

# Abuse Of Human Rights Vis-A-Vis Lifting The Corporate Veil

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## **Abstract**

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The doctrine of lifting the veil can be understood as the identification of the company with its members. In other words lifting the corporate veil is a legal decision to treat the rights or duties of a corporation as the rights or liabilities of its shareholders. Although this fundamental rule has considerable influence in Company Law across the globe, including India, it cannot be absolute and must allow some exceptions, where the court may disregard the legal personality of the company. Such exceptions as there are, represent haphazard refusals by the legislature or the courts to apply logic where it is to flagrantly opposed to justice, convenience or the interest of the revenue. Ordinarily, corporate personality of a company is to be respected. The whole law of corporations is still based on this basic principle of corporate entity. There are umpteen instances in which the courts have upheld this principle and resisted the temptation to break through the veil. But when the benefit is misused, the court is not powerless and it can lift the veil of corporate personality to see the realities behind the veil. In doing so the court sub serves the important public interest, namely, to arrest misuse or abuse of benefit conferred by law. This project will make an attempt to be au fait with the concept of Human Rights in the corporate arena, and discuss how abuse of Human Rights is sufficient reason for lifting the corporate veil.

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## **Introduction:**

The doctrine of lifting the corporate veil means ignoring the corporate nature of the body of individuals incorporated as a company A company is a juristic person, but in reality it is a group of persons who are the beneficial owners of the property of the corporate body. Being an artificial person, it cannot act on its own, it can act only

through natural persons. The doctrine of lifting the veil can be understood as the identification of the company with its members. In other words lifting the corporate veil is a legal decision to treat the rights or duties of a corporation as the rights or liabilities of its shareholders.

An important case which marked origin of lifting of corporate veil was, *Salomon Vs Salomon*. An important principle of 'separate legal entity' has been recognized in this case which means a company has its own legal personality, distinct from its members. It allows a company to perform juristic acts in its own name, as well as to sue and to be sued. Members and Directors enjoy protection against personal liability. Although this fundamental rule has considerable influence in Company Law across the globe, including India, it cannot be absolute and must allow some exceptions, where the court may disregard the legal personality of the company. Such exceptions as there are, represent haphazard refusals by the legislature or the courts to apply logic where it is to flagrantly opposed to justice, convenience or the interest of the revenue. The veil of incorporation never means that the internal affairs of the company are completely concealed from view.

Ordinarily, corporate personality of a company is to be respected. The whole law of corporations is still based on this basic principle of corporate entity. There are umpteen instances in which the courts have upheld this principle and resisted the temptation to break through the veil. But when the benefit is misused, the court is not powerless and it can lift the veil of corporate personality to see the realities behind the veil. In doing so the court sub serves the important public interest, namely, to arrest misuse or abuse of benefit conferred by law.

This project will make an attempt to be au fait with the concept of Human Rights in the corporate arena, and discuss how abuse of Human Rights is sufficient reason for lifting the corporate veil.

### **Origin Of The Doctrine Of Corporate Veil**

According to *Black's Law Dictionary*, "piercing the corporate veil is the judicial act of imposing liability on otherwise immune corporate officers, Directors and Shareholders for the Corporation's wrongful acts." Aristotle said, in this regard, "when one talks of lifting status of an entity corporate veil, one has in mind of a

process whereby the corporate is disregarded and the incorporation conferred by statute is overridden other than the corporate entity an act of the entity”.

In England the legal personality of a company was recognized in 1867 but it was firmly established in 1897 in the case of *Saloman v. Saloman & Co. Ltd.* In this case one Saloman was a boot and shoe manufacturer. His business was in sound condition and there was a substantial surplus of assets over liabilities. He incorporated a company named Saloman & Co. Ltd for the purpose of taking over and carrying on his business. The seven subscribers to the Memorandum were Saloman, his wife, his daughter and four sons and they remained the only members of the company. Saloman and two of his sons, constituted the Board of Directors of the company. The business was transferred to the company for £ 40000. In payment Saloman took 20000 shares of £ 1 each and debentures worth £ 10,000. These debentures certified that the company owned Saloman £ 10000 and created a charge on the company's assets. One share was given to each remaining member of his family. The company went into liquidation within a year. Its assets amounting to £ 6,000 were insufficient to pay the debentures in full and the ordinary creditors received nothing and contended that though the company was incorporated under the Act, the Saloman & Co. Ltd. had no independent existence and it was in fact only Saloman who was the sole person behind it, he was the managing director, the other directors being his sons were under his control. Saloman and Company Ltd. was incorporated complying with all the formalities which were necessary to incorporate a company having a personality separated from that of its members and since Saloman was one of its members or share holders he was under no obligation to meet liabilities of the company. The House of Lords refused these arguments on the ground that after incorporation the Saloman and Co. Ltd. became in law a different person altogether from its members with its own rights and liabilities. So, the House of Lords has made it clear that after incorporation a company is conferred on a legal entity different from the motives or conduct of its members and promoters.

### **Human Rights Vis-A-Vis Doctrine Of Lifting Of Corporate Veil**

Human rights are rights inherent to all human beings, whatever our nationality, place of residence, sex, national or ethnic origin, colour, religion, language, or any

other status. We are all equally entitled to our human rights without discrimination. These rights are all interrelated, interdependent and indivisible.

The following are some of the most important characteristics of human rights:

- Human rights are founded on respect for the dignity and worth of each person;
- Human rights are universal, meaning that they are applied equally and without discrimination to all people;
- Human rights are inalienable, in that no one can have his or her human rights taken away; they can be limited in specific situations (for example, the right to liberty can be restricted if a person is found guilty of a crime by a court of law);
- Human rights are indivisible, interrelated and interdependent, for the reason that it is insufficient to respect some human rights and not others. In practice, the violation of one right will often affect respect for several other rights.
- All human rights should therefore be seen as having equal importance and of being equally essential to respect for the dignity and worth of every person.

Lifting the corporate veil is a legal decision to treat the rights or duties of a corporation as the rights or liabilities of its shareholders. Human rights of each individual are of utmost importance and cannot be denied in any case. They are to ensure the dignity and worth of every individual. Since the very existence of the company is due to its shareholders and members it is important that the dignity of the shareholders must be ensured. Now in order to ensure that each shareholder is ensured basic human rights the doctrine of lifting of corporate veil comes into picture and is quite important. Dignity of any member of the company in any case cannot be ignored.

### **Doctrine Of Lifting Of The Corporate Veil In India**

Most of the provisions of Indian Company Law were borrowed from English law. *Salomon's case* has been the authority since, in taking the decisions relating to the doctrine, of Indian Company Law cases.

The Supreme Court in *Tata Engineering Locomotive Co. Ltd. v. State of Bihar and others* stated-"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.

### Need for the Doctrine of Lifting the Corporate Veil

The theory of lifting the corporate veil becomes necessary when unscrupulous people started using the corporate veil as an instrument to conceal fraud in company's affairs. Thus, it becomes compulsory for the legislature and court to evolve and to lift the corporate veil and find out the person behind the company, who are the actual beneficiaries of the corporate body.

In *Andhra Pradesh State Road Transportation Case* the Supreme Court pointed out that a corporation has a separate legal entity is so firmly rooted in our notions derived from common law that it is hardly necessary to deal with it elaborately.

### 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.

### 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.

### Holding and Subsidiary Company

*Section 212* of the Companies Act, 1956 provides that in relation to financial disclosure a true and fair view of the overall position of the group is to be presented and therefore, the parent company must present financial statements of its subsidiaries as well as its own individual statement, thereby avoiding any misleading picture given by presenting only the financial statement of the parent company. However, it would be highly misleading to construe this action alone as resulting in a lifting of the corporate veil as this provision nowhere provides for the holding company being liable for the debts of its subsidiaries. Its sole object seems to be ensured accurate information about the finances of its subsidiaries.

### Failure to Deliver Share Certificate

*Sub section (2) of Section 113* provides that in case a company fails to deliver the share/debenture certificate within 3 months of allotment and within 2 months of application for transfer, then the company as well as every officer of the company who is at fault shall be punishable with fine up to Rs. 5000 per day till such default continues

### The Companies Act, 2013

Although there is no specific mention of the Doctrine of Lifting the Corporate Veil herein, it can be inferred from various provisions of the Act. Some of them are given asunder:

#### 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.

### 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.

### 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.

### Civil Liability For Misstatements 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 o 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 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 intend 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 parities 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**.

**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.

**Establishment of Serious fraud Investigation Office-**

The central government shall, by notification, establish an office to be called the Serious Fraud Investigation Office to investigate fraud relating to a company.

**Investigation of Ownership of Company-**

Where it appears to the central government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons-

- a. who are or have been financially interested in the success or failure, whether real or apparent, of the company; or
- b. Who are or have been able to control or to materially influence the policy 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 intend 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 caring one 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.

## Other Laws

### The Income Tax Act, 1961

Under the Income Tax Act, there are some sections where the principal of lifting of the corporate veil is applied. **Section 178** applies to a company in liquidation. The liquidator of any company shall be personally liable for tax due from the company and remaining unpaid if he has failed to give notice to the income tax officer having jurisdiction to assesses the company of the fact of his appointment as liquidator of the company within 30 days of his becoming such liquidator or fails to set aside amounts equal to the amounts notified to him by the income tax officer. The Income Tax officer's notice notifying the amount to be set apart by the liquidator has to issue within three months of receipt by the income tax officer of the intimation of appointment of the liquidator. The liquidator personal liability is limited to the amount notified by the Income Tax officer under **section 178 (2)** if so notified. This is strictly not a case of lifting the corporate veil but one where for non-compliance with certain provisions in the I.T. Act, the liquidator is personally held liable for the tax obligations of the company in liquidation. **Sec- 179 (1)** of the Income Tax Act is the one provision which fit in well with the concept of a lifting the corporate veil. It provides for personal liability of directors of a private company for the taxes due from a private company and becoming irrecoverable from the company, in respect of the income of the private company for any period during which it was a private company, unless the person who was a private company, unless the person who was a director during that period proves that the ir-recoverability cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. This is a negative provision throwing the onus on the director to prove his non-culpability.

According to **section 278**, where an offence under the income Tax has been committed by a company, not only the company, but also every person who, at the time of commission of the offence was incharged of and responsible to the company

for the conduct of its business will also be personally liable deeming him to be guilty of such offence unless he proves that the offence was committed without his knowledge or could not be prevented in spite of all due diligence exercised by him. This does not involve the principle of lifting the corporate veil as personal guilt of the individuals is itself proved.

### Foreign Exchange Regulation Act, 1973

**Sec- 63** of this Act deems guilty for contravention of the provisions of the Act, every person in charge of and responsible to the company for its affairs.

### Conclusion

The Doctrine of Lifting the corporate Veil and exposing the corporate identity merely seeks to strike a balance between the interest of the public and the concept of a separate personality. Thus the device is essentially used as a flexible tool to ensure justice. It would be defeat the object of the device if it were to be applied rigidly with no scope at all left for judicial discretion. There can be no single unifying principle that underlines the decisions of the Courts. Although on ad hoc explanation may be offered by a Court which so decides, there is no principle approach to be derived from the authorities. Thus it is not possible to evolve a rational, consistent and inflexible principle which can be invoked in determining the question as to whether the veil of corporation should be lifted or not. Courts and Legislature must adopt a single set of statutory standards as to when limited liability should be disregarded. This will provide the certainty in this area of law and will allow uniformity, applying the doctrine of lifting the corporate veil.