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Public Interest and Lifting of Corporate Veil under Companies Act

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ABSTRACT

The phrase "corporate veil" refers- fictitious barrier that divides the firm from people who run it and those who own it. The primary benefit of incorporation is that the firm becomes a separate legal entity with limited liabilities. In actuality, the individuals who constitute the association are the ones who do business on behalf of the incorporated organisation. That is, while a corporation is a separate entity in the eyes of the law, in actuality, it is a group of people who benefit from the corporate personality. As a result, granting firms legal personality at the time of incorporation is a privilege.

However, there may be occasions where fraudulent or criminal behaviours are conducted in the shadow of this.The corporate image must be taken away to reveal the genuine perpetrators because artificial creatures are incapable of conducting any illegal or fraudulent acts. The lifting of the corporate veil is a premise that runs counter to Salomon's prevailing rule. As a result, lifting the corporate veil is used to learn about the facts hidden beneath the corporate veil. Despite the fact that it contradicts the rule in Salomon, it does not render the rule invalid. The concept posits the existence of a corporate identity that can be lifted in the interest of the entire membership or in the public good in order to identify and hold those who abuse the privileges bestowed upon them accountable. When the judge or legislature chooses to maintain the separation of the company's and members' personalities, the veil of incorporation is regarded to be removed.

"As a result, the piercing (or lifting) of the corporate veil refers to the possibility of looking beyond the company framework to hold members liable, as an exception to the general rule that they are protected by corporate law."

I. PUBLIC INTEREST

The general welfare (as opposed to a person's, group's, or firm's self-interest) in which the entire society has a stake and which the government and its agencies should recognise, promote, and preserve.

Despite the term's ambiguity, governments claim public interest when it comes to

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governmental secrecy and confidentiality. It's calculated by weighing the projected benefits against the probable costs or losses of a decision, policy, programme, or project.

II. Public interest under Companies Act

The word “in public interest” or “in the interest of the public” has been used several times in the Companies Act of 2013, and it refers to having a monetary interest or any other interest that affects the community's legal rights and duties.

III. Concept of public interest and its impingement on company law

It is considered to be in the public interest when something is or can be made to appear to be in the public interest rather than particular privileges of class, group, or individual. It is assumed to signify the interest of the society or nation as a whole, as well as the state government that represents it, in common usage. Because our social, political, and economic values change frequently, the concept of public interest is destined to alter as well.

Anything that advances the general interest of the community rather than the individual's particular interest (a company founded and registered under the act is a legal person) is termed "public interest," which is an interest in which the community is directly and vitally interested.

A review of the act's provisions reveals the veracity of the statement that the notion of "public interest" has been rapidly gaining traction in Indian corporate law.

- As you may recall, Section 396 authorises the central government to require the forcible amalgamation of firms (notwithstanding Sections 394 and 395) into a single company in the public interest. It's worth noting that the term "national interest" was first used in 1956.The act was amended, and the term "public interest" was replaced with "national interest." There were no provisions in the Indian Companies Act of 1913 that were analogous to those in section 396.
- Section 397 gives a member of a corporation the right to make an application with the company law board for appropriate redress if the corporation's affairs are being conducted, among other things, in a way harmful to the public interest, provided that section 399 is met.
- In circumstances when the company's affairs are being conducted in a manner harmful to the public interest, the shareholder company can file an application to the company law Board for relief under section 398.
- Under section 408, the central government has the authority to nominate as many people as the company law board deems necessary to hold office as directors in the company in

order to effectively preserve the public interest (beside the interest of company or its shareholders). Such an order may be issued in response to a request from the central government or in response to an application by at least 100 company members or members holding one tenth of the company's total voting power.

- "Under section 394(1) of companies act 1956, the court has been empowered: (a) to refuse its sanction to any compromises or arrangement in connection with a scheme for the amalgation of a company which is being wound up, with another company where it receive a reoport from the registrar that the the affair of the company have been conducted inter alia in a manner prejudicial to public interest: and (b) to refuse the dissolution of any transferor company under clause (i)(b) of section 394 (1) where the company have been conducted, inter alia in a manner prejudicial to public interest."
- The post of public trustee was established to allow him to take over the voting rights of shares and debentures held in trust from their trustees and exercise them as he sees fit. The goal was to make sure that voting power attached to monies held in trust for the company or the public was used to further the public interest rather than private individuals who had set up tax-free trusts apparently for "public motives."

IV. Corporate veil

A legal notion that distinguishes a corporation's personality from that of its owners and protects them from personal liability for the company's debts and other obligations.

Lifting of Corporate veil:

It is not uncommon for a company's corporate personality to be used to commit frauds and other unethical or criminal activities. Because an artificial person is incapable of doing any illegal acts, the façade of corporate personality may need to be removed in order to uncover the true criminals. This is referred to as the "raising of the corporate curtain."

Despite the rule of limited liability and/or separate personality, it was held liable for the debts of its corporation. When stockholders blur the line between the corporation and the shareholders, the veil doctrine is applied. As a result, a firm can be held liable in corporate law in two ways: first, through direct liability (for direct infringement), and second, through secondary liability (for the acts of its human agents acting in the course of their employment)

The uncovering of the corporate veil is based on two primary theories. The "alter-ego" or other self theory is the first, and the "instrumentality" hypothesis is the second. The alter-ego theory examines whether the borders between the corporation and its stockholders are separate.

The instrumentality thesis looks at how a corporation is used by its owners to benefit them rather than the corporation. It is up to the court to decide which theory to use or if the two concepts should be combined.

V. Concept of Limited Liability

The restricted liability that a corporation or firm provides to its shareholders is one of the primary reasons for its formation. According to this idea, a shareholder can only lose the value of the shares he or she has provided to the corporation. As we describe in detail in the study, this concept is in direct contrast to the doctrine of removing the veil, as the two do not co-exist.

When a company's true legal position and the conditions in which its entity as a corporate body will be ignored, the corporate veil will be lifted, and the individual shareholder may be held accountable for the company's actions.

“It is not necessary to enumerate the classes of cases where lifting the veil is allowed, that must depend on the relevant statutory or other provisions, the object sought to be achieved, the involvement of the element of public interest, the effect on parties who may be affected, etc.”. This was iterated by the Supreme Court in ***Life Insurance Corporation of India v. Escorts Ltd*.**

The circumstances under which corporate veil may be lifted can be broadly classified into two following heads:

1. ***Statutory Provisions*** - The term "officer who is in default" is defined in Section 5 of the Companies Act “as an individual who commits a wrong or an illegal act and is held accountable in respect of the violation. It includes a managing director or a whole-time director on the list of officers who are responsible for punishment or penalty under the ‘officer who is in default' clause”.

Reduction of Membership (Section 45 of the Act) – A public company must have at least seven members, but a private company must have at least 2 members “(Section 3 of the Act)”. However, if This minimum condition is not met when a corporation is created. if the firm continues to operate, each member who is aware of this knowledge is individually liable for any obligations the firm incurs during that time.

Improper use of Name (Section 147 of the Act)– **“**The liability of the mproper use of Name (Section 147 of the Actofficer who signs a Bill of Exchange, Hundi, Promissory note, or check under the improper name of the firm is provided in sub-section 4 of Section 147 of the Act.

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Unless such Bill of Exchange, hundi, promissory note, or cheque is duly paid by the firm, such officer shall be to the holder of such Bill of Exchange, hundi, promissory note, or cheque".

Fraudulent conduct (Section 542 of the Act)– *"* If it is discovered at the time of the corporation's termination that the company's operations were carried out in order to deceive the company's investors, the individuals who had knowledge of the business would be personally accountable for any loss caused to such investors, as the court may instruct".

Failure to refund application money (Section 69 of the Act)– "If a company fails to reimburse the application money to applicants who were not allotted shares within 130 days after the prospectus's release, the firm's directors are jointly and severally liable to repay the application money plus interest". This, on the other hand, will have no influence on the company's continued existence.

2. ***Judicial interpretation-*** Judicial intrusions into there are more people who believe in the concept of a separate personality than the restricted and meticulous statutory orders to "raise the curtain." The courts, in addition to the corporate veil is lifted by statutory provisions, allowing the genuine situation of business to be seen.

FRAUD OR IMPROPER CONDUCT– "When the courts lift the corporate veil, the most typical reason is that the company's members have committed fraud. The goal is to find out what the members' true interests are. IIn such instances, the members are unable to apply the Salomon principle to avoid culpability. The corporate veil of a corporation can be lifted in circumstances of criminal actions of fraud by officers of a firm, according to one of Shri Ambica Mills Ltd.'s leading cases, Re. In the case of VTB Capital v. Nutritek, the court pierced the corporate veil and held the directors personally accountable for illegally securing a loan".

Tax Evasion– The corporate veil is sometimes employed for tax evasion or to evade any form of responsibility to pay taxes. Because the legislature will not be able to fix all of the holes it is necessary for the judiciary in the law. to intervene. As a result, the circumstances, the courts raise the company's veil to reveal the company's true condition of affairs. Vodafone was a notable example of a business structure created to avoid paying taxes. "Once the transaction is shown to be fraudulent, sham, circuitous, or a device designed to defeat the interests of the shareholders, investors, parties to the contract, and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction," the apex court stated in this case. "In this instance, the court granted the Income Tax Office the authority to breach the company's corporate veil".

Company as an Agent– "The idea of vicarious liability is used in every scenario when a company serves as an agent for its shareholders, and the shareholders are held liable for the company's actions". In such cases, the court will look at the facts of the case to establish whether the corporation is acting as an agent for its members. "This can be deduced either from the agreement itself, when it is expressly stated, or from the facts of each case".

VI. PUBLIC INTEREST AND LIFTING OF CORPORATE VEIL

It is permissible for the Court to authorise the removal of the corporate veil to assess the reality whether a corporation has been set up or employed against the public interest. Members of the company are no longer protected against limited liability in such situations. The veil may be lifted by the courts to defend public policy and prevent transactions that are against it. When raising the veil provides the most "fair" consequence, the Courts will rely on this ground, despite the fact that there are no specific reasons for lifting the veil. As a result, when there is a conflict with public policy, the Courts look at the substance rather than the form.

LIC v. Escorts**:**

In the case of "Life Insurance Corporation of India v. Escorts Ltd. & Ors", the Supreme Court of India declared for the first time that the business has its own legal personality and lifted the corporate veil.

"It dealt with a non-resident portfolio investment strategy under the former Foreign Exchange Regulation Act of 1973 (FERA). At least 60% of the original capital was invested in Indian companies".

Such enterprises were allowed to invest up to 1% of their equity capital that has been paid up, with a maximum of 5%. Caparo Group Ltd, which invested in Escorts Ltd, owned 13 companies under this programme.

Swraj Paul and his family were the beneficiaries of a trust that held 60 percent of Caparo Group Limited shares.

The scheme permitted non-resident corporations to invest in Indian enterprises if they were owned by or had a beneficial interest in them that was at least 60% held byIndividuals of Indian ancestry or nationality who are not residents in the United States.

The 13 Caparo Group companies have invested was contested on the grounds that it was an attempt to get around the Scheme's 1% investment cap, and that "one merely had to pierce the corporate veil to reveal Mr. Swraj Paul hiding behind."

According to the Supreme Court, the verdict in "Salomon" established that the corporation has

an autonomous and legal identity apart from that of its members. In certain circumstances, and when the members are recognised for who they are, the corporate veil may be lifted.

"In order to a limited extent to ascertain the nationality or origin of the shareholders it would be necessary to lift the veil for the purpose of ascertaining the ownership in the investment."- Supreme court. It was not essential to determine each individual's identification. Because a trust owned 60 percent of the shares in the foreign investor companies, and the trust's beneficiaries were Mr. Swraj Paul and his family.

Importance:

In this age of corporatization, most jurisdictions consider a corporation as a separate legal entity with its own identity separate from its owners, members, or directors. This corporate existence distinguishes a corporation from its promoters or stockholders.It enables the corporation to purchase and hold property in its own name with its shareholders and other third parties. A company's existence is not contingent on the actions of its shareholders, and it will continue to exist regardless of membership changes until it is liquidated. A corporation's the firm is not linked to its stockholders and can't be held directly responsible accountable for the company's actions or liabilities.

Ratio of the case:

In the end, the Supreme Court declined to pierce the corporate veil in Vodafone because the tax authorities were unable to show that the transaction was a sham or a a tax evasion scheme. The Court noted, "*There is a conceptual difference between a preordained transaction which is created for tax avoidance purposes, on the one hand, and a transaction which evidences investment to participate in India*" – and that to ascertain which bracket the transaction fell into, the six factors mentioned above should be taken into account. "The fact that the Hutchison structure (i.e., the parent company in Hong Kong, the intermediate subsidiary in the Cayman Islands, and the final subsidiary in India, etc.) had existed for a long time (since 1994), generating taxable revenues, the transaction envisioned "continuity" of the telecom business, and thus the Hutchison structure was not a sham, was noted".

The Supreme Court continued by stating that if the court is convinced that the transaction meets all of the criteria for "participation in investment," it does not need to consider issues like "de facto control vs. legal control, legal rights vs. practical rights", and so on, and As a result, there is no need to lift the Hutchison or Vodafone corporate veil.

RELEVANCE OF THE CASE**:**

The notion of a company's legal and juristic independence, as well as the corporate veil that separates it from, a key but not inviolable principle of modern corporate law is that it must protect its stockholders..

This curtain can be lifted or breached in unusual circumstances, as indicated in “LIC v. Escorts and Beyond”, to examine and assess the shareholders or entities that control the corporation in question.

“The economic reality, the substance of the transaction, and the overall view of the transaction are all scrutinised, but unless there are compelling circumstances, Indian law requires that courts respect the sanctity of the corporate veil and the independent corporate personality that emerges immediately after a company is incorporated.”

VII. Conclusion

It should be highlighted that the fundamental principle of “Salomon v. A. Salomon & Co. Ltd”. remains the guideline, with piercing the veil examples being the exceptions. The corporate veil has been lifted in several circumstances by the law and the courts**.** The notion that a company has its own unique legal identity is also enshrined in the Indian Constitution. According to “Article 21 of the Indian Constitution”, "no individual should be deprived of his life or personal liberty unless in accordance with the procedures established by law."

Because a corporation is made up of and governed by persons acting as representatives of the firm, it can acquire and sell properties, file or be served with a lawsuit, or commit a criminal offence. Members or shareholders conduct fraud or other illegal acts while under the ‘seal of the company,' hence the corporation should be held accountable as well, as it is a person with fundamental rights under “Article 21 of the Indian Constitution”.

The other side of this coin could be that, because the company is fortunate to have its own right to life and personal liberty, how can its fundamental rights be taken away by blaming its members for wrongdoing rather than the company itself?

An incorporated firm obtains the ‘corporate personality' as a result of incorporation, which hides the stockholders who created the company behind a ‘corporate veil.' Although the corporation is a legal entity, it is an artificial person, and thus there are natural persons, i.e. stockholders, behind the corporate veil. When the corporate personality is revealed, it is usually the shareholders or directors who are found to be hiding behind the curtain.

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