



## Corporate Personality and Lifting of the Corporate Veil

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### ABSTRACT

*Corporate veil has been one of the most controversial subjects under corporate. Over the year, various judicial and legislative bodies have looked into the subject and have had differing and varied views. This paper will provide an understanding of the concept of corporate veil and will analyze how different Courts have interpreted this concept over the period of years.*

*This paper then looks into various attributes of corporate personality and analyses each one of them. The paper along with explaining the characteristic feature of corporate personality also analyses when and why Courts can lift corporate veil. An analysis of reasoning of Courts is provided in the last part of the paper. This paper concludes by providing explanation on Statutory provisions under which veil of a corporation can be pierced.*

**Keywords : CORPORATE PERSONALITY, CORPORATE VEIL, PIERCING OF CORPORATE VEIL**

### Introduction:

The instant paper deals with concepts of corporate personality and the corporate veil. It footmark the origins of corporate personality and its application from the era of Salomon case. In corporate law the concept of corporate personality has been a significant issue, thus it throws up number of concerns regarding how a company is to be treated in the eyes of law.

For the purpose of the present paper, the following two issues have been dealt with-

- The concept of corporate personality.
- Lifting of Corporate veil.

To fully understand and appreciate the above concerns, the nature of the company must Be comprehended first. Although the legal definition is somewhat vague and ambiguous,

From common parlance we do have some idea about what a company is. A company is an artificial body -an association of persons too numerous to be a firm, united for profit.

The ordinary law of the land does not let a sole proprietor segregate his private means from those of his business. Consequently, in the event of a business-related crisis, financial or otherwise, his debts relating to his business will have to be met from his private finances. Thus, some unfortunate miscalculation on part of his business may leave him and his family facing bankruptcy and financial ruin and it may not be worthwhile to carry on in other commercial ventures.

In the case of a partnership, the position is even more precarious. A partner would not Only be responsible for his acts committed in the course of business, he would also be

Liable for the acts of his partner .The partnership relation is itself based on mutual confidence. If a partner misuses this confidence, he may land the other partners in insurmountable difficulties, since a partner's liability is unlimited.

Thus, the advantages of a company in this case are huge, especially in relation to investment, technical expertise, limited liability, resources, etc. However, one of the most coveted benefits that is to be gained from the formation of a company

and consequently, the main thrust of this paper, deals with the concept of the company as a legal person separate from its members.

### Corporate Personality:

From the date of its incorporation a company becomes in law a different person altogether from the member who compose it. Thus, an incorporated company has legal personality distinct from that of its members from the date of its incorporation.

The concept of corporate personality of a company was recognized in the case of Saloman v. Saloman &Co.Ltd. The facts of the case are as such:

Solomon was a leather merchant. Due to the overwhelming response to his leather business he decided to convert his business into Limited Company- Solomon & Co. Ltd. The company consisted of Solomon, his wife and five of his children as members. The company purchased the business of Solomon for £39,000, the purchase consideration was paid in terms of £10,000 debentures conferring a charge over the company's assets, £20,000 in fully paid £1 share each and the balance in cash. Within a year of incorporation of a company, it ran into financial crisis and liquidation proceedings commenced. The assets of the company were not even sufficient to discharge the debentures (held entirely by Solomon himself). And nothing was left for the unsecured creditors. The House of Lords held that the company has been validly constituted, since the Act only required seven members holding at least one share each. It said nothing about their being independent, or that there should be anything like balance of power in the constitution of the company. Hence, the business belonged to the company and not to Solomon. Solomon was its agent. The company was not the agent of Solomon.

### Attributes of Corporate Personality:

- 1) Separate Property: A company is the beneficial owner of its property and it does not hold it as trustee for it members. Shareholders should be regarded not as proprietors of the company but merely as suppliers of capital entitled to no more than reasonable return. Because of being a legal person a company is capable of owning, enjoying

and disposing of property. A member has no interest in the property of the company and, therefore he cannot issue it, but a shareholder can insure the success of an adventure in which the company is engaged. It is to be noted that a debenture-holder can insure the property of the company on which his debenture is secured, because a debenture-holder as a secured creditor has an interest in the property of the company. Thus, the doctrine of corporate personality enables the property of the company to be distinguished from that of its members. The shares of a company may be transferred without affecting the property of the company.

- 2) **Perpetual Succession:** The continuity of company does not get affected with any change in the membership of a company. An Incorporated company is an entity with perpetual succession. The corporate existence of the company is never affected by the insolvency of its individual members.
- 3) **Transferable Shares:** The doctrine of corporate personality facilitates the transfer of the member's interest without the consent of the other member of the company. As S. 82 provides shares or other interest of a member in the company in movable property transferable in the manner provided by the articles of the company. After the transfer of shares the transfer drops out and the transferee step into his shoes.
- 4) **Suing and being sued:** An incorporated company being a legal person can sue and be sued in its own name. Thus, the corporate personality of the company has made the litigation convenient, cheap and easy.
- 5) **Limited Liability:** A company is a separate person from its incorporation, its members are neither the owner of its assets nor liable for its debts. A company which is registered with unlimited liability then only its members are liable to contribute to the debts of the company to the full extent of his property, but if a company is registered with limited liability, the liability of each of its members will be limited to certain extent. The doctrine of limited liability has played an important role in the development of the trade and commerce. It has enabled the businessmen to invest their money in business run by the corporate form of organization with limited risk or liability. This has encouraged the investor to invest their capitals in business and thereby has encouraged the aggregation of small sums into large capitals. Besides, in the case of company with limited liability, it is possible for every member to know the exact extent of his risk. It is also possible to make the liability of the member of the company limited without restriction on their participation in management.

#### **Lifting of Corporate veil:**

After the incorporation, a company becomes 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. Thus, a veil of incorporation exists between the company and its members and due to this a company is not identified with its members. In order to protect themselves from liabilities of the company, its members often take shelter of the corporate veil. Sometimes this corporate veil is used as a vehicle of fraud or evasion of tax and statutory provisions. To prevent unjust and fraudulent acts, it becomes necessary to lift the veil or disregard the corporate personality to look into the realities behind the legal façade and to hold the individual members of company liable for its acts or liabilities. The Corporate veil is generally lifted under the following circumstances:

- 1) Lifting the Corporate veil under Judicial Interpretation.
- 2) Lifting the Corporate veil under Statutory Provisions.

#### **Lifting of Corporate veil under Judicial Interpretation:**

- 1) **Determination of character:** The Corporate veil has been lifted by the courts to determine the enemy character of a company in time of war. The court will lift the veil for the purpose of finding out the person who in reality controls the company's affairs and if the affairs of the company

are found to have been controlled by enemy aliens, it will assume the enemy character.

- 2) **Determination of Residence for Tax Purposes:** The determination of the residence of a company is important for tax purpose also because the assessment is usually made on the basis of its residential status. A company is usually considered to be residing at the place where its central management and control is situated. The court may lift the veil to find out the place where its central management and control is situated and generally the place will be that where the meetings of the Board of directors are held. According to S.6 (3) of the Indian Income Tax Act, 1961, a company is said to be resident in India in any previous year if: (i) it is an Indian Company, or (ii) during that year, the control and management of its affairs are situated wholly in India. For this purpose the expression "control and management" means de facto control and management and the place of the control and management of the affairs of a company is the place where the meetings of the directors are held.
- 3) **Fraud and evasion of contractual obligation:** The corporate existence cannot be used as vehicles of fraud. Whenever the corporate existence is used for fraudulent purpose as to defraud creditors or to avoid legal obligation, the courts will lift the corporate veil to see the realities behind it and strike down the transaction.

For example, in *Gilford Motor Co. v. Horne*, Mr. Horne was an ex-employee of The Gilford motor company and his employment contract provided that he could not solicit the customers of the company. In order to defeat this, he incorporated a limited company in his wife's name and solicited the customers of the company. The company brought an action against him. The Court of appeal was of the view that "the company was formed as a device, a stratagem, in order to mask the effective carrying on of business of Mr. Horne" in this case it was clear that the main purpose of incorporating the new company was to perpetrate fraud. Thus the Court of appeal regarded it as a mere sham to cloak his wrongdoings.

- 4) **Evasion of Statutory provision –Inference of agency to prevent it:** Where a company is acting as agent for its shareholder, the shareholders will be liable for the acts of the company. It is a question of fact in each case whether the company is acting as an agent for its shareholders. There may be an Express agreement to this effect or an agreement may be implied from the circumstances of each particular case. In the case of *F.G. Films Ltd., Re*, An American company financed the production of a film in India in the name of a British company. The president of the American company held 90 per cent of the capital of the British company. The Board of trade of Great Britain refused to register the film as a British film. Held, the decision was valid in view of the fact that British company acted merely as he nominee of the American Company.
- 5) **Trustees:** As a general rule, a company does not hold its property on trust for its members or for another company but in some exceptional cases the court avoided the general rule and held a company acting as a trustee for its members or another company. Thus, the concept of trust has also been used by the courts as a device to lift the corporate veil.

#### **Lifting of Corporate veil under Statutory Provisions:**

- 1) **Reduction of the number of members:** If at any point of time the number of members of company is reduced below the minimum number i.e. (seven in case of public company and two in case of private company) and the company carries out the business for more than six months then all the members of the company at that point of time will be held liable for the payment of company's debts contracted during that time.
- 2) **Misrepresentation:** According to the section 62 & 63 of The Indian Companies Act, 1956 if there is a misrepresentation in a prospectus then Promoter, Directors and every other person who is authorized to issue such pro-

spectus will incur the liability toward those people who have subscribed for share on the faith of the untrue statement.

- 3) Failure to Return Application Money: When a company fails to receive minimum subscription, then it must refund the entire application money within 10 days. However if the company fails to return the application money within 10 days then the company has to refund the same with 6% interest per annum.
- 4) Misdescription of the Name: When any officer of the company signs on the behalf of the company any contract, promissory note or cheque, then such person is liable to the holder if the name of the company is not mentioned properly or it is not mentioned at all.
- 5) Holding and Subsidiary Company: A holding company is required to disclose to its members the accounts of its subsidiaries. Sec. 212 of the Indian companies Act, 1956 provides that every holding company is required to attach to its balance sheet, copies of balance sheet, profit and loss account etc., in respect of each subsidiary company.

#### Conclusion:

Thus it is absolutely clear that incorporation does not clear personal liability in circumstances. The sacredness of a separate entity is upheld only in so far as the entity is consonant

with the underlying policies which give it life.

Enjoying the benefits of incorporation the enterprise need to have an adequate capital structure. They must not withdraw the corporate assets or mingle their individual accounts should with those of the corporation. The Courts have at times seized upon these facts as evidence to justify the imposition of liability upon the shareholders.

Lifting of corporate veil until now remains one of the most controversial subjects in corporate law. There are categories such as fraud, sham, agency or facade, unfairness and group enterprises, which are believed to be the most uncharacteristic criteria under which the Law Courts would pierce the corporate veil. But these criteria's are just guidelines and by no means far from being extensive.

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