the debts of their corporation beyond the value of their investment.

References

1. Hahlo and Trebilcock, Hahlo's Case book on Company Law, 2nd edition, p.42.
2. Eastern book company's Company Law, Avtar singh, 16th edition, p.37.
3. Lexis Nexis, the companies act 2013 with rules and forms, 4th edition, p.42.
4. Bacha F Guzdar v. CIT, AIR 1955 SC 74: (1995) 25 Comp case1.
5. Bond la review, separate legal personality: legal reality and metaphor, Nicholas James, p. 3.
6. Eastern book company's Company Law, Avtar singh, 16th edition, p.5.
7. Soloman V Soloman& Co. Ltd [1897], AC 22.
8. Macaura v. Northern Assurance Co. Ltd., 1925 AC 619 (HL).
9. Lee v. Lee's Air Farming Ltd., 1961 AC 12 (1960) 3 WLR 758.
10. Kondoli Tea Co. Ltd, re, ILR (1886) 13.
11. Hobart Bridge Co. Ltd. v. FCT, (1951) HCA 33; 82 CLR 372.
12. Industrial Equity v. Blackburn (1977).
13. Eastern book company's Company Law, Avtar singh, 16th edition, P.13.
14. Littlewoods Mail Order Stores Ltd. v. IRC, (1969) 1 WLR 1241.
15. JH Rayner Ltd v. deptt. Of trade and industry, (1990) 2 AC 418: (1989) 3 WLR 969 (HL).
16. London and Globe Finance corporation Ltd, re, (1903) 1 Ch 728, 731.
17. Gopalpur Tea Co Ltd v Peshok Tea Co Ltd..
18. Punjab National Bank v. Lakshmi Industrial and Trading Co (p) Ltd, AIR 2001, 28.
19. RT Perumal v John deavin, AIR 1960,
20. Macaura v. Northern Assurance Co. Ltd., 1925 AC 619 (HL).
21. Union bank of India v. Khaders International Construction Ltd, (1993).
22. PALMAR PRIVATE COMPANY 42nd EDTITION (1961) 25-26.
23. State Of U.P. And Ors vs Renusagar Power Co. And Others, 1988 AIR 1737, 1988 SCR Supl. (1) 627.
24. Daimler Company v Continental Tyre [1916] 2 AC 307.
25. Gilford Motor Co Ltd v Horne [1933] Ch 935.
26. Jones v Lipman [1962] 1 WLR 832.
27. dinshawmaneckjee petit, 1926.
28. Anshuman Singh vs State Of U.P, AIR 2004 All 260.
29. http://www.legalserviceindia.com/articles/corporate.htm, 12/10/2017, 11:30 AM.
30. Eastern book company's Company Law, Avtar singh, 16th edition, P.47.
31. Ibid, p.43.
32. https://www.lawteacher.net/free-law-essays/business-law/article-on-lifting-of-the-law-essays.php, 14/10/2017, 11:43 AM.
33. Santanu Ray vs Union Of India, 1989 65 CompCas 196 Delhi.