BEYOND SEPARATE LEGAL PERSONALITY: A CRITICAL COMPARATIVE STUDY OF THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN INDIA

Nishalya Singh, Jindal Global Law School, O.P. Jindal Global University

ABSTRACT

The Research Paper undertakes a comparative analysis of the doctrine of piercing the corporate veil, examining how courts across different jurisdictions depart from the foundational principle of separate legal personality established in Salomon v. Salomon & Co. Ltd. While this doctrine ordinarily shields directors and shareholders from being personally liable for the acts of a company, courts have recognized exceptions where the corporate form is used to perpetuate fraud, evade taxes and circumvent statutory obligations or conceal the true relationship between companies which are affiliated. Drawing on Judicial precedent from various jurisdictions such as the United Kingdom, Germany, China and India, the paper argues that although certain grounds for invoking this doctrine are broadly shared across jurisdictions, their application differs significantly in practice. In the absence of codified statutory guidance, Indian courts rely heavily on judicial precedent and have extended the doctrine to encompass public interest. The English Courts apply a stricter test requiring evidence of both control and impropriety before the invocation of the doctrine. German Law addresses shareholder liability primarily through codified statutory provisions rather than judicial discretion while the Chinese Courts have adapted an increasingly expansive approach to shareholder liability, particularly in cases of Undercapitalization. The paper concludes that the doctrine of piercing the corporate veil remains an exercise in Judicial pragmatism, shaped as much by each jurisdiction's institutional and statutory context as by any single unifying legal principle.

INTRODUCTION:

In the field of Company law, there are numerous doctrines and policies which ensure limited liability for the company and its shareholders or owners. The Corporate Veil theory is one such theory which has a significant role in protecting the stakeholders of a company from being personally liable to the wrongdoings of the organisation or company. To define, Corporate Veil stands as a legal concept which shields the members of a company from liabilities arising out of the actions taken by a company, by separating the identity of the Company from its members. This concept was first recognized in the landmark case of *Saloman v. Saloman*[1]. In this case, the House of Lords held that the Company is a distinct legal entity with its own rights and liabilities. The Court also affirmed that the liability of the Shareholders is only limited to the amount unpaid in regards to the number of shares and is limited to the nominal value of the shares. The liability towards the debts of the Company does not go beyond that. In the context of India, the doctrine of Corporate Veil was seen in the case of Bacha *F. Guzdar v. Commissioner of Income Tax*[2], where the court recognized the Juristic personality of a company as distinct from its shareholders.

The question then arises as to who is to be held accountable where allegations of fraud of misrepresentation are made against a company and a lawsuit follows, given that the Company is ordinarily protected by the veil. It is in such circumstances that the doctrine of piercing the corporate veil comes into play. Piercing the Corporate veil operates as an 'exception' to the corporate personality rule of company law. Since the veil serves as a fundamental protection for the company, courts are often cautious in applying the doctrine, as doing so has the potential to harm the company's business prospects and lead to undesirable outcomes.

ANALYSIS OF THE DOCTRINE:

The doctrine of Corporate Veil as noted above, can only be invoked in certain exceptional circumstances, though the circumstances under which courts of law can invoke this doctrine differ. The paper aims undertakes a comparative analysis of the broader application of the piercing of Corporate Veil in context of the Courts of law of different countries. Firstly, the general principles commonly accepted across courts of law as grounds to invoke the doctrine

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[1] *Salomon v. Salomon & Co. Ltd., [1897] A.C. 22 (H.L.).*
[2] *Bacha F. Guzdar v. Comm'r of Income Tax, (1955) 27 I.T.R. 1 (S.C. India).*

are set out below:

1. A company formed for the purposes of Fraud or Improper Conduct: When allegations or a reasonable doubt exists as to the Fraudulent acts of a company, the courts can invoke the doctrine to reveal the true intention of the members and directors behind such fraudulent acts. In the case of *United States v. Milwaukee Refrigeration Transit Company*[3], the Court stated that "*A corporation will be looked upon as a legal entity as a general rule but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime the law will regard the corporation as an association of persons*."

2. For the Purposes of Tax Evasion: The protection of limited liability offered by the Corporate Veil can also be used by certain Companies to avoid tax obligations. In the case of *Vodafone International Holdings B.V. v. Union of India & Anr*[4], the court opined that, "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."

3. Non-adherence to Corporate Formalities: Corporate Formalities such as non-payment of debts, non-filing of essential documents, non-compliance with regulatory guidelines, not maintaining clear corporate structures can lead Courts to invoke the Doctrine of Piercing the Corporate Veil, where in order to determine the true intent of the owners or shareholders behind the questionable conduct of the Company, they can hold the Shareholders personally liable.

4. Failure to foster or maintain separate identities among companies: Many companies operate under the umbrella of a single parent company or are so inextricably connected that they may be regarded as one entity. In such cases, it becomes pertinent to examine whether these companies are being used as a front for improper purposes.

In the case of *State of Up v. Renusagar Power Co.*[5], the Apex court ruled that the companies

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[3] *United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905).*
[4] *Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 S.C.C. 613 (India).*
[5]*State of U.P. v. Renusagar Power Co., (1988) 4 S.C.C. 59 (India), Paragraph 68.*

of Hindalco and Renusagar were to be treated as one concern, following the lifting of the Veil. The court further held that Hindalco was consuming energy from its own source of generation and hence the rate of duty applicable to captive generation should accordingly apply to such consumption.

Thus, while there are no established guidelines regarding when the courts ought to invoke the doctrine of Piercing the Corporate Veil, these are some commonly accepted grounds which are followed in Courts of law worldwide. However as stated above, the application of this doctrine varies country to country. In India for example, there is an apparent inconsistency as to the application of this doctrine due to the lack of codified laws in respect to this matter. While a stricter application is generally accepted, precedents such as, *Life Insurance Corporation of India v. Escorts Ltd*.[6] The courts observed that there is no clear set of guidelines as to when the doctrine may be invoked, nor is it desirable to list exhaustive categories of cases where the doctrine can be invoked, because this would inevitably be in accordance with the legislation in place, its alleged conduct, its object, its impact of the parties so affected by the cause and the Public interest element the cause of action may hold. Thus, we will now look into a comparative analysis of the application of this doctrine in the United States and India.

The Applicability of the Doctrine by Various Courts:

In India, while there is a lack of specific codified laws in relation to the piercing of Corporate Veil, there are certain statutory provisions and Judicial Precedents which assist in the application of this doctrine, however there have been instances of peculiar approaches adopted by the Indian Courts for invoking the doctrine of Piercing the Corporate Veil. A few such instances are discussed under:

In the landmark case of *State of Rajasthan v. Gotan Limestone Khanij Udyog and Anr*.[7] Where after receiving a mining lease from the state, the Company decided to sell of the mining lease to another company to make profits. The court ruled here that "*that the doctrine of lifting the veil can be invoked if the public interest so requires or if there is allegation of exploitation of law by using the curtain of a corporate entity. In the present case, the corporate entity has been used to conceal the real transaction of transfer of mining lease to a third party for consideration without statutory consent by terming it as two separate transactions – the first*

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[6] *Life Ins. Corp. of India v. Escorts Ltd., (1986) 1 S.C.C. 264 (India), Paragraph 92*
[7] *State of Rajasthan v. Gotan Limestone Khanij Udyog Pvt. Ltd., (2016) 4 S.C.C. 469 (India).*

of transforming a partnership into a company and the second of sale of entire shareholding to another company. The real transaction is sale of mining lease which is not legally permitted. Thus, the doctrine of lifting the veil has to be applied to give effect to law which is sought to be circumvented." (State of Rajasthan v. Gotan Limestone Khanji Udyog) Through this precedent, Indian Courts have recognized 'public interest' as one of the grounds for invoking the doctrine of Corporate veil, a ground not similarly followed by courts in other jurisdictions. In the United Kingdom, for instance, courts are reluctant to lift the corporate veil in the absence of clear evidence of wrongdoing and impropriety, and do not do so merely because the company is alleged to be involved in some impropriety.

This position was laid down in the case of *Ben Hashem v Al Shayif & Anor*[8], an English case where after a review of the arguments, the court had summarized the following principles: The court cannot pierce the corporate veil, even where there is no unconnected third party involved, merely because it is thought to be necessary in the interests of justice. If the court is to pierce the veil it is necessary to show both control of the company by the wrongdoer(s) and impropriety, that is, (mis)use of the company by them as a device or façade to conceal their wrongdoing. The motive of the wrongdoer is therefore, highly relevant. The court cannot pierce the corporate veil just because the company is involved in some impropriety. Upon a bare reading of the summarized principles, we can note that the courts of law in the UK adhere to a stricter interpretation in matters of lifting the Corporate Veil as compared to India.

A further point of comparison is the heavier reliance on statutory provisions in the Courts of Germany as regards Cases involving the doctrine of Piercing the Corporate Veil. In India, due to lack of Codified laws regarding lifting of corporate veil, there is a heavier reliance on Judicial Precedents. In Germany, however, courts rely more on statutory provisions. Even in the UK, a functional piercing of the Corporate Veil to hold shareholders liable on statutory grounds is largely absent. Examples of such statutory provisions in Germany include the liability for existence destroying shareholder interference according to § 826 Civil Code (BGB), the subordination of shareholder loans according to § 39(1) no 5 Insolvency Code (InsO), the liability for a delayed filing for insolvency according to § 15a (3) Insolvency Code (InsO) and the liability to cover losses the company suffers before incorporation (*Verlustdeckungs-* and *Vorbelastungshaftung*). The greater willingness of the German legislature and courts to hold shareholders liable, notwithstanding the generally codified principle of limited liability,

[8] *Ben Hashem v. Al Shayif, [2008] EWHC (Fam) 2380 (Eng.).*

is also reflected in German lending practice. Banks require comparatively fewer personal securities when extending credit to German GmbHs than when doing so to English limited companies.

Courts of Law in China also adopt a somewhat different albeit a more expansive approach when considering matters involving lifting of the Corporate Veil. China did not have a specific set of provisions or laws in reference to corporate veil for a long time until the implementation of the Company Law of China in 2006. In China, recent judgements have focused on the liability of Shareholders especially in matters where there is a failure of the liquidation process especially in matters of Undercapitalization. "Under *Provisions on Several Issues concerning the Application of the Company Law of the People's Republic of China V* ("The Provisions")[9], shareholders are strictly prohibited from abusing shareholders' rights, the independent company's status as a legal person, or the limited liability of shareholders. Any shareholder that causes loss to the company or other shareholders by such abuse will be liable for compensation.

In practice, shareholders have been afforded the right to initiate legal proceedings against other shareholder (s) who are acting against the interest of the company, such as diverting company funds or profits, entering into contracts running contrary to the interests of the company. Given the relatively recent implementation of these provisions, there is a growing emphasis on holding shareholders liable in Chinese courts.

CONCLUSION:

Thus, based on the aforementioned analysis we see that the doctrine of Piercing the Corporate Veil emerges as an important aspect of Judicial Pragmatism, applied by courts of law globally on the basis of various grounds. While some of these grounds appear common across jurisdictions, there is a variation in the narrower or expansive approach used by different courts. As discussed above, courts in the UK tend to focus on the clear evidence of fraud or wrongdoing and are usually reluctant to lift the veil until such evidence is established. Courts in Germany rely more on established statutory provisions in comparison to reliance on Judicial precedents in India and the United States. Courts in China notwithstanding the relative novelty of their statutory provisions on corporate veil, have adopted a more expansive approach to shareholder liability as compared to other jurisdictions. Thus, the doctrine of Piercing the

[9] Company Law of the People's Republic of China (2006), art. 20.

Corporate Veil stands as an ever-evolving concept, owing to its fluid nature, different interpretations of it are required to adjudicate cases involving abuse of the corporate personality, underscoring its importance within the intricacies of corporate law across all courts of law.