

LIFTING OF CORPORATE VEIL BY THE COMPANY

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The business of the artificial 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 entity, for while by fiction of law a company is distinct personality, yet in reality it is an association of persons who are in fact the real or beneficial owners of the Corporate property. Lord Parker in *Daimler Co. v. Continental tyre & Rubber Co.*, (1916) 2 AC 307 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 corporators is to be ignored.

The Supreme Court has expressed its views as follows:

The Corporation in law is equal to a natural person and has a legal entity of its own, is entirely separate from that of its shareholders, has its own name and seal, its assets are separate and distinct from those of its members, it can sue and be sued in its own name, its creditors cannot obtain satisfaction from the assets of its members; liability of its members is limited to the capital invested by them, similarly the creditors or the members have no right to the assets of the Corporation. This legal position has been well established in case of *Solomon v. Solomon & Co.*, 1897 AC 22.

The doctrine that a company has legal and separate entity of its own has been subjected to certain exceptions by the application of the fiction that the veil of the Corporation can be lifted and its real face can be examined.

A company, cannot for instance, be convicted of conspiring with its sole director. “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, (*R.V. McDonnell* (1966) 1 All ER 193). But a company has been held liable for conspiring with its directors where there are atleast two directors, (*Rex. V.I.C.R. Haulage*, (1944) KB 551). A company cannot be prosecuted for violation of an Act, which provides for compulsory imprisonment, (*Modi Industries Ltd., v. B.C. Goel*, (1983) 54 Comp Cos 835 (All)). It is impossible to ascertain the factors which operate to break down the Corporate insulation. (*Warner Fuller, The incorporated individual, A study of one man company*).

The companies Act of 1956 itself provides for circumstances when Corporate veil will be lifted and the individual members/directors will be made liable for certain transactions *vide* Sections 45, 147 & 542. Following are the instances where the Courts have lifted the Corporate personality of a company.

(1) *Piercing the veil in liquidation proceedings:*

The Court held that the doctrine of lifting the veil could not be invoked here to declare that the assets of one legal entity were those of the other as veil are torn mainly in cases of control rather than of ownership, (*Official Liquidator v. E.N. Vasudevan*, 1979 Tax LR NOC 178 (Ker)). Also in the instant case, there was no diversion of business, no parent-subsidary relationship or agency business, no motive or fraud or no clubbing of profits.

(2) *If Corporate entity is used for tax evasion:*

The Court has power to disregard Corporate entity if it is used for tax evasion or to circumvent tax obligation, (*Juggilal v. CIT*, AIR 1970 SC 529). The leading Indian case law is found in the facts of (*In re sir*

Dinshaw Maneckjee Petit, AIR 1927 Bom. 371), where it was held that “The company was formed by the assessee purely and simply as a means of avoiding super tax and the company was nothing more than assessee himself, did no business every, was created to ostensibly receive the dividends and interests and to hand them over to the assessee as pretended loans. In one case, a separate corporate entity was incorporated outside the taxable territory with the ulterior motive of evading the tax obligation, (*CIT v. Meenakshi Mills Ltd.*, AIR 1967 SC 819).

The leading English authority is (*Apthorpe v. Peter Schoenhofen Brewing Co.*, (1899) 4 TC 41), where it was held that the American company had become the agent of the English company and therefore, the whole of its profits were liable to be taxed as the income of the English company.

The Supreme Court held that the Court is entitled to lift the mask of Corporate entity, if the concept is used for tax-evasion, or to circumvent tax obligation, or to perpetuate fraud. However, tax planning may be legitimate provided it is within the frame work of the law, (*Union of India v. Play world Electronics (P) Ltd.*, AIR 1990 SC 202).

(3) Piercing the veil in holding - subsidiary relationships:

Although the advent of rigorous role of *Saloman v. Salomon & Co.*, (1897) AC 22, regarding the independent Corporate existence of a company, the Courts of U.S.A. have developed a set of laws governing in cases where separate legal entities may be disregarded. The following instances will throw light on when veil can be pierced *vis-a-vis* in that of a holding and subsidising company.

(a) In *Free Wheel (India) Ltd., v. Dr. Veda Mitra*, AIR 1969 Del. 258, a fifty two percent subsidiary company proposed to issue further capital which, following Section 81 was offered to the existing holders of equity shares. The holding company requested the Court that its subsidiary should be restrained from going ahead with the issue as it would deprive its parent of *their controlling interest*,

thereby also diluting its share holding and would also depreciate the value of its shares. Refusing for injunction prayed for the learned Judge said : “Here the parent holds only a nominal majority in the share capital of the subsidiary with the meagre majority alone, I am not prepared to hold, even if it were possible to do so for such a purpose, that the subsidiary company has lost its identity as a separate legal entity. The documents in the possession of a foreign subsidiary cannot be deemed to be in the possession of the “Parent” *Lonrho Ltd. v. Shell Petroleum Co. Ltd.*, (1980) 2 WLR 367.

(b) Liability for insolvent subsidiary of holding company:

It is not astonishing that when one of the subsidiary companies turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and the other subsidiary companies may prosper to the joy & merriment of the shareholders without any liability for the debts of the insolvent subsidiary. Like this a holding company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent/ holding company. The principle of non-liability applies even when the holding company had given a comfort letter to a creditor of the subsidiary, (*Klein West Benson Ltd v. Malaysia Mining Corporation Bhd.* (1989) 1 WLR 379 CA).

(c) Lifting of veil of small scale industry:

Where small scale industries were given certain exemptions only when the company owning an industry was not controlled by any group of persons or companies, it was held that it was permissible to lift the veil of the Company to see whether it was a subsidiary of another company and therefore, not entitled to the proposed exemptions, (*Inalsa Ltd v. Union of India*, (1996) 87 Comp. Cases 599 Delhi).

4. Evasion of personal & Statutory obligations:

In the instant case, (*Gilford Motor co. v. Horne*, (1933) Ch. 935 (CA)). *Horne* a

former employee of the plaintiffs covenanted not to solicit its customers. He attempted to evade this obligation by forming a company which undertook the soliciting. An injunction was granted against both him and company. The company was described in the judgment as “a device, a Strategem” and a “mere cloak or sham”. A company could not escape liability by “clothing themselves in a corporate veil of their own spinning” as held in *Einhorn v. Westmount Investments Ltd.* In a very recent case, the properties of two companies were ordered to be attached in order to do justice to persons when the promoter of the companies had duped by allotting a floor to more than one person, (*Delhi Development Authority v. Skipper Constructions (P) Ltd.*, (1997) 89 Comp. Cases 362 (SC)).

Another interesting case of evasion of personal and statutory obligation came before the Supreme Court, (*Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd.*, (1986) 59 Com.Cases 134 SC). A parent company incorporated a subsidiary company and transferred to it some of its investments and securities only for the purpose of splitting the profits into two hands and thereby to reduce the incidence of the obligation to pay bonus. The Supreme Court held that “the subsidiary has no business or income of its own except receiving dividends from shares transferred to it by the principal and serving no purpose whatsoever except to reduce the gross profits of the principal company.

5. Managing Directors vis a vis company's due:

A Managing Director was held to be not personally liable for unpaid dues to workers, (*Rundan Singh v. Moga Transport Co.P.Ltd.*, (1987) 62 Comp. Cases 600 (P&H)). Likewise proceeding against Managing Directors & Shareholders personal assets for recovery of Sales Tax Dues of the company were held to be void, (*Surinder Nath Khosala v. Excise & Taxation Commissioner, Punjab*, (1995) 4 Comp. LJ. 343 (Punj)).

6. Regarding matters of property & contracts:

Courts are usually most hesitant to lift the Corporate veil in response to superficial consideration of “common sense” or “reality” or “fairness” in matters of property and contracts. Those who adopt the Corporate form should surely be expected to take the rough with the smooth. This point was emphasised in *Tata Access Floors Inc. v. Boswell*, (1991) Ch. 512.

7. Government company as separate legal entity:

Even assuming that the Union Government subscribes entire share capital of a company, it cannot be said that Union Government owns its properties, (*Bharath Aluminium Co. v. Area Development authority*, 1981 Comp. Cases 184 (M.P.)). The Government and the company were two different & distinct entities, (*Lajpat Rai Mago v. Governor of Haryana*, (1971) 41 Comp.Cases 693 (P & H)). Supreme Court had held that the property of the Government company did not belong to the Government of India. The company, therefore, could not escape liability to pay property tax under a statute which exempted the lands owned by or vesting in the Union Government from such tax, (*Western Coal Fields Ltd. v. Special Area Development*, AIR 1982 SC 697).

Conclusion :

The above study reveals that “Honest enterprise, by means of companies is allowed; but the public are protected against Kiting and humbuggery, (*Re Southend & Co. Ltd.*, (1979) 1 WLR 1198). The sanctity of a separate corporate identity is upheld only insofar as the entity is consonant with the underlying policies which gave it life, Cadman: *The Corporation in New Jersey*, 353 (1949). The Courts have at times seized upon these facts as evidence to justify the imposition of liability upon the shareholders, (*Judicial Supervision of One-man Corporation*, 46 Harv. LR 1084).