

# Breaking the Corporate Veil: Challenges, Threats, and Legal Evolution

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## **Concept of Corporate Veil and its Application**

Although not been statutorily defined, a Company has been popularly hailed as a legal fiction.<sup>1</sup> Claimed to be an association of members who run a particular business, Its composition as a separate legal entity in the eyes of law as opposed to those who are concerned with its management has been the most simplistic feature of such a kind of a set up. This distinction is maintained by the corporate veil.<sup>2</sup> The Corporate veil has been time and again hailed as an important device to limit the liability of the members. It acts as a shield that safeguards the interest of those who own such an organization from being personally liable for the misdemeanour of those who run it.

The House of Lords' judgement in the case of *Salomon v. Salomon* set an illustrious precedent in the jurisprudence of company law on the subject of the corporate veil which later came to be constructed as a doctrine. It set in stone that lifting the corporate veil is an exception and not the rule; the veil must be respected in all cases.<sup>3</sup> Equating the lifting of the corporate veil to an act of sacrilege, the implication of the *Salomon rule* was that the shareholders of a company were now instilled with a sense of privilege and often benefitted from this distinct corporate personality.

Over the course of time this benefit came to be misused and courts across the world were compelled to tweak their stance in order to lift or pierce this veil under exceptional circumstances like fraud, creation of sham companies and tax evasion. Today, the scope for lifting the once considered sacrosanct veil has been ever so expansive, with courts invoking vague terms like public interest, equity and meeting the ends of justice to settle matters.

## **Objective**

The purpose of this paper is to critically analyse the scope of the Doctrine of Corporate Veil and examine its application through notable judicial pronouncements from major jurisdictions, such as India and the United Kingdom. While these legal jurisdictions have extensively deliberated on the grounds for piercing the corporate veil, their efforts differ significantly. Some have been successful in coming up with an exhaustive list where the doctrine can be invoked, other find themselves lurking

<sup>1</sup> Sibani Dash & Pallavi Chakra, *Public Interest and Lifting of Corporate Veil under Companies Act - International Journal of Law Management & Humanities*, International Journal of Law Management & Humanities (2021), <https://ijlmh.com/paper/public-interest-and-lifting-of-corporate-veil-under-companies-act/>.

<sup>2</sup> *Bacha F. Guzdar v. CIT, Bombay*, MANU / SC / 0072 / 1954.

<sup>3</sup> *Salomon v. A Salomon & Co. Ltd.*, [1897] AC 22

around ambiguous principles like Public Interest, justice, and equity to resolve matters.

As a recent phenomenon, Courts across India appear to fall into the latter category, which has led to inconsistent application of what was once considered an exceptional doctrine. These inconsistent judicial outcomes risk rendering the doctrine anomalous and diminishing its significance. This paper seeks to highlight these developments, critically evaluate their adverse implications on corporate structures, and discuss how the current anomalous position poses a threat to the predictability and stability of corporate law at large.

### **Legal Position in the UK**

The English law jurisprudence is where the Doctrine of Corporate veil has found its origins. And the legal gymnastics that these courts across England subjected themselves to post the Salomon era stressed on the inviolability of the veil. The popular understanding of the existence of this veil highlighted that even though the shareholders virtually owned the entire share capital of the organization, legally, they held a separate existence from that of the company.

The concept of limited liability as seen as a counterpart to the Doctrine of Corporate veil protected the interest of these shareholders and asserted that: in any case, the shareholders cannot be held to be liable for the deeds of the company. With the upscale of commercial activities throughout the past century, combined with the emerging capitalistic mindset, elements such as fraud, tax evasion, mismanagement came to plague the corporate framework. With a rise in such instances, it was imperative that the corporate veil was no longer a foolproof mechanism. And shareholders often found themselves indulging in wrongdoing under the garb of this legal façade.

This backlash and potential abuse of the once considered novel concept meant that judicial systems around the world were now faced with a dilemma where it had to figure out a way around this impenetrable wall and expose any sneaky approaches of shareholders. This dilemma gave the courts an opportunity to devise a mechanism to disregard the separate legal identity in specific instances. And the new age concept of Piercing or Lifting the corporate veil came to be birthed. Commonly conceived to be an exception to the idea of a distinct legal identity, lifting of the corporate veil enabled courts to unmask perpetrators and hold those exercising untrammelled control over the affairs of the company accountable for their misdeed.

Although considered to be a popular mechanism, the application of the Doctrine of lifting the corporate veil has been restricted to a limited sense in the UK. From the case of *Salomon v. Salomon*, the courts of equity have shown very little progress in terms of coming up with legal grounds where the veil can be lifted. Apart from the obvious likes of fraud;<sup>4</sup> evasion of taxes;<sup>5</sup> the imagination of the courts in the UK has only stretched as far as incorporation of sham companies;<sup>6</sup> misdemeanour;<sup>7</sup> instances such as

<sup>4</sup> Catherine Lee v Lee's Air Farming Ltd [1961] AC 12; Lim Leong Huat vs. Chip Hup Hup Kee Construction Pvt Ltd [2009] 2 Slr 318., MANU/SGHC/0064/2009

<sup>5</sup> In re. Young v. David Payne & Co. Ltd., [1904] 2 Ch. D. 608

<sup>6</sup> Adams v Cape Industries plc [1990] Ch 433 at 513

<sup>7</sup> Mihir Naniwadekar, *British decision on lifting the corporate veil: Clarity or more confusion? – India Corp Law*, India Corp Law (Oct. 28, 2008), <https://indiacorplaw.in/2008/10/british-decision-on-lifting-corporate.html>.

war;<sup>8</sup> to permit the legal piercing of the veil. Essentially, the scope in the UK has been ever so limited. The case of *Ben Hashem v. Ali Shayif* garnered importance in this regard by laying down an exhaustive list of conditions and the same holds to be good law even after decades. The following principles can surmise the position as established in the UK for piercing of the veil:

1. Only in instances of impropriety can the veil be lifted;
2. The impropriety in question must have a connection with the structure or form of the company that must be used to conceal some sort of a liability.
3. To justify the lifting of the veil, it must be proved that the impropriety was used by the wrong doers as a measure to conceal their wrongs.
4. Form and control of the organization cannot be sole grounds to lift the veil.
5. The court would not be justified in lifting the veil merely because it is considered important in the interest of justice.
6. The court is justified lifting the veil only up to the extent necessary to give a remedy for the specific wrong committed by individuals in charge of the corporation.<sup>9</sup>

As a recent measure, the case of *Prest v. Petrodel* laid yet another defining position on the said contention by asserting that lifting the veil should only be the final resort and it must only be undertaken when no alternative recourses seem viable.<sup>10</sup>

### **Legal Position in India**

The position held in the case of *Salomon v. Salomon* has been well respected in other common law nations as well. From an Indian jurisprudential perspective, the existence of the corporate veil has never been a matter of dispute. From the earliest instance of the Constitutional Bench verdict of *LIC v. Escorts Ltd*, the court set out the veil can be lifted to prevent improper conduct, fraud, evasion of taxes;<sup>11</sup> beneficent statutes, and even instances of public interest. It was also remarked that enumerating the list of instances where the veil can be lifted is beyond the ambit of the court and a wide interpretation is desirable.<sup>12</sup> A closer look reveals that top courts have taken a significant departure with regards to the application of this principle in India and the United Kingdom.

Unlike the courts in the UK, courts across India have seemed to be less reluctant to limit themselves to grounds such as fraud and evasion of law and have rather leaned towards a holistic approach to lift the veil. This approach seeks to enlarge the benefit of all stakeholders, including third parties and the general public as opposed to that of the company and its shareholders.<sup>13</sup> The same stance has time and again been approved by the Apex Court in several prominent cases. From reiterating that the

<sup>8</sup> *Daimler Company Ltd. v. Continental Tyre and Rubber Co. (Great Britain) Ltd.*, [1916] 2 A.C. 307., *Inland Steam Navigation Workers' Union and Ors. vs. Rivers Steam Navigation Company Ltd. and Ors.*, MANU/WB/0002/1967

<sup>9</sup> *Ben Hashem v. Ali Shayif*, 2008 EWHC 2380 (Fam)

<sup>10</sup> *Prest v. Petrodel Resources Ltd.*, MANU/UKSC/0079/2013; *ArcelorMittal India Private Limited vs. Satish Kumar Gupta and Ors.*, MANU/SC/1123/2018

<sup>11</sup> *Commissioner of Income Tax v. Sri Meenakshi Mills Ltd.*, Madurai, MANU / SC / 0138 / 1966, Paragraph 13.

<sup>12</sup> *Life Insurance Corporation of India v. Escorts Ltd.*, MANU / SC / 0015 / 1985, Paragraph 92.

<sup>13</sup> Diksha Pherwani, *The Doctrine Of Lifting The Corporate Veil: Origin, Evolution, Challenges*, Mondaq - Law Articles and Insights (Mar. 4, 2022), <https://www.mondaq.com/india/shareholders/1168276/the-doctrine-of-lifting-the-corporate-veil-origin-evolution%20challenges#:~:text=%22The%20lifting%20of%20the%20corporate,or%20by%20very%20compelling%20reasons.%22>.

facets where the veil can be pierced are countless;<sup>14</sup> instances where the public interest, natural law principles like justice, equity and fairness is of paramount importance have also satisfied the reason of these judges to warrant veil piercing.<sup>15</sup>

The cases of *Arcelor Mittal India Private Limited v. Satish Kumar Gupta and Others*;<sup>16</sup> and *State of Rajasthan & Ors. v. Gotan Limestone Khanji Udyog Pvt. Ltd. & Ors* became a decisive judgement in this regard where the court undertook an exceptional effort to employ the ground of public interest to lift the veil. The encompassing view as taken by the judges in the latter case revealed the nature of the transaction as a ‘Two-Step’ transaction which became integral to distinguish the corporate personality from its members.<sup>17</sup> Additionally, the nature of the mining lease, which was the subject matter in dispute, which was owned by the state and the fact that the permission of the state wasn’t taken before the discreet transfer of the lease which held the parties in contravention of Rajasthan Minor Mineral Concession Rules, 1986 allowed the courts to peruse the Doctrine of Public Interest in order to settle the matter.

On a similar matter, a violation of public policy as opposed to public interest gave court the opportunity to lift the veil. An effort to examine the finances of Jyothi Limited revealed a liability for contempt of court against the shareholders which resulted in strict legal action against them.<sup>18</sup> Which became another glaring instance where the Doctrine and its implications came at play. It also set the stage in a recent instance, where the Delhi High Court opined that non-adherence of a judgement, or a non-execution of a decree goes against the values of justice and fairness and raises serious concerns about the efficacy of the Indian justice delivery system.<sup>19</sup> While acknowledging the fact that the shareholding pattern of the Union Government and the Delhi government grants them autonomy over Delhi Metro and Rail Corporation (DMRC) which makes them alter egos of one another, the Delhi government can possibly in no way seek amnesty from DMRC’s liability by seeking protection of the distinct legal set up.<sup>20</sup> And since DMRC is merely a mirror of its primary shareholders, its duties must flow to the union. In essence, DMRC’s repeated failure to comply with terms of the arbitral award and discharge its legal obligations attacks at the very root of public interest and contravenes the noble principles of justice and equity.<sup>21</sup>

## **Conclusion**

From a commercial perspective, the existence of the corporate veil is closely linked to the concept of ring-risk fencing. However, the tendency of Indian courts to deviate from the common law position undermines the golden appeal of limited liability structures. This shift has the potential to reduce risk appetite of investors, and consequently, increase the cost of investment, thereby discouraging economic activity.

<sup>14</sup> *State of UP v. Renusagar Power Co*, MANU/SC/0505/1988

<sup>15</sup> *LIC v. Escorts Ltd*, SUPRA, NOTE 11

<sup>16</sup> *Arcelor Mittal (India) (P) Ltd. V. Satish Kumar Gupta* MANU/SC/1123/2018

<sup>17</sup> *State of Rajasthan Vs. Gotan Limestone*, MANU/SC/0058/2016

<sup>18</sup> *Jyoti Limited vs. Kanwaljit Kaur Bhasin and Ors*, MANU/DE/0038/1987, Paragraph 22,30.

<sup>19</sup> *Delhi Airport Metro Express Private Limited vs. Delhi Metro Rail Corporation*, MANU/SC/0298/2024

<sup>20</sup> Souvik Ganguly et al., *Justice, Equity and Lifting of the Corporate Veil*, Lexology (May 22, 2023), <https://www.lexology.com/library/detail.aspx?g=3f311c82-4b6e-4414-a0f7-41a632367d6a>.

<sup>21</sup> id

On the legal front, adopting a *numerus clausus* approach, where courts base their decisions on vague ideals like public policy, public interest, justice, equity, and fairness rather than on a clear and definitive set of factors, creates a glaring hole in the justice delivery system. These gaps are often prone to misuse, leading to uncertainty and inconsistency in judicial outcomes. A more pragmatic view was established in the case of *Balwant Rai Saluja v. Air India*. In this case, the court, drawing on settled common law precedents like *Prest v. Petrodel Resources*, emphasized that “*it is only viable to resist the temptation to lift the veil as a convenient resort and it must only find it attractive to do so when no other alternative is available.*” The court further asserted that a strong presumption must always lie in favour of respecting the contours of the corporate veil.<sup>22</sup> Importantly, it also garnered much deserved attention by asserting that the principle of piercing the corporate veil must be applied restrictively, limited to cases where it is amply clear that the company has been misused for illegitimate means, such as avoiding liabilities.<sup>23</sup>

Despite this position, certain judicial interpretations continue to hark upon the *numerus clausus* approach, undermining the principles laid out in *Balwant Rai Saluja* and *Prest v Petrodel*. Legislative actors and Policymakers, too, bear the responsibility of addressing this anomaly through statutory reforms. The absence of significant legislative intervention further exacerbates the inconsistencies in the judicial outcomes, leaving a gap that demands prompt attention. Achieving a balanced framework that upholds the sanctity of the corporate veil while preventing its misuse remains a critical challenge a goal requiring collaborative efforts across judicial and legislative domains.

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<sup>22</sup> *Balwant Rai Saluja v. Air India*, MANU/SC/0732/2014.

<sup>23</sup> *id*