



# A Descriptive Study of the Doctrine of Lifting of Corporate Veil

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## ABSTRACT

*From the juristic point of view, a company is a legal person distinct from its members [Salomon v. Salomon and Co. Ltd. (1897) A.C 22]. This principle may be referred to as the 'Veil of incorporation'. The courts, in general, consider themselves bound by this principle. The effect of this Principle is that there is a fictional veil between the company and its members. That is, the company has a corporate personality which is distinct from its members. But, in a number of circumstances, the Court will pierce the corporate veil or will ignore the corporate veil to reach the person behind the veil or to reveal the true form and character of the concerned company. The rationale behind this is probably that the law will not allow the corporate form to be misused or abused. In those circumstances in which the Court feels that the corporate form is being misused, it will rip through the corporate veil and expose its true character and nature disregarding the Salomon principal as laid down by the House of Lords. Broadly there are two types of provisions for the lifting of the Corporate Veil- Judicial Provisions and Statutory Provisions. Judicial Provisions include Fraud, Character of Company, Protection of revenue, Single Economic Entity etc. while Statutory Provisions include Reduction in membership, Misdescription of the name, the fraudulent conduct of business, Failure to refund application money, etc. This article at first introduces to the readers the concept of "Veil of incorporation", then it explains the meaning of the term-'Lifting Of The Corporate Veil', it then points out the Judicial as well as the Statutory provisions for Lifting of The Corporate Veil with the help of various case-laws.*

**Keywords:** *Veil of Incorporation, Judicial Provisions, Statutory Provisions.*

## 1. INTRODUCTION

Incorporation of a company by registration was introduced in 1844 and the doctrine of limited liability of a company followed in 1855. Subsequently in 1897 in Salomon v. Salomon & Company, the House of Lords effected these enactments and cemented into English law the twin concepts of the corporate entity and limited liability. In that case, the apex Court laid down the principle that a company is a distinct legal person entirely different from the members of that company. This principle is referred to as the 'veil of incorporation'.

The chief advantage of incorporation from which all others follow is the separate entity of the company. In reality, however, the business of the legal person is always carried on by, and for the benefit of, some individuals. In the ultimate analysis, some human beings are the real beneficiaries of the corporate advantages, "for a while, by the fiction of law, a corporation is a distinct entity, yet in reality, it is an association of persons who are in fact the beneficial owners of all the corporate property." And what the Salomon case decides is that 'in questions of property and capacity, of acts done and rights acquired or, liabilities assumed thereby...the personalities of the natural persons who are the companies corporates are to be ignored"

## 2. MEANING

### The lifting of Corporate Veil

After the incorporation, a company becomes 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 individual members. 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 liabilities of the company, its members often take shelter of the corporate veil. Sometimes this corporate veil is used as a vehicle of fraud or evasion of tax and statutory provisions. To prevent unjust and fraudulent acts, it becomes necessary to lift the veil or disregard the corporate personality to look into the realities behind the legal facade and to hold the individual members of the company liable for its acts or liabilities.

## 3. OBJECTIVE OF THE STUDY

- To provide a basic understanding of the topic lifting of the corporate veil.
- To substantiate the case study.

#### 4. SCOPE OF THE STUDY

The corporate veil is initiated by the government to help the company and its members to defend from various problems. We have found that this study is directed to analyses the problems and drawbacks on the corporate veil. We determine the actual drawbacks existing on the selected cases in this study may facilitate the legal entities, various corporate and shareholders. This study will focus on deduction the reasons on the lifting of the corporate veil.

#### 5. RESEARCH METHODOLOGY

- The study that we made is a descriptive study.
- Descriptive study is used to describe characteristics of a population or phenomenon being studied. It does not answer the question about “how, when, and why the characteristics occurred”. Thus, descriptive research cannot a relationship, where one variable affects another.
- As a descriptive study, we have taken some cases on the topic corporate veil.

#### 6. REVIEWS ON CORPORATE VEIL

##### 1. C.A. Sandeepkanoi: Lifting of Corporate Veil, 21/5/2017, on the Article Tax Guru.

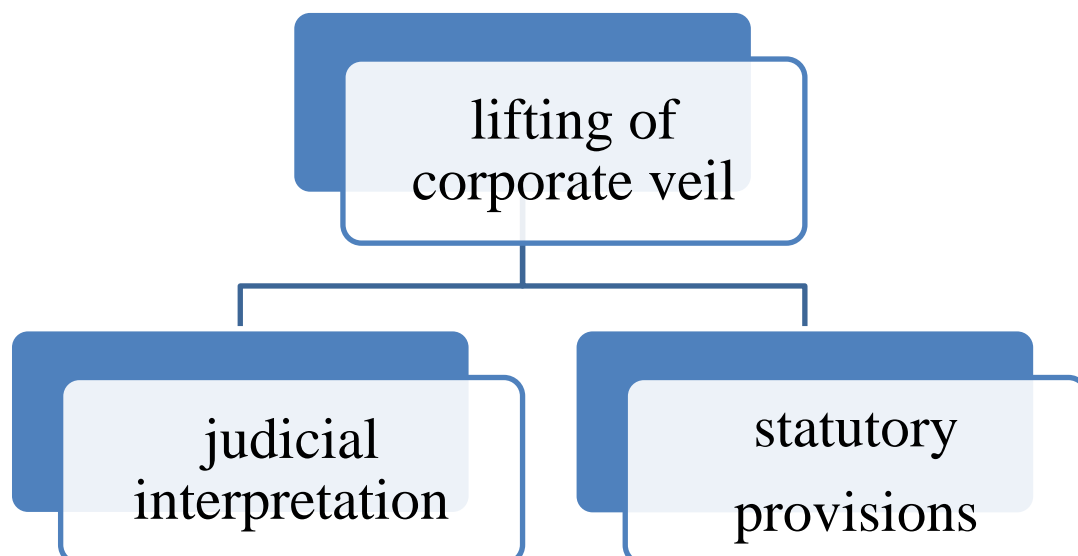
In cases where it is established that an individual or other entities have used a corporate form for a wrongful purpose; to perpetuate a fraud; circumstance a statute or some other misdeeds, the court may decide to ignore the corporate personality and hold the directors, shareholders/officers responsible for the obligations of the corporate entity, however, as stated earlier, in the facts of the present case, there is no grand to disregard the corporate form of UEIT, in view of above, the petition is allowed & the impugned award to the extent that the petitioner is held liable for the awarded amounts, is set aside. The parties are left to bear their own costs.

##### 2. Bello & Nrichel: Piercing the Veil of Business Incorporation; June 2014, on the Article American Research Institute for Policy and Development:

The article has explained that the concept of lifting the veil of incorporation in an age long corporate rule spanning at most 2 centuries going by the decision. It is enunciated in this article that the sanctity of a business corporation rests on the veil of its incorporation without which the company is prone to corporate assault & litigation from all & sundry by incorporation, therefore, a veil may be said to be drawn between persons dealing with a company & its members, so that direct proceedings may not generally be taken against their members themselves. Just like 3rd party cannot proceed against the members by ignoring the members by the company, he may be similarly unable to proceed against the company through the medium of one of its members too.

##### 3. Vasundhara Majithia, Yamini Rojora: Lifting of Corporate Veil; April 8 2015, on the Articles Academike – Articles on Legal Issues.

The fundamental attribute of corporate personality, from which all other consequences flow if that the corporation is a legal entity distinct from its members. This doctrine has been established for business efficacy, necessity, and convenience. In the doctrine of ‘lifting the corporate veil’, the law goes behind the mask of a company. It is one of the most widely used doctrines to decide when a shareholder or shareholders will be held liable for obligations of the corporation and continues to be the most litigated and most discussed doctrines in all of the corporate law. Therefore, a study of the same through the lens of leading case laws and judgments as done by the author would be highly beneficial.



### The lifting of Corporate Veil under Judicial Interpretation:

**1) Determination of Character:** The Corporate veil has been lifted by the courts to determine the enemy character of a company in a time of war. The court will lift the veil for the purpose of finding out the person who in reality controls the company's affairs and if the affairs of the company are found to have been controlled by enemy aliens, it will assume the enemy character.

**2) Determination of Residence for Tax Purposes:**

The determination of the residence of a company is important for tax purpose also because the assessment is usually made on the basis of its residential status. A company is usually considered to be residing at the place where its central management and control is situated. The court may lift the veil to find out the place where its central management and control is situated and generally the place will be that where the meetings of the Board of directors are held. According to S.6 (3) of the Indian Income Tax Act, 1961, a company is said to be resident in India in any previous year if:

- (i) It is an Indian Company, or
- (ii) During that year, the control and management of its affairs are situated wholly in India. For this purpose, the expression "control and management" means de facto control and management and the place of the control and management of the affairs of a company is the place where the meetings of the directors are held.

**3) Fraud and Evasion of Contractual Obligation:**

The corporate existence cannot be used as vehicles of fraud. Wherever the corporate existence is used for fraudulent purpose as to defraud creditors or to avoid legal obligation, the courts will lift the corporate veil to see the realities behind it and strike down the transaction.

**4) Evasion of Statutory Provision –Inference of Agency to prevent it:**

Where a company is acting as agent for its shareholder, the shareholders will be liable for the acts of the company. It is a question of fact in each case whether the company is acting as an agent for its shareholders. There may be an Express agreement to this effect or an agreement may be implied from the circumstances of each particular case. In the case of F.G. Films Ltd., Re, An American company financed the production of a film in India in the name of a British company. The president of the American company held 90 per cent of the capital of the British company. The Board of trade of Great Britain refused to register the film as a British film. Held, the decision was valid in view of the fact that British company acted merely as he nominee of the American Company.

**5) Trustees:**

As a general rule, a company does not hold its property on trust for its members or for another company but in some exceptional cases the court avoided the general rule and held a company acting as a trustee for its members or another company. Thus, the concept of trust has also been used by the courts as a device to lift the corporate veil.

### The lifting of Corporate Veil under Statutory Provisions:

**1) Reduction of the Number of Members:**

If at any point of time the number of members of company is reduced below the minimum number i.e. (seven in case of public company and two in case of private company) and the company carries out the business for more than six month then all the members of the company at that point of time will be held liable for the payment of company's debts contracted during that time.

**2) Misrepresentation:**

According to the section 62 & 63 of The Indian Companies Act, 1956 if there is a misrepresentation in a prospectus then Promoter, Directors and every other person who is authorized to issue such prospectus will incurs the liability toward those people who have subscribed for share on the faith of the untrue statement.

**3) Failure to Return Application Money:**

When a company fails to receive a minimum subscription, then it must refund the entire application money within 10 days. However, if the company fails to return the application money within 10 days then the company has to refund the same with 6% interest per annum.

**4) Misdescription of the Name:**

When any officer of the company signs on the behalf of the company any contract, promissory note or cheque, then such person is liable to the holder if the name of the company is not mentioned properly or it is not mentioned at all.

**5) Holding and Subsidiary Company:**

A holding company is required to disclose to its members the accounts of its subsidiaries. Sec. 212 of the Indian Companies Act, 1956 provides that every holding company is required to attach to its balance sheet, copies of the balance sheet, profit, and loss account etc., in respect of each subsidiary company.

## **Recent Cases on Lifting of Corporate Veil**

The landmark case of Vodafone International Holdings BV v Union of India was a reconciliation of the cases of Commissioner of Inland Revenue v His Grace the Duke of Westminster and WT Ramsay v Inland Revenue Commissioner which concluded that if the taxpayer has used colourable devices or resorted to dubious methods to minimize tax then the revenue authorities have every right to lift the corporate veil. India's tax authorities had raised a \$2.2-billion bill on Vodafone, British mobile company after Hutchison, a joint venture in India with Essar sold the shares of a foreign company, Cayman Islands Co. to Vodafone, on the ground that the company had to pay capital gains tax as the deal-making involved an Indian asset. Finally, on appeal, the Supreme Court ruled in Vodafone's favors, interpreting the law as it is today, concluding that the income-tax law does not use the word 'indirect transfers' and, hence, cannot be interpreted to cover such transfers of capital assets or property situated in India.

In paragraph 66 of the Vodafone case, the Chief Justice suggested lifting of the corporate veil wherever and whenever possible. He affirmed that “a subsidiary and its parent are totally distinct taxpayers” and that would hold good even if a parent exercises substantial control over the affairs of its subsidiary. Further in paragraph 67, he gives exceptions in cases where the decision-making is “fully subordinate” to the holding company or if the parent company makes an “indirect transfer through abuse of legal form and without reasonable business purpose”.

Even Sudhir Chandra, Former Chairman, Central Board of Direct Taxes, agreed that Vodafone’s case was classically the right case for lifting the “corporate veil,” for levying taxes. As a response to the Vodafone case, various retrospective amendments in the Finance Bill, 2012 were triggered, to handle taxation of international transactions associated with Indian assets. It had given rise to such a situation that a retrospective amendment is indispensable and fair in such a situation.

If a company has done legitimate tax planning, it is unjust to hold it illegitimate or illegal or impermissible merely because tax is minimized, further, it has been held that where the taxpayer has arranged its affairs through the use of colourable device or by resorting to dubious methods and subterfuges to minimize tax then the revenue authorities have every right to lift the corporate veil.

In a recent case of Kotak Mahindra Bank Limited v Subhiksha Trading Services Limited, 18 Kotak Mahindra Bank was asking for winding up of Subhiksha after it failed to repay a loan of Rs 35 crore with interest. Since Subhiksha failed to prove how it suffered losses of Rs 800 crores due to the global financial crunch, Kotak's counsel, Mr. H. Karthik Seshadri, submitted that, the conduct of Mr. R. Subramanian (Managing Director of Subhiksha) required a detailed investigation by lifting the corporate veil as there were a reasonable grounds to believe that he has “willfully” transferred the company's assets to entities such as Cash and Carry Wholesale Traders Pvt. Ltd., Custodial Services India, Pentagon Trading Services, Shevaroy Holiday Resorts and Triad Trading Services, which are controlled by Mr. Subramanian(59%) along with a few others.<sup>19</sup> The Court in this case rightly upheld the winding up request made by Kodak and in my opinion; it is a fit case of lifting of corporate veil because of fraudulent conduct of Mr.Subramaniam which was deliberately done with knowledge with an intention to defraud creditors by not paying borrowings and loans.

## **7. CONCLUSION**

The doctrine of piercing the corporate veil is not subject to any bright-line tests. Courts have struggled for years to develop and refine their analysis of these claims. However, each new action brings a different set of facts and circumstances into the equation and a separate determination must be made as to whether the plaintiff has adduced sufficient evidence of control and domination, improper purpose, or use and resulting damage. The decision whether to pierce the corporate veil may be assisted, at least in part, upon the opinion of qualified experts. In particular, expert testimony would be helpful to the trier of fact in determining whether the corporation has been adequately capitalized for its intended purpose. Ultimately, however, the judgment whether to disregard the corporate entity will be based upon a balancing of various factors all or some of which are necessary but may not be sufficient to pierce the veil.

## **8. REFERENCE**

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