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# Lifting of Corporate Veil: Recent Developments and Ways for Protection

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## ABSTRACT

*The legal division between a business and its owners, directors, and members is referred to as the "corporate veil."*

*A company is seen by the law as being a separate legal entity from its members. Even if he owns all of the company's shares, a shareholder or member cannot be held accountable for the actions. The removal of the corporate veil doctrine enables the court to ignore the corporate form and hold individuals accountable for its deeds. The conventional method of removing the corporate veil as well as more recent innovations are examined in this essay along with any ramifications for corporate law.*

*The paper begins by outlining the conventional justifications for breaching the corporation veil, such as fraud, inappropriate intent, and alter ego. It then examines recent cases where the courts have applied the doctrine more broadly, including the acceptance of the corporate veil piercing doctrine in the context of group companies, the use of the doctrine to hold parent companies accountable for the deeds of their subsidiaries, and the application of the doctrine to LLCs and LLPs. The article also examines the legislative ramifications of these changes, including possible effects on liability, risk management, and corporate governance. The conclusion of the paper discusses the difficulties that these developments present for corporation law as well as the necessity for additional study in this area.*

## I. INTRODUCTION

Corporate veil is the concept that separates the legal status of the corporation from that of its stockholders. When a corporate body's legal entity is used fraudulently, individuals' concerns are not permitted to hide behind the company's corporate entity. The corporate veil of a firm may be lifted or pierced by the courts in certain extraordinary situations. Raising or piercing the corporate veil refers to making the people in charge of the business responsible for its actions.

The idea has its origins in English common law, and it is accepted in many countries all over the world. The conventional justifications for removing the corporation veil are alter ego, fraud,

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and wrong intent. Yet, the theory has recently been broadened by the courts to reflect fresh issues and realities of the contemporary commercial environment. These changes have enormous effects on corporate law and pose serious policy issues. This article looks at the most recent changes to the corporate veil doctrine and how they affect corporate law.

## **II. LANDMARK CASE: *SALOMON VS. SALOMON & Co. LTD. (1897) A.C. 22***

Facts of the case: When Salomon made the decision to form Salomon Ltd., which would have as its members only himself and his family, he was a sole proprietor running a boot and leather merchant business. The business had failed and was in the red. After its business failed, the company entered liquidation. Creditors of the corporation asserted that Salomon and his company "Salomon Company" were one and the same, but Salomon's right of recovery, supported by a floating charge on debentures, took precedence. The liquidator asserted that the company was a fiction and was only acting as a Sham agent on behalf of unsecured creditors.

Salomon was held accountable for the Co.'s debt and unsecured creditors as the company's principal. Because of this, it was unclear if he would be held personally liable for the company's debt, regardless of whether the business itself was a separate legal entity.

Held - It was decided that the company conformed with all legal requirements and was a valid, legal entity. Unsecured creditors had to be paid before secured debentures because it had a separate identity from its members.

## **III. TRADITIONAL GROUNDS OF LIFTING CORPORATE VEIL**

### **(A) Statutory provisions**

The Companies Act, 2013, has been changed in a number of provisions with the goal of identifying the person responsible for any such inappropriate or illegal behaviour. The term "officers in default" (as defined in Section 2(60) of the Companies Act) most frequently refers to those people, which includes those in director or senior management positions. Some examples of these frameworks are provided below.

## *Statutory Provisions*

- *When the number of members fall below the statutory minimum.*
- *Misrepresentation in prospectus.*
- *Failure to return application money.*
- *Non disclosure of representative capacity.*
- *To examine the relationship of holding and subsidiary company.*
- *To investigate into the affairs of related companies.*
- *When business is carried on to defraud the creditors.*

Misstatement in the Company's Prospectus - Businesses sell securities by releasing prospectuses. The prospectus created in accordance with Section 26 contains key information about the company, including information on the shares and debentures, the names of the directors, and its main objectives and recent activity. Depending on the situation, someone who makes an attempt to include false, misleading, or inaccurate assertions in a prospectus of the company may be subject to the fine, imprisonment, or both provided.

### ***1. Reduction of the number of members below the statutory minimum-:***

If the minimum number of members of a company falls below 2 (for private companies) or below 7 (for public companies), the company may continue to operate for a period of six months while the number is reduced, and each member of the company during that time may do so with the knowledge that the minimum number of members has been decreased. If the six-month grace period has passed, the corporation and its shareholders may be sued separately or held liable for the money they made during that time.

### ***2. Failure to refund application fees -:***

In accordance with Section 39 (3) of the Act, the directors of the company will be jointly and severally liable to pay back the money along with interest of 6% p.a. from the date the 120-day grace period expires if they fail to reimburse the application money (without interest) within 120 days when the Co. fails to allot shares.

### 3. *Misrepresentation of the name of the company – :*

Section 12 of the Corporations Act states that any officer of a corporation who signs a bill of trade, hundi, promissory note, or check where the name of the organisation is not referenced in the proper manner could be held personally liable to the holder of the bill of trade, hundi, or check unless it is properly paid by the corporation.

### 4. *Liability for fraudulent business conduct-:*

If it becomes apparent during the course of business that any business of the company has been conducted with the intent to defraud its creditors or for any fraudulent purpose, the court may order that any person who was aware of such fraudulent business conduct shall be personally liable for all of the company's debts or other obligations under Section 339.

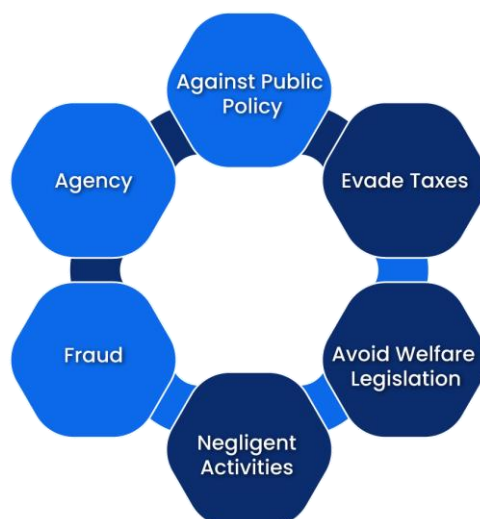
### 5. *Liability for Ultra vires Act-:*

Every corporation must function in line with its AoA, MoA, and the Companies Act of 2013[1] in the event of Ultra-Virus Acts. Any action taken outside the purview of either is seen as "ultra-virus," improper, or going beyond the bounds of the certification. If the company's operations are discovered to be unlawful, penalties may be levied. If they are ultra-virus the corporation, directors and other officers are individually responsible for all actions taken on its behalf.

### 6. *Investigation ownership of the company- :*

According to Section 216 of the Act, the Central Government may appoint Inspectors to investigate and report on the membership of the company in order to identify the actual people who are financially involved in the business and who have an influence on its policies. Hence, the corporate veil can be disregarded by the Central Government.

## (B) Judicial Interpretation



**(i) Determination of the Enemy Character of the company:** In some circumstances, it is crucial to remove the corporate façade, examine each person's personality, and ascertain whether they are an enemy of the state. In the case of *Daimler Co. Ltd. v. Continental Tire and Rubber Co. Ltd.*, a German firm that had most of its ownership held by German citizens established a tyre sales company in England. The English-based firm began a recovery procedure during World War One, and it was ultimately determined that the company was an enemy character. As a result, the court decided to lift the corporate veil.

**(ii) Where the firm is a sham** - the courts may also lift the corporate veil if they think the operations are fraudulent or a "Sham". These kinds of businesses are merely cloaks, and it is possible to miss the genuine culprit by ignoring their traits. In the case of *Gilford Motor Co. Ltd vs. Horne (1993)* At Gilford Motor Home Company Ltd., Mr. Horne previously held the position of managing director. After he left the company, he was forbidden from contacting any of the clients under the terms of his employment contract. Both Mr. Horne's job and his post were terminated. In the wake of that, he established a very competitive company in which only his wife, himself, and one of his friends were the shareholders. More affordable than Gilford's is Horne's company. Consumers of Gilford Motor Company were approached by the stockholders. With the exception of Horne personally, Gilford had little legal recourse against Horne's company. Gilford filed a lawsuit against Horne or initiated legal proceedings against him, claiming that Horne's business was an effort to circumvent legal obligations by enlisting customers. It was held that, Horne created the Company to get out from under his contractual obligations and to cover up his criminal behaviour. The corporate veil was broken by the court, which also issued an injunction against him.

**(iii) When a firm is operating as the shareholder's agent-** the corporate veil principle may be ignored if it becomes necessary to identify the principal and agent in connection with improper behaviour committed by the agency. In the case of *RG Films Ltd. (1953)*, The president of an American corporation owned 90% of the shares in the British company, which was used to produce a movie in India under the name of a British company. Beyond its registered office, the corporation had no other assets and no workers. The Board of Commerce then refused to register the picture as a British production because the British company was merely working as an agent for an American company. The British company was just serving as a proxy for the American entity; hence the decision was upheld. The corporate veil was lifted in this case by the court, and it was decided that the principle of a distinct legal entity did not mean that the company would act as a simple agent of the shareholders.

**(iv) Protection of Revenue:** If it is established that the company was established in order to

evade paying taxes, the court may breach the corporate veil and hold each member personally accountable for the firm's obligations.

(v) **Contrary to Public Policy:** Courts have the power to pierce the corporate veil and hold those responsible personally liable when a company's conduct are against the law or the public interest. Protecting public policy is the proper justification for piercing corporate personality.

In the case of *Connors Bros vs. Connors (1940)*, the company's members' behaviour caused the court to use the lifting of the corporate veil concept to punish the offenders because the corporation was founded to engage in immoral activity. The idea was applied to the managing director who acted in a way that violated public policy and exploited his position. The court determined that the corporation was an enemy company since the employees were de facto residents of Germany, which at the time was at war with the British. The act, which was considered against state policy because it entailed providing money to the enemy directly or indirectly, was not allowed to be carried out by the foreign company.

#### **IV. RECENT DEVELOPMENTS IN DOCTRINE OF LIFTING OF CORPORATE VEIL**

The traditional grounds for penetrating the corporate veil have been enlarged as a result of recent developments in the doctrine of lifting the corporate veil. These changes include:

The growing application of the theory by courts to hold parent firms accountable for the deeds of their subsidiaries is one such trend. The examples involving multinational firms and their operations in underdeveloped nations have made this particularly clear.

Another change has been the rising understanding of the necessity of striking a balance between shareholders' interests and those of the larger community. As a result, corporate procedures and structures that could be exploited to circumvent or go around legal and regulatory obligations are being scrutinised more closely.

To ensure that corporations are held accountable for their deeds, particularly in cases involving environmental harm, human rights violations, and other types of corporate wrongdoing, there have also been calls for the corporate veil theory to be revised.

Overall, the corporate veil theory is still a hot topic for legal and policy debate due to its importance in balancing the rights and obligations of corporations, shareholders, and society at large.

#### **V. WAYS TO MAINTAIN PROTECTION CORPORATE VEIL**

Spending should be kept separate for personal and business objectives: The majority of instances in which corporate veils are breached include situations in which the owner may have

used company money for personal or illegal purposes.

This type of financial "commingling" is seen as a serious violation. Separate bank accounts and accounting systems for personal and corporate expenses are solid financial practises that will help you control your spending on both fronts.

Make sure you have the required paperwork: To demonstrate that you have the required legal authorizations to conduct business in a particular country, running a business necessitates considerable documentation.

They range from incorporation documents to business licences and permissions. Check to see whether you've applied to or received approval for these licenses

Keep up with statutory requirements: As was previously said, disputes involving corporate veils are typically resolved on a case-by-case basis, largely depending on state laws and regulations for conducting business.

You can be responsible for adhering to numerous legal requirements if your company operates in different jurisdictions.

## **VI. CONCLUSION**

In conclusion, while the concept of lifting the corporate veil is an important tool for ensuring that individuals and entities are held accountable for their actions, it should only be applied in limited circumstances where there is clear evidence of wrongdoing or abuse of corporate structure. It is important for businesses to adhere to proper corporate governance practices and maintain transparency in their operations to avoid the need for the veil to be lifted.

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