

# Company Law Semester 2

Lifting of corporate veil

## LIFTING THE VEIL OF CORPORATE PERSONALITY

- After incorporation a company becomes a 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.
- A veil of incorporation exists between the company and its members and due to this a company is not identified with its members.
- The doctrine of lifting the veil has been developed as a device to avoid the hardship of the doctrine of corporate personality. It may be understood as the identification of a company with its members. In order to protect themselves from the liabilities of the company its members often take the shelter of the corporate veils. Sometimes these corporate veils are used as a vehicle of fraud, or evasion of tax. To prevent unjust and fraudulent acts, it becomes necessary to lift the veils to look into the realities behind the legal facade and to hold the individual member of the company liable for its acts. **The corporate**

## The Philosophy Behind the Doctrine of Lifting of Corporate Veil

The concept of corporate veil is a fundamental aspect of a Company Law. This is a protective device for those who exist behind the veil. **Pickering** says that there are two main reasons why there are exceptions to the separate entity doctrine.

**Firstly**, he says that a company cannot all the times and in all the circumstances be treated as an ordinary independent person, e.g. a company has no **mens rea** and therefore is not capable of committing a crime, unless the court lifts the veil and impose the intention of the Directors or members on the company.

**Secondly**, if there were no exception to the separate entity rule, Directors and members would be allowed to hide behind the shield of limited liability, with potentially disastrous effects. Thus, the doctrine of lifting the corporate

- In ***State of U.P. V Renusagar Power Co.***, the court held that the concept of lifting the corporate veil is a changing concept. Its frontiers are unlimited. However, it depends primarily on the realities of the situation.
- In ***The Deputy Commissioner V Cherian Transport Corporation***, the court has held that the company is a legal person distinct from its members. It is capable of enjoying rights and being subject to duties which are not the same as those enjoyed or borne by its members. In certain exceptional cases the court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal façade. *The corporate veil has been lifted by the courts and legislatures both in the interests of justice, equity and good conscience.*
- In ***Sugar India Ltd. V Chander Mohan Chadha***, the Supreme Court has made it clear that it is not open to the company to ask for unveiling its own cloak and examine as to who are the directors and shareholders and who are in reality controlling the affairs of the company.

- The doctrine of the lifting the veil of corporate personality is a doctrine that advocates going behind and looking behind the juristic or corporate personality of a body corporate.
- In exceptional cases, that veil of corporate personality can be lifted; and looking behind the veil, one could see the corporate personality fading away.
- **Courts have lifted the veil, with the objective of preventing fraud.** In such cases the members of the corporation are considered as persons working for the corporation.
- In England, the problem was faced soon after War. The court may lift the veil of personality for a number of reasons- Firstly- it may be done to ascertain whether a company is to be treated as an “**Enemy Company**” in times of War.
- During the First World War in *Dalmer Co. Ltd. V Continental Tyre & Rubber Co. ( Great Britain) Ltd.*, a company which was registered in England and which should normally be treated as an English Company was nevertheless held by the House of Lords to be an enemy company because, all its directors and its shareholders except one were Germans. This is, however, not a departure from the general rule that a company is distinct from its members, it only shows that its character whether friendly or enemy is to be ascertained by looking behind the veil.



## Salomon v Salomon – in brief



**The Companies Act 1862 required 7 shareholders**

# Indian law

- The most of the provisions of Indian company law were borrowed from English law, it more or less resembles the English law.. (Originated from Common Law)
- The Supreme Court in **Tata Engineering Locomotive Co. Ltd. v. State of Bihar and others**,“ the corporation in law is equal to natural person and has a legal entity of its own. The entity of corporation is entirely separate from that of its shareholders; it bears its own names and has seal of its own; **its assets are separate and distinct from those of its members, the liability of the members of the shareholders is limited to the capital invested by them, similarly, the creditors of the members have no right to the assets of the corporation.**”

In **LIC of India v. Escorts Ltd**, Justice O. Chinnapa Reddy had stressed that the corporate veil should be lifted where the associated companies are inextricably connected as to be in reality, part of one concern. *After the Bhopal Gas leak disaster case, the lifting of corporate veil has been escalated.* Furthermore in **State of UP v. Renusagar Power Company**, the Supreme Court lifted the veil and held that Hindal co, the holding company and its subsidiary, Renusagar must be treated as the own source of generation of Hindalco and on that basis, Hindalco would be liable to pay the electric duty.

- Doctrine Law lifting the corporate veil as such is not given in the text of **Indian Company Law** but could be inferred from number of provisions.

### **The Companies Act, 1956**

The Companies Act 1956, itself provides for circumstances, when corporate veil will be lifted and the individual members or directors will be made liable for certain transactions.

#### **1) Reduction of Membership:**

**Section 45** of the Act makes the members of the company severally liable for the payment of the whole debts of the company if the membership of the company is reduced below the statutory requirements i.e. two for the private company and seven for a public company. It must be noted that this section 45 does not operate to destroy the separate personality of the company, it still remains an existing entity though there may be one or more member. However, this provision applies only to members who remain as members if the company continuous with less number for a period more than 6 months after the membership falls below the statutory limits.

## **The Companies Act- 2013**

### **I. Failure to return application money (Section-39)**

- In the case of issue of share by a company, whether to the public or by way of rights if, minimum subscription as stated in the prospectus has not been received directors shall be personally liable to return the money with interest, in case application money is not repaid within a prescribed period.

### **II. Misrepresentation in prospectus (Section- 34 and 35)**

- In case of misrepresentation in a prospectus, every director, promoter and every other person who authorize such issue of prospectus incurs liability towards those who subscribed for shares on the faith of untrue statement.

### **III. Fraudulent Conduct (Section 339):**

- Where in the case of winding-up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, those who are knowingly parties to such conduct of business may, if the Tribunal thinks it proper so to do, be made personally liable without any limitation as to liability for all or any debts or other liabilities of the company.

## **CRIMINAL LIABILITY FOR MISSTATEMENTS IN PROSPECTUS**

Where a prospectus, issued, circulated or distributed, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorities the issue of such prospectus shall be liable under section 447.

Provided that nothing in this section shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

- Madhurima Banerjee
- Sources: Google (edited)

- **Civil liability for misstatement in prospectus:** where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who-
  - a. is a director of the company at the time of the issue of the prospectus;
  - b. has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director;
  - c. is a promoter of the company;
  - d. has authorized the issue of the prospectus, and
  - e. is an expert (Chartered Accountant etc) referred to in sub section (5) of section 26, Shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

Where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in sub sec. (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damage that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

- **Punishment for Fraudulently Inducing Persons to Invest money:** any person who, either knowing or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into-
  - a. any agreement for, or with a view to, acquiring, disposing of subscribing for or under-writing, securities, or
  - b. any agreement, the purpose or the pretend purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuation in the value of securities; or
  - c. any agreement for, or with a view to, obtaining credit facilities from any bank or financial institutions, shall be liable for action under section 447.

**IV. Miss description of Name:** where an officer of any company signs on behalf of company any contract, bill of exchange, cheque promissory note etc. such person shall be personally liable to the holder if the name of the company is not mentioned or not properly mentioned.

Every person shall have its name printed on hundies, promissory notes, bill of exchange and such other documents as may be prescribed.

If any default is made in complying with the requirements to this section, the company and every officer who is in defaults shall be **liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.**

## **Investigation into affairs of Company:**

Where the central government is of the opinion, that it is necessary to investigate into the affairs of a company-

- a.** on the receipt of a report of a the Registrar or Inspector under Sec.- 208
- b.** on information of a special resolution passed by a company that the affairs of the company ought to be investigated; or
- c.** In public interest,

It may order an investigation into the affairs of the company.

- **Liability for fraudulent conduct of business:**

If in the course of the winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the tribunal, on the application of the official Liquidator, or the company Liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that any person, who is or has been a director, manager, or officer of the company or any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts, or other liabilities of company as the tribunal may direct.

- **Liability for ultra vires acts:**

- Directors and other officers of a company will be personally liable for those acts which they have done on behalf of a company if the same are ultra vires the company.

