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**LIFTING THE CORPORATE VEIL UNDER COMPANY LAW: AN
ANALYSIS**

- Tanu Rajput, Kavya Singh & Aayushi Shukla¹

Abstract

We often discuss how a 'company' is treated as a 'person' in the eyes of law. A company is an artificial person as it is a human of its kind. It is a mandate which provides various kinds of information such as the motive behind the corporation of the company, number of directors and managing directors, rules of the company, number of employees & departments, etc. In legal terms, a company is a person but it remains a company in another sense. The company is not real but a juristic person in nature. The company's personality differs from that of its subscribers, promoters, directors, employees, and other members. The relation between the company's personality and the member's personality is the protection added to which the former gives the latter.² The company's personality acts as a blind screen that hides its members under its blindness, which is being taken advantage of by committing the illegal act. This paper will define the various phenomena and aspects of the doctrine of the lifting of the corporate veil. In the hands of the Indian Judiciary, this doctrine is the key to the lock to find the real culprit and hold him liable instead of the company.

Keywords: Company, Corporate veil, Artificial Person, Lifting.

INTRODUCTION

"The lifting of the corporate veil is a legal concept that allows a court to disregard the separate legal personality of a company and hold the individuals behind the company

¹ Students at Amity Law School, Amity University, Lucknow Campus

² Naman, 'Principle of Lifting the Corporate Veil' (*Legal Service India*)

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responsible for its actions.”³ In India, the concept of lifting the corporate veil is primarily governed by the Companies Act, of 2013, and the judicial decisions that have evolved over time. The concept of the corporate veil has its roots in the legal fiction of a company being a separate legal entity from its shareholders. The doctrine of separate legal personality provides that a company has its own distinct identity, separate from its shareholders, and is capable of owning property, entering into contracts, and being sued in its own name. This means that the shareholders of a company are not personally liable for the debts or obligations of the company, except to the extent of their shareholding.

The doctrine is applicable only in the corporate world. “A company is a group of persons who eat together.” The definition of the company can be seen under the Indian Companies Act 2013. According to the said Act, a company means “*a company incorporated under this Act or under any previous company law.*”⁴ But the definition seems non-exhaustive, so many dignitaries tried to define the definition in their way.

1. Lord Justice Lindley –“*A company is a relationship of numerous people who contribute cash or cash's worth to normal stock and utilize it for a typical reason. The basic stock so contributed is signified in cash and is the capital of the organization. Individuals who contribute to it or to whom it has a place are individuals. The extent of cashflow to which every part is entitled is his offer.*”⁵

2. Prof. Haney –“*A company is an artificial person created by law having a separate entity with perpetual succession and a common seal. Thus, it can be stated that a company is an artificial person which consists of a group of people who come together to achieve the common objective or goals which are approved by law.*”⁶

An organization is not like a real individual unlike human beings, it's a mere creature of law. The company can be run by its director or the Board of directors.

³Stephen Bloomfield, *Theory and Practice of Corporate Governance: An Integrated Approach* (Cambridge University Press 2013) 10

⁴Companies Act 2013, s 2(20)

⁵ ‘What is a Company? - Definition, Characteristics and Latest Case Laws’ (*Taxmann*, 22 November 2022) <[⁶ ‘Meaning and Characteristics of Companies’ \(*Taxmann*, 29 November 2021\) <\[For general queries or to submit your research for publication, kindly email us at \\[editorial@ijalr.in\\]\\(mailto:editorial@ijalr.in\\)\]\(https://www.taxmann.com/post/blog/6174/all-about-companies/> accessed 23 March 2023</p></div><div data-bbox=\)](https://www.taxmann.com/post/blog/what-is-a-company-definition-characteristics-and-latest-case-laws/#:~:text=Lord%20Justice%20Lindley%20%E2%80%93%20%E2%80%9CA%20company,the%20capital%20of%20the%20company.> accessed 23 March 2023</p></div><div data-bbox=)

THE DOCTRINE OF SEPARATE LEGAL ENTITY

According to the Doctrine of the Separate Legal Entity, the company is itself a legal person and is different from its owners. It states that the company and the owner have a separate existence and can be made liable separately for the offences. The company and the owner have their legal rights, obligations, and existence that are very different from the person opening or incorporating the company. For the organization to be indicated as a Separate Lawful body there should be legitimate Registration and Incorporation of the Company. On the off chance that the organization will be appropriately consolidated, just it will have a separate legitimate presence from its–

- **Directors** - As they manage the working of the organization;
- **Members of the Organization** – They are the genuine proprietors of the organization;
- **Shareholders** - They have bought into the portions of the organization.

In *HL Bolton Engineering Co Ltd v. TJ Graham Sons Ltd*⁷, It was decided by the court that “*It is possible for a corporation to possess qualities and characteristics that are comparable to those of a living organism. Similar to how an individual possesses a brain and nervous system that regulates bodily functions, an organisation also possesses a collective set of minds and nervous systems. The organisation's activity and adherence to guidelines set forth by its overseers have been duly recognised. The association is primarily composed of personnel and agents who are under the control of the organization, responsible for executing tasks, and cannot be considered representatives of the company's intentions or decision-making. Some individuals hold positions as chiefs and managers, responsible for addressing the fundamental organisational concepts and overseeing the operations of the company. The potential of these leaders is the contemplation of the organisation and is addressed accordingly by legal means.*”

In India, The separate legal entity concept was established and developed by the Hon'ble Apex Court in the case of *RustomCavasjee Cooper v Union of India* held that “*an organization enlisted under the Companies Act is a different lawful individual and particular*

⁷*HL Bolton Engineering Co Ltd v TJ Graham Sons Ltd* (1957) 1 QB 159

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from its individuals.”⁸ The property possessed by the organization isn't the property of the investors. This feature of an incorporated company was first founded in the case of *Salomon v Salomon & Company Ltd.*⁹

Corporate personality refers to the legal concept that corporations are considered separate entities from their owners or shareholders, and as such, they have legal rights and obligations similar to those of individuals. This concept is an important aspect of modern business law, and it has significant implications for the way that corporations operate and interact with society.

The idea of corporate personality has its roots in English common law, where it was established in the 19th century in the landmark case of *Salomon v Salomon & Co.*¹⁰ In this case, the House of Lords recognized that a company could be a separate legal entity from its owners, and as such, it could enter into contracts, own property, and be held liable for its actions. This decision paved the way for the modern concept of corporate personality, which has been adopted by legal systems around the world. One of the key benefits of corporate personality is that it allows companies to raise capital from investors without exposing those investors to personal liability. In other words, if a company goes bankrupt or is sued, the owners or shareholders are not personally responsible for the company's debts or legal obligations. This gives investors greater confidence in the business, and it allows companies to attract more investment capital than they would if investors were personally liable.

However, the concept of corporate personality also has its downsides. One of the main criticisms of the concept is that it can shield companies from accountability for their actions. Because corporations are separate legal entities, it can be difficult to hold them responsible for wrongdoing. This has led to concerns about corporate social responsibility and the need for companies to act ethically and responsibly in their dealings with stakeholders. Another issue with corporate personality is that it can lead to conflicts between the interests of the company and those of its owners or shareholders. Because the company is a separate entity, it may prioritize its own interests over those of its owners, which can lead to disputes and conflicts. This can be particularly problematic in cases where the company is publicly traded,

⁸*RustomCavasjee Cooper v Union of India* (1970) SCR (3) 530

⁹*Salomon v Salomon & Company Ltd.*[1897] AC 22

¹⁰*Ibid*

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and its owners are dispersed among a large number of shareholders. Despite these concerns, the concept of corporate personality remains an important aspect of modern business law. It provides a legal framework that allows companies to operate and interact with society in a way that is efficient and effective. However, it is important for companies to recognize the responsibilities that come with their legal status and to act in a way that is ethical and responsible.¹¹

One way that companies can address these concerns is by adopting a stakeholder approach to business. This approach recognizes that companies have responsibilities to a wide range of stakeholders, including employees, customers, suppliers, and the broader community. By taking a more holistic view of their role in society, companies can build trust with their stakeholders and demonstrate their commitment to acting ethically and responsibly. Another way that companies can address concerns about corporate personality is by embracing transparency and accountability. This means being open and honest about their operations and their impact on society and being willing to take responsibility for any negative consequences that arise from their actions. Companies can also adopt codes of conduct and ethical guidelines that guide their behaviour and help ensure that they act in a way that is consistent with their values and commitments.

Corporate personality is an important aspect of modern business law that has significant implications for the way that companies operate and interact with society. While there are concerns about the potential for corporate personality to shield companies from accountability and create conflicts between the interests of the company and those of its owners, it also provides important benefits such as allowing companies to raise capital without exposing investors to personal liability. To address these concerns, companies can adopt a stakeholder approach to business, embrace transparency and accountability, and act in a way that is consistent with their values and commitments.¹²

PRINCIPLE OF LIFTING THE CORPORATE VEIL

¹¹Fenner Stewart, 'Berle's Conception of Shareholder Primacy: A Forgotten Perspective For Reconsideration During the Rise of Finance' (2011) 34 Seattle University Law Review 1457

¹² *Ibid*

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The owners and the company have separate legal powers and obligations in the eyes of law. The problem exists where the persons working in the company misuse the power and the company is held liable in that case. Though a company is not a human in reality it acts as a human when it is managed by the members of the company. Whenever the In-Charge or the Directors of the company commit any fraud or any other illegal activity then the concept of lifting the corporate veil comes into existence. This principle is initiated to look behind the scene and look after the real culprit who did the offence in the name of the company. Thus, wherever the director tries to commit any offence in the name of the company the principle is applied.

The Courts have the power to look at reality and ignore the corporate character of the company to ensure that justice should be done. The approach of our judicial system is too wide in the application of this principle.

Lord Macnaghten observed that *“The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.”*

In the *United States v Milwaukee Refrigeration Transit Company*, the US Court decided: *“A corporation will be looked upon as a legal entity as a general rule but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime the law will regard the corporation as an association of persons.”*¹³ The basic explanation for what causes special cases for the different element rule subsist can be distinguished. In the first place, albeit a company is a legitimate individual, it cannot be dealt with like some other free individual. For Example, an enterprise is not provided for carrying out a misdeed or wrongdoing requiring confirmation of men's rea except if courts ignore the distinctive objects and finalized the goal set by the chiefs and additional investors of the organization.

WHEN THE VEIL CAN BE LIFTED?

¹³*United States v Milwaukee Refrigerator Transit Company* [1906] 145 F. 1007

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Various conditions arise where the corporate veil can be lifted. “In *Life Insurance Corporation of India v Escorts Limited and Ors*,¹⁴ the Supreme Court set down two significant cases when the corporate veil is lifted.”

1. Statutory Provisions:-

Officer in Default: This section pertains to the obligations of individuals deemed as "officials in default," referring to those who participate in illegitimate or unlawful demonstrations, with regard to the offences they have committed. This section subsequently examines the collective responsibilities and certain liabilities of the parties involved. The phrase 'official in default' refers to a supervising director or a full-time executive.¹⁵

Reduction of Membership: A minimum of seven individuals is required for the formation of a public company, while a minimum of two individuals is required for the formation of a privately owned business. (Section 3 of the Act). In the event that an organisation has been established without adhering to this fundamental requirement and persists in conducting its operations, then each member who is aware of such fact is individually accountable for any liabilities incurred by the organisation during that period.¹⁶

Improper use of Name: The responsibility of the signatory of a bill of exchange, Hundi, promissory note, or check under an incorrect organisational name is outlined in Sub-section 4 of Section 147 of the Act. The aforementioned individual shall be entitled to all rights and privileges associated with the possession of said Bill of Exchange, hundi, promissory note, or check unless it has been duly settled by the issuing company.

Fraudulent Conduct: In the event that at the hour of the end of the partnership, it is discovered that the exercises of the organization were conveyed to mislead the financial backers of the organization than the people who realized that such business would be actually obligated for any misfortune caused to such financial backers as the court may coordinate.¹⁷

¹⁴*Life Insurance Corporation of India v Escorts Limited and Ors* (1986) 1 SCC 264

¹⁵Companies Act 1956, s 5

¹⁶Companies Act 1956, s 45

¹⁷Companies Act 1956, s 542

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Failure to refund application money– If the organisation fails to refund the application fee to the unsuccessful candidates within 130 days from the issuance of the summary, then the company executives are jointly and severally liable to refund the application fee along with interest. However, this will not have an effect on the longevity of the institution and its various manifestations.¹⁸

Judicial Pronouncements:-

In addition to the legislative requirements, the Indian courts may also choose to remove the corporate shroud for certain reasons.

Some of the cases in respect of this area–

A company as an Agent: The principle of indirect accountability is implemented in these situations, where an organisation is acting as a consultant for its owners, and the investors are held accountable for the organisation's actions. In these situations, the judge would look at the present circumstances to determine whether or not the organisation was acting as an expert for its clients. This can be gathered either from the arrangement where it has been explicitly referenced or can be suggested from the conditions of each case.

This is known as the “*alter ego*” doctrine. Under this doctrine, the courts may disregard the separate legal personality of the company and treat it as an extension of its shareholders where the company is being used to carry out the personal objectives of its shareholders. For example, in the case of *Life Insurance Corporation of India v. Escorts Ltd.*¹⁹, the Delhi High Court held that the corporate veil could be lifted to expose the true nature of a transaction where the company was being used as a mere instrumentality of its shareholders. In this case, the shareholders of Escorts Ltd. had used the company to acquire a majority stake in another company but had done so in a manner that was detrimental to the interests of the shareholders of that company. The court held that the corporate veil could be lifted to hold the individuals behind Escorts Ltd. responsible for their actions.

¹⁸Companies Act 1956, s 69

¹⁹*Life Insurance Corporation of India v Escorts Ltd.* (1986) AIR 1370

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Evasion of Tax: Here and there, the corporate cover is utilized for tax avoidance or to keep away from any sort of expense commitment. “It isn't feasible for the assembly to fill all the holes in the law and hence the legal executive requirements to meddle. In such cases, the courts lift the shroud of the organization to discover the genuine situation of the organization, In the case of **Vodafone International Holdings B. V. v Union of India & Anr** held that – “*The Court can always remove the corporate curtain and look behind it to see what exactly is going on once it is established that the transaction is false, fake, convoluted, or a tool used to undermine the interests of the stockholders, investors, parties to the contract, as well as for tax avoidance. In this instance, the court granted the Income Tax Office permission to penetrate the company's corporate shroud.*”²⁰

Improper Conduct or Fraud: The aim behind it is to locate the genuine interests of the individuals. In such cases, the individuals can't utilize the Salomon standard to escape from risk. In *Shri Ambica Mills Ltd*, the court held that “*the corporate shroud of the organization can be lifted in instances of criminal demonstrations of extortion by officials of an organization.*” Essentially, the court punctured the corporate shroud on account of **VTB Capital v Nutritek**²¹ and expected the chiefs by and by to take responsibility for getting a credit falsely.

This is known as the “*fraudulent purpose*” doctrine. The courts in India have consistently held that where a company is formed or used for a fraudulent purpose, the corporate veil may be lifted to expose the true nature of the transaction and hold the individuals behind the company liable. For example, in the landmark case of *VTB Capital PLC v. Essar Global Fund Limited*, the Supreme Court of India held that the corporate veil could be lifted to expose the true nature of a transaction that was entered into with fraudulent intent. In this case, Essar Global Fund Limited had created a complex corporate structure to evade paying a debt owed to VTB Capital PLC. The Supreme Court held that the corporate veil could be lifted to hold the individuals behind the company responsible for their fraudulent actions.

CONCLUSION

²⁰*Vodafone International Holdings B. V. v Union of India & Anr* Civ App No 733/2012

²¹*VTB Capital v Nutritek* [2012] EWCA

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In this manner, it can be said the precept of the different lawful elements of the organization isn't appropriate in altogether cases. Some examples are when the court developed some new guidelines and raised the corporate veil. Notwithstanding, the justification for penetrating the cover is not comprehensive. It relies upon the current realities and conditions of each case. In addition to the law provisions, the Indian courts have repeatedly removed this defence in cases of blackmail, fraud, tax evasion, and other promises to assign blame to the investors. But despite being frequently used, the concept of breaking through the barrier is still in its infancy. Additionally, the legal conclusions for removing the veil change as each court's viewpoints depend on the relevant facts of the case at hand. As a result, the courts ought to do away with this ambiguity by providing an exhaustive list of instances in which the corporate curtain may be removed.

The doctrine of lifting the corporate veil is an important tool for ensuring that companies are held accountable for their actions. It is important to note, however, that the courts will only lift the corporate veil in exceptional circumstances where there is clear evidence of fraud, abuse of the corporate structure, or other misconduct.



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