

## PIERCING OF CORPORATE VEIL: AN OVERVIEW

---

**Muzakkir Khan\***

### ABSTRACT

*When a company is incorporated, it is vested with certain characteristics such as a separate legal persona existing independent from its members, limited liability, perpetual succession, etc. However, such advantages of the corporate veil and limited liability shall not be applicable in case of illegitimate use of such privileges. To overcome such abuses Doctrine of Piercing of Corporate Veil is introduced. In the 'doctrine of Corporate Veil', the law lifts the mask or veil of incorporation to recognize the real person behind the veil for the purpose of holding them personally liable. The article delves into the Doctrine, its characteristics, and case laws.*

**Keywords:** Corporate Veil, Distinct Legal Entity, Incorporation, Company, Limited Liability.

### INTRODUCTION

The origin of corporations is traced back to the 17<sup>th</sup> century. Initially, the corporations worked for monarchs as well as investors. Joint stock companies need to get permission through a royal charter. Since then, so many changes occurred globally. Incorporated companies take advantages as compared to other business organizations. One of the most profound advantages is independent corporate existence. An increase in corporate fraud results in the piercing of the corporate veil of the company. The concept was first introduced in the case *Solomon v Solomon & Co Ltd* of 1897<sup>1</sup>. In India, once the business is incorporated as per the provisions of the Companies Act 2013, it becomes an independent corporate existence and its members shall be a body corporate, which is based on the theory of legal fiction.

### CORPORATE PERSONALITY

The most important feature of a company is its corporate existence. Contrary to this, the partnership doesn't have an independent existence apart from its members as it is nothing but the collection of the partners<sup>2</sup>. By incorporation under the Act, the company has adopted the corporate personality that is a distinct legal entity that is separate from its members. The House

---

\*BLS LLB, FOURTH YEAR, MUMBAI UNIVERSITY, MUMBAI.

<sup>1</sup> *Solomon v Solomon & Co Ltd*, [1897] AC 22 (HL).

<sup>2</sup> *Bacha F Guzdar v CIT*, [1955] AIR SC 74

of Lords in the landmark case of *Solomon Co.* Case adopted this doctrine. The court held that a company is a distinct legal entity separate from its members. It becomes impersonalized, as no one can be the owner of the company. The business now belongs to an institution. The Company can sue and be sued. The veil of incorporation does not mean the company's internal affairs would be hidden. Now here the doctrine of lifting of corporate veil comes into the picture.

### **LIFTING THE CORPORATE VEIL**

One of the merits of incorporation is a separate legal entity of the Company. However, the legal person who is benefitting from this business carries out the business. At last, some legal persons are real beneficiaries of the corporate personality, "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".<sup>3</sup> The Court held 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 company's incorporators are to be ignored".<sup>4</sup> There are more than a few instances in which the court pierce the corporate veil. A landlady's bid to regain tenanted premises for self-business could not succeed as the business was in the name of her company.<sup>5</sup> In a case where a company acquires a majority of the shares and the assets of another company.<sup>6</sup> In the case of *Lee v Lee's Air Farming Ltd*, Lee incorporated a company became its managing director, and was appointed as the pilot of the company. While during the business of the company, he was lost in a flying accident. His widow was compensated under the Workmen's Compensation Act. "In effect, the magic of corporate personality enabled him to be the master and servant at the same time."<sup>7</sup>

The Doctrine of Corporate personality has its limits. There are situations in which Courts are bound to lift the corporate veil and recognize the company by its members. "There are situations where the court will lift the veil of incorporation in order to examine the 'realities' which lay behind. Sometimes this is expressly authorized by the statute... and sometimes the court will lift of its own volition."<sup>8</sup> In *State of Karnataka v Selvi J. Jayalalitha*,<sup>9</sup> The Supreme

<sup>3</sup> *Gallagher v Germania Brewing Co*, [1893] Minn 214.

<sup>4</sup> Lord PARKER in *Daimler Co Ltd v Continental Tyre & Rubber Co Ltd*, [1916] UKHL 845.

<sup>5</sup> *Turnstall v Steigmann*, [1962] 2 QB 593

<sup>6</sup> *Spencer & Co v CWT*, [1969] AIR Mad 359.

<sup>7</sup> Gower, *Principles of Modern Company Law* (3<sup>rd</sup> Edn 1969) 202.

<sup>8</sup> John P. Lowry, "Lifting the Corporate Veil" (1993) JBL 41

<sup>9</sup> *State of Karnataka v Selvi J. Jayalalitha* [2017] Comp Cas 230 SC

Court held that the company is a distinct legal entity except in the situation where the corporate entity is a mere cloak, or sham used to misdirect shareholders and authorities. The court held that “where the sole responsible person in the company is the defendant himself, it would not be right to say that there were two persons or two minds.”<sup>10</sup> In such case, the Solomon principle will not be considered and the corporate veil shall be lifted. The doctrine will be applicable in case of tax evasion and execution proceedings.

## **GROUND FOR PIERCING OF CORPORATE VEIL**

The corporate veil will be lifted from the company on several grounds.

**Determination of character:** The court has to pierce the corporate veil in order to determine the character of the company. To recognize whether the company is owned by an enemy country. In the case of *Daimler Co Ltd v Continental Tyre & Rubber Co Ltd*<sup>11</sup>: A German tyre manufacturing Company incorporated a company in England to sell German-manufactured tyres. Germans held the majority of the key positions. The English company was in the hands of German. The company commenced an action to recover the trade debt. The House of Lords held that, however, the company is a legal person. It may be considered as an enemy character on the occasion when the company is in control of residents of the enemy country.

**For the benefit of revenue:** The court disregards the corporate entity on tax evasion or to circumvent tax obligation. In the case of *Dinshaw Maneckjee Petit, re*<sup>12</sup> The assessee formed four private companies. Revenue generated by the company returned back to him as a pretended loan. This way he divided his income to reduce tax liability. The court held that the assessee formed the company for the sole purpose of avoiding super-tax. The company did no business rather it was formed to receive profits in the name of a pretended loan.

**Fraud or improper conduct:** The court will refuse to uphold the distinct legal existence of the company if it is formed to defeat or circumvent the law, to defraud creditors, or to avoid legal obligations. The corporate veil will be pierced in cases of fraud, misrepresentation, and diversion of funds.<sup>13</sup> In the case of *Gilford Motor Co Ltd v Horne*,<sup>14</sup> the defendant was appointed as the managing director of the plaintiff company. Under the employment

<sup>10</sup> *R v McDonnell*, [1966] 1 QB 233.

<sup>11</sup> *Daimler Co Ltd v Continental Tyre & Rubber Co Ltd* [1916] 2 AC 307 (HL).

<sup>12</sup> *Sir Dinshaw Manockji Petit v Commissioner of Income-tax* AIR [1927] Bom 371.

<sup>13</sup> *Atul, Gupta v Trident Projects Ltd*, [2010] 153 Comp Cas 474.

<sup>14</sup> *Gilford Motor Co Ltd v Horne* 1933] Ch 935 (CA)

agreement, the company put a non-solicit clause. Shortly after he opened a company that solicited the plaintiff's customers. The court held that the defendant's company was a mere sham for the purpose of soliciting the plaintiff's customers. Hence, the defendant company shall be restrained from carrying on business.

**Government companies:** President Roosevelt<sup>15</sup> once said, "Concentration of economic power in all-embracing corporation ... represents private enterprise become a kind of private Government which is a power unto itself- a regimentation of other people's money and other people's lives." When a company is considered an agent or trustee of its members or of another company, it will lose its corporate personality. This applies to the government companies who are incorporated under the Companies Act for taking advantage of corporate personality. A large number of private companies for commercial purposes have been registered under the Companies Act with the President and a few other officers as the shareholders.<sup>16</sup> The obvious advantage of forming a government company is that it gives the activities of the State "a little of the freedom which was enjoyed by private corporations and escaped the rules and principles which hampered action when it was done by a government department instead of a government corporation. In other words, it gave the Government some of the robes of the individual"<sup>17</sup>. Supreme Court assuring freedom has reiterated in different cases that a government company is not a department or extension of the state.<sup>18</sup> Hence, its employees are not civil servants.<sup>19</sup> No one can initiate prerogative writs against it.<sup>20</sup> In *Ram Singh v FCI Ltd.*<sup>21</sup> They held that "The company being a non-statutory body and one incorporated under the companies act there was neither a statutory nor a public duty imposed in it by a statute in respect of which enforcement could be sought by means of a mandamus.

In the case of *Som Prakash Rekhi v Union of India*,<sup>22</sup> The company in dispute arose out of the acquisition by the central government of the assets and business of *Burmah Shell*. The employee holding the rights to provident funds against the former company claimed them against the Government through a writ. The claim was resisted on the ground that the company is registered under the Companies Act and the writ cannot be issued a writ against a private

---

<sup>15</sup> Franklin D., *Roosevelt, Acceptance Speech, Democratic National Convention, 27-6-1936*

<sup>16</sup> Shradha Kumari, "Government Companies in India" (1957) *Indian Law Journal* 143.

<sup>17</sup> Thurman W. Arnold, *The Folklore of Capitalism* [1956] 193.

<sup>18</sup> *State Trading Corpn of India Ltd v CTO*, AIR [1963] SC 1811.

<sup>19</sup> *Praga Tools Corpn v CA Imanual*, SCC [1969] 1 SCC 585.

<sup>20</sup> *Heavy Engg Mazdoor Union v State of Bihar*, [1969] 1 SCC 765.

<sup>21</sup> *Ram Singh v Fertilizer Corporation of India Ltd*, [1980] 50 Comp Cas 553.

<sup>22</sup> *Som Prakash Rekhi v Union of India*, [1981] 1 SCC 449.

company. KRISHNA IYER J held against this contention. He laid emphasis upon the contention that the company had been vested in the central government and, therefore, it was considered a state company. He stressed that the law should not only go by the facts but also the nature and functions that undertaking performing.

### **STATUTORY PROVISIONS FOR LIFTING OF CORPORATE VEIL**

**Misdescription of the company:** Section 147(4) of the Indian Companies Act, 1956 makes liable the officer of a company or any person on its behalf who uses or authorizes the use of, any seal purporting to be a seal of the company whereon its name is not engraved in the manner. Such officer shall be liable with a fine which may extend to five hundred rupees, and shall further be personally liable to the holder of the bill of exchange, hundi, promissory note, cheque, or order for money or goods, for the amount thereof, unless it is duly paid by the company.

**Reduction of Members:** If any course of time, the prescribed requirement of members as per sec 3(1) decreased below its statutory requirement. Prescribed requirements should be filed within six months. Otherwise, the remaining members shall be liable for all the debts taken after the expiry of six months from the date of reduction.

**Misrepresentation in the prospectus:** Under sections 34 and 35 of the Act, every director, promoter, and every other person who is in charge of the issue of prospectus shall be held liable for such misrepresentation. There is civil and criminal liability for false representation in the prospectus.

**Fraudulent Trading:** On the winding up of the company, if any fraudulent business activities were carried out with the wrong intention. The director of the company will be personally liable irrespective of the limitation of liability for all debts.

**Ultra-Vires Acts:** Action beyond the powers of memorandum and articles of association of the company. The managing director and officials to do so will be personally liable for their acts.

### **CONCLUSION**

The doctrine of the corporate veil is subject to the facts and circumstances of the case. All matters are decided by taking into consideration the gravity of the case. In all circumstances,

entities cannot refuse individual liability. Whenever the members of the entity indulge in illegal activity or violate statutory provisions under the veil of corporate personality, the court is entitled to pierce and go beyond the corporate veil and penalize those individuals. There are circumstances under which courts shall lift the corporate veil such as agency, fraud, facade or sham, group enterprises, and unfairness, which are regarded to be the most curious premise under which the court of law would lift the corporate veil. With the increasing scams in the corporate world, the court lifted the corporate purdah in the course of execution proceedings in order to punish the real offenders.

