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Beyond the Curtain: Trailing the Judicial Approach on the Lifting of Corporate Veil in India

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ABSTRACT

After the much famous Solomon's case, the concept of corporate veil expanded throughout the length and breadth of different legal systems of the world. The Indian legal system, which has adapted much from the colonial masters and their laws, has significantly incorporated this concept and given way to further elucidation of this concept in the courts. The doctrine of corporate veil is inherently a mystical concept, whose application cannot be successfully contained within statutory boundaries. This has resulted in judicially established factors, where the corporate veil is applicable.

The judicially established factors are an inclusive list of some of the fundamental factors, which, according to the courts, mandate piercing through the famed, impenetrable shell of a company and bringing to book those human beneficiaries, who abuse this protection to accrue shady benefits without much accountability. There is a caveat that much of these factors are the results of courts' discretion, which, if not sufficiently guided, may cause unnecessary application of this concept.

Keywords: *Corporate Veil, Judicial factors, piercing the shell, corporate personality, Indian corporate law.*

I. INTRODUCTION

Corporate veil is an indispensable concept to company law. Based on the concept of distinct corporate personality of a company, corporate veil found its way into the corporate world through the landmark judgment of *Solomon*³ in which the court upheld the distinct personality of a company from that of the members constituting it who shall be only be liable to the extent provided in law.⁴

“Piercing/lifting the corporate veil” refers to a concept that provides an exception to the otherwise applicable distinct legal personality principle, enabling courts to pierce through the shell which protects the members of a company from liabilities and identify those members

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³ *Solomon v. Solomon*, [1896] U.K.H.L. 1 (India).

⁴ *Id.*

who are responsible for a particular action.⁵ It is a concept that ascertains the liability of the members of a company with respect to certain activities conducted under the name of the company to further motives that are not acceptable in law. As noted in the *Milwaukee*⁶, the application of the separate corporate personality principle is general in nature, and such application can be excluded in cases where a legal entity is being used as a tool to harm public policy or violate a law. In such a scenario, the legal entity will be regarded as “*an association of persons.*”⁷

The Indian jurisprudence on corporate veil is heavily inspired from the English law. But, with time and commendable judicial scholarship, the Indian jurisprudence on the “lifting of corporate veil” has developed immensely. The onslaught of huge scams such as the *Satyam* case pressed on the legislators and judges alike to consider strict application of “lifting of corporate veil” concept to prevent persons from employing companies as tools to further their illegitimate aims and ideologies.

The Companies Act 2013 does not explicitly use the term “corporate veil”, but offers plentiful provisions on the lifting of the same. For example, under Section 36 of the Act, any member of a company who induces any person to invest in the company shall be personally liable. Under Section 216 of the Act, the Central Government is authorised to appoint inspectors for the purpose of investigating and reporting matters pertaining to the company and its members so as to ascertain persons with real influence or control over the company.⁸ Section 448 of the Act punishes any person who furnishes falsified statements such as return, financial statement, etc or conceals any material fact.⁹

The decision to lift corporate veil requires an extensive inquiry into the facts of the present case. There may be circumstances when mere application of statutory provisions does not suffice, and courts have been in those circumstances quite a few times. It has been observed that there is no “unifying principle”¹⁰ for the lifting of corporate veil, and while statutory bodies and authorities may stipulate specific circumstances when the veil can be lifted, there still be many circumstances beyond what has been stipulated.¹¹ Hence, judicial developments

⁵ Ian M Ramsay & David B Noakes, *Piercing the Corporate Veil in Australia*, COMPANY AND SECURITIES L. JOURNAL, 19 (2001), http://www.celrl.law.unimelb.edu.au/files/dmfile/Piercing_the_Corporate_Veil1.pdf (last updated March. 25, 2021).

⁶ *United States v. Milwaukee*, 272 U.S. 713 (1927)

⁷ *Id.*

⁸ *Id.* at §§ 216.

⁹ *Id.* at §§ 448.

¹⁰ *Id.*

¹¹ *Id.*

regarding corporate veil have been plenty

When one peruses the judicial trends in corporate veil, it is not difficult to realise the relevance of piercing through the corporate shell in corporate governance. With an unfortunate surge in mismanagement and scamming schemes involving tax evasion, etc often operated by individuals under the name of a company, courts have taken it upon themselves to bring to book those who try evading the eyes of law by hiding behind a corporate curtain.

II. CORPORATE VEIL AND THE JUDICIARY

The jurisprudence on corporate veil, in principle, is settled: individuals must not benefit from the shell protection that the distinct corporate personality of a company offers to its members. The application of the concept requires investigation into a number of factors such as control of the respondent, harm caused, and improper purposes. The application of these factors may vary and one has to dwell into the facts and circumstances in the present case.

The Indian courts accept the six principles that have been laid down in *Ben Hashem*¹² case as follows;

- (i) ownership and control of a company do not suffice;
- (ii) the corporate veil cannot be pierced just because interests of justice so require;
- (iii) there must be a case of impropriety;
- (iv) the said impropriety must be connected to the exploitation of the nature of the company for the avoidance of any liability;
- (v) to justify piercing the corporate veil, there must be presence of control and impropriety, so as to employ the company as an instrument to provide a protective cover to such act impropriety.¹³; and
- (vi) Irrespective of the original intention of the incorporation of the company, the company has been used as a 'façade' to further an illegitimate transaction in a present case.¹⁴

Even prior to the *Ben Hashem* principles, the courts adhered to similar jurisprudence in determining the circumstances when veil can be lifted. The following discussion contains enumeration of many judicial trends in the development of the concept of corporate veil that show how the jurisprudence on corporate veil took shape:

¹² [2008] E.W.H.C. 2380 (Fam.) (U.K.).

¹³ *Id.*

¹⁴ *Id.*

(A) Tax Evasion and Non Payment of Revenues

There have been plentiful cases in which a Company was incorporated with the sole objective to utilize it as an instrument to forestall payment of revenues, or to evade taxes or to obstruct observance of its obligation.¹⁵ Perhaps, the most infamous use of corporate personality is in tax evasion and deviation of revenues for personal motives.

The case of *Dinshaw*¹⁶, in which the assessee was an affluent man who enjoyed handsome dividends as well as interest income, is a good case to start with. He had created four private companies and agreed with each to hold a block of investment as its agent. He put to use these companies to hold his income on his behalf and then hand it over to him in the form of an ostentatious loan.¹⁷ The court made an observation stating that the companies were not engaged in any business and their sole purpose was to hold dividends on behalf of the assessee until they were handed over to him in the form of ostentatious loans.¹⁸

The Supreme Court of India in *Tata Engineering*¹⁹, where the corporations petitioned together, claiming protection under Article 286 of the Constitution for non-imposition of tax on the sale or purchase of goods²⁰, held that the purpose behind lifting corporate veil is to prevent companies from achieving what they cannot achieve directly.²¹

In the case of *Bacha F. Guzdar*²² the court had pierced the corporate veil in which the plaintiff, a member of a tea company which was operating an agricultural business, obtained dividends and claimed that these dividends are agricultural income and hence, should be exempted from tax. The Supreme Court, however, rejected the claim stating that the agricultural income is that of the company, not the plaintiff's and the dividends obtained out of such income are not exempted from tax.²³

In *Saurabh Exports*²⁴, the Delhi High Court made the defendant liable even though he was not a director or shareholder of the company, and that the deposits were received in the name of the company. The court observed that the company was a mere family arrangement, and a business was being operated under its garb.

¹⁵ AVTAR SINGH, COMPANY LAW 16 (15th ed. 2007).

¹⁶ *Dinshaw Maneckjee Petit, Re*, A.I.R. 1927 Bom 371 (India).

¹⁷ AVTAR SINGH, *supra* note 17.

¹⁸ *supra* note 17.

¹⁹ *Tata Engineering And Locomotive Co. Ltd. vs. State of Bihar & Ors* , 1964 S.C.R. (6) 885 (India).

²⁰ *Id.*

²¹ *Id.*

²² *Bacha F. Guzdar vs Commissioner Of Income-Tax, Bombay* , A.I.R. 1955 S.C. 74 (India).

²³ *Id.*

²⁴ *Saurabh Exports v. Blaze Finance & Credits Pvt. Ltd* , [2006] 133 Comp. Cas. 495 (India).

(B) Companies Acting as Agents

Under general rules of law, a parent company and its subsidiary company are treated as separate entities, and one cannot be an agent of the other when there is no agency contract between them.²⁵ A mere fact that claims have been made against a subsidiary company would not automatically bring in the question of whether corporate veil should be lifted. The statutorily imposed distinction between parent company and subsidiary company can be set aside only when there exist circumstances that compel looking beyond the corporate veil. For example, one such circumstance could be when the nominees of a holding company exercises control on its subsidiary company, which is indicative of the latter being under material influence of the former.²⁶

There has to be certain level of agency involved, in which the court is able to identify that there is a principal i.e. the parent company on whose behalf the agent conducts business. A certain degree of 'control' must be exercised by the parent company over the subsidiary company. However, the determination of the character of 'control' is based on facts of the case. A dispositive criterion, as applied in the *Vodafone*²⁷ case, is whether there exists a managerial influence and control on the principal activities, and such influence should be such that the subsidiary cannot be considered to engage in its operations under the authority of its executive directors.²⁸ This test has been applied in a number of cases such as *Balwant Rai Saluja*²⁹ wherein the Supreme Court noted that while Air India exercises a certain extent of control over HCL this fact does not automatically mean that the latter's employees are essentially former's employees.³⁰

(C) Fraudulent and Improper Conduct

The unfortunate *Satyam* scam is a grim reminder that companies can be used tools for effectively hiding material facts and defrauding people for personal motives. In this scam, Ramalinga Raju, along with his confidants occupying top positions, was involved in defrauding a company of its funds and business opportunities by inflating profits in the company's financial statements. As a consequence, the health of Raju's companies was understood to be positive and many investors invested in the company, thinking that they would get high returns which, of course, they did not. Just like *Satyam* (though not as humungous as this), there have

²⁵ AVTAR SINGH, *supra* note 18, at 23.

²⁶ *Freewheels (P) Ltd., New Delhi v. Veda Mitra And Anr.*, A.I.R. 1969 Delhi 258 (India).

²⁷ *Vodafone International B.V. v Union of India & Anr.*, (2012) 6 S.C.C. 613 (India).

²⁸ *Id.*

²⁹ *Balwant Rai Saluja Anr. V. Air India Ltd. & Ors.*, (2014) 9 S.C.C. 407 (India).

³⁰ *Id.*

been many other cases where members of a company tried defrauding people associated with it in which the court unflinchingly lifted the corporate veil and brought to book those with malicious intents.

The English jurisprudence, on this point, is quite agreeably followed in India courts. For example, the observations in the case of *Horne*³¹ are popularly referred to. In this case, the court ruled that the company, in the present case, was created to serve as a “stratagem” to put a concealer on the underhand business activities in which EB Horne was involved³²—and this did not go down well with the Court.

In the sensational case of *Sahara*³³, the Securities Appellate Tribunal considered the question whether the corporate veil should be lifted. The Sahara group had argued against any such move to lift the veil, as it is separate legal entity different from its members and therefore, SEBI should not be allowed to exercise its power to lift corporate veil under the SEBI Act 1992.³⁴ The Tribunal noted that the SEBI Act authorises the SEBI to lift the corporate veil of a regulated entity so as to preserve and protect the interests of shareholders.³⁵ It was found that there is an individual director/promoter who, on the face of it, is found to be in complete managerial control of and exercising substantial influence over the companies in question. Such circumstances, therefore, makes it necessary that the SEBI lifts the veil to uncover the truth underlying the substance of the companies.

(D) Ascertainment of the Character of the Company

It is an absolute necessity to determine in what relation the members of a company stand against the company itself. The nature and constitution of a company are regarded as highly determinative factors to figure out who the true people are behind its actions. Thus, it becomes relevant to determine who runs the company, where all its members come from, the nationality of the members, place of incorporation, etc because presence of hostile members may indicate an unfavourable agenda which must be stalled from operating.

In *Daimler*³⁶, a case which is often relied upon in the Indian courts, the House of Lords decided to lift the corporate veil and held that a company cannot, itself, acquire an enemy status, but such character can be reflected on its operations through its members.

³¹ Gilford Motor Co. v Horne , [1933] Ch. 935 (U.K.).

³² *Id.*

³³ Sahara Assets management Co. Pvt. Ltd. V. Securities and Exchange Board of India, Appeal No. 428 of 2015 (India).

³⁴ *Id.*

³⁵ *Id.*

³⁶ Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd, [1916] 2 A.C. 307 (U.K.).

Taking into account the *Daimler* case, the Supreme Court in *State Trading Corporation of India*³⁷ noted that the question of ascertaining the enemy character of a company becomes material during wartime. It stated that the law of nationality becomes heavily operable during wartime to determine whether a particular entity is enemy in nature, and hence, companies of other nationalities cannot claim benefits which they, otherwise, enjoyed during peacetime. The aforementioned judicial trends are, under no circumstances, exhaustive in nature. The “corporate veil” jurisprudence has been growing with time and needs of the corporate world. Due to the availability of a plethora of English as well as American jurisprudence on this point, India courts did not start from scratch. However, Indian courts were able to shape the jurisprudence with the aid of their own creative interpretation, and now, we have substantial case laws which have given more structure and substance to corporate veil concept.

III. CONCLUSION

Ordinarily, the liability of shareholders is limited to the amount paid for shares in a company. The general principle of limited shareholder liability is a fundamental principle in the corporate law. A company is deemed to be separate from its members, and hence, has its own set of liabilities that cannot be imposed on its members. The underlying objectives of this principle are to further economic interests of the companies and prevent imposing extraneous burden on their members; however, there are and will always be miscreants who would try exploiting all avenues to abuse this protection.³⁸

Due to the rise in scams which inevitably resulted in losses to investors and indirectly to the economy of the nations, it became imperative to infuse some accountability on the part of the members of companies who were otherwise watching business run into shambles from behind the curtains without worrying a dime about anything. To cater to this problem, early legal principles on corporate veil developed in the form of case laws, particularly in the English legal system. The journey began with the famous *Solomon* case, and there seems to be no reason to halt it.

Corporate Veil identifies and accepts the distinct personality of corporate entities. It exists to further efficiency and good business, but it is not an absolute protective shell which will eternally guard members of the company. Legal systems have drafted and enforced stringent rules in the form of statutory provisions and case laws which ensure that companies are not used as tools to perpetrate acts or omissions that may impact investors and business. This,

³⁷ *State Trading Corporation of India Ltd. V. Commerical Tax Offcier & Ors* , 1964 S.C.R. (4) 89 (India).

³⁸ Douglas G. Smith, *Piercing The Corporate Veil In Regulated Industries*, GEORGE MASON UNIV. FILE:///I:/08-08%20PIERCING%20THE%20CORPORATE%20VEIL.PDF (last updated March. 25, 2021).

however, must be kept in mind that corporate veil should be pierced only under “exceptional circumstances”³⁹ and hence, the lifting of corporate veil is an “extreme remedy, sparingly used.”⁴⁰

In this paper, the researcher tried to enumerate areas where Indian courts have, often with the aid of English jurisprudence, tried refining the contours of the concept of “corporate veil”. The degree of emphasis given to the issue of accountability and transparency—which are amongst the pillars of corporate governance—make “lifting of corporate veil” more than just an act of finding who is who. It is a powerful tool in the hands of the courts to ensure that corporate entities do not conduct businesses in such way so as to put the interests of investors and businesses at stake—something that has an inevitable detrimental effect on the overall market of a country.

³⁹ Calvert v. Huckins, 875 F. Supp. 674, 678 (E.D. Cal. 1995).

⁴⁰ *supra* note 20.