

REVERSE CORPORATE VEIL IN MARITAL DISPUTES

Written by *Abhilasha Mittal*

Final Year Student, BA.LLB, O.P. Jindal Global Law University, Sonapat, Haryana

ABSTRACT

The paper focuses on understanding the doctrine and development of the doctrine of reverse piercing of the corporate veil. Though it's not as well established as the traditional corporate veil doctrine, it is picking up as an applicable concept through various subject matters such as tax debts owed to the government, marital disputes etc. The aim of this paper is to establish the connection between divorces and reverse corporate piercing through several case laws around the world. It is worth noticing that such cases haven't yet brought to courts of India.

The paper is a qualitative research that relies extensively on judicial judgments and precedents. To narrow down the analysis, the paper focuses mainly on the cases decided in the courts of the United States of America and United Kingdom. The paper also attempts to understand the position of the principle in India.

These cases display the development of this doctrine and its wide application in familial disputes. Where company law and family law are seen as two distinct and distinguished fields of civil law, they are integrated through this doctrine.

Keywords: Reverse Corporate Veil, Marital Disputes, Case Laws, Qualitative

INTRODUCTION

The word ‘company’ takes its origin from Latin words ‘com’ that means “with or together” and ‘pains’ that refers to bread. It was originally comprehended as a group of people who are taking their meals together.ⁱ In modern times, the definition has evolved to mean a legal entity that is incorporated by coming together of different individuals. The purpose of incorporating such an organization is to generate profits by indulging in any or several commercial activities. The Indian Companies Act, 2013 defines company as an entity that has been incorporated under this Act or any previous company law.ⁱⁱ One of the main features of a company is the principle of separate legal entity. This principle states that every company is a separate person from its members that is its shareholders. When a company is incorporated under the Companies Act, 2013, it assumes a corporate personality which is distinct from the members or shareholders of the company. This means that the company has several separate advantages like owning assets, transferring the assets, suing and being sued in their own name etc. This was majorly done in order to ensure perpetual succession that is the company and its business capacity should not cease or die merely because its member(s) have decided to leave the company or have passed away.ⁱⁱⁱ This principle has been upheld through common law jurisprudence several times. In *Salomon v. Salomon*^{iv}, a landmark case, the court held that the members or shareholders or a company are distinct from the company due to its separate corporate personality. Even if the company was owned by a single shareholder, the company would be treated as a separate legal entity from the single shareholder.

The conclusion from the Salomon case is that corporate devices are also subject to abuses like almost all other applicable rules and principles. Every right that is guaranteed in company law is accompanied by a liability. In other words, the principle of separate corporate personality is linked with another feature of a company which is known as the limited liability principle. In the practical world, even though a company is considered a separate legal person, the decisions that are taken on behalf of the company are taken by natural persons. Therefore, when a situation of abuse of power arises, the principle of separate legal entity is ignored and the people responsible for the abuse of such power are held directly liable. This concept is known the lifting or piercing of corporate veil. The main purpose of this concept is to hold the shareholders or officers personally liable for the debts or liabilities of the company. The concept of lifting of corporate veil is evolving and inclusive in nature due to the changing market circumstances.

These changing circumstances require a changing law in order to inculcate all possible situations that would lead to abuse of power and application of this concept. According to the present legal jurisprudence, there are mainly four situations under which the courts are satisfied to lift the corporate veil of the company i.e. fraud, protection of public revenue, formation of a company in order to escape any legal obligation and comprehension of the character of the company.

These four categories have been created after analyzing several cases where the courts applied this principle in order to ensure justice in the special circumstances. The evolution of the concept can be traced through three main phases which have been laid down by Alan and John.^v The first phase is called the classical veil lifting phase which continued from 1897 to 1966. The courts in these phases relied heavily on the ratio discussed in the *Salomon v. Salomon*^{vi} case which placed great emphasis on the separate legal entity principle. There has been a gradual shift, however, by the courts towards the application of this concept in situations that were then identified as exceptional or special circumstances. This divergence was seen in *Daimler Co. Ltd. v. Continental Tyre and Rubber Co.*^{vii} case. This case dealt with a situation where it had to be determined whether the company was an enemy company or not due to a war between Britain and Germany. The court lifted the corporate veil to understand the character of the board of the company and held that since the majority of the board was German, the company would be seen as an enemy company and therefore no consideration needs to be paid. This decision was followed by the decisions of the court in *Gilford Motor Co. Ltd. v. Horne*^{viii} and *John v. Lipman*.^{ix} These two cases identified fraud and sham as necessary grounds for lifting the corporate veil.

By the time 1960s arrived, the courts displayed a tendency to depend less on the old precedents as they were being interpreted as extremely unjust in the situations. This was the beginning of the second phase which came to be known as the Interventionist Years. The period continued from 1966 to 1989. The name of this phase took inspiration from the nature of the courts in this period to constantly intervene and treat the separate legal entity principle as a negotiating basis that could be overruled in the interests of justice. A decision supporting this ideology and interpretation of the court was laid down in *Littlewoods Mail Order Stores v. IRC*^x wherein the court held that the courts may disregard the principle stated in the *Salomon* case in the interests of justice. This created an imbalance and a sense of uncertainty in the jurisprudence with

respect to the corporate veil lifting principle. This uncertainty was finally put to rest in 1990 when the court decided the case *Adams v. Cape Industries Plc.*^{xii} The decision in this case set base for the beginning of the third phase which was known as the back to basics phase. The court settled the conflict between the classical and interventionist approach and favored the classical approach. This third phase started from 1989 and is currently the phenomenon of courts as well. It has now been settled that the courts cannot disregard the separate legal entity principle only in the interest of justice. The petitioner should be able to explain the special circumstances which may have been laid down under the statute or contract as well as the established reasons for lifting the corporate veil.^{xii}

The more recent cases would be *In Re: Dinshaw Maneckjee Petit*^{xiii} and *Life Insurance Corporation of India v. Escorts Ltd. & Ors*^{xiv}, In the former case, the Bombay High Court refused to apply the principle of separate legal entity. The court reasoned the decision by stating that the four companies that were incorporated by the defendant in order to avoid payment of dividend tax to the government and therefore defraud the government. Therefore, companies were merely an extension of the defendant and not separate legal entities. The second case could be discussed in this light is the *Life Insurance Corporation of India v. Escorts Ltd. & Ors*^{xv}. The facts of the case explained that there was a scheme under the Foreign Exchange Regulation Act which stated that the non-resident companies in which the interest of the Indian individuals or other companies was at least 60% were allowed to invest 1% of the paid-up capital of the Indian companies but the ceiling was 5%. In lieu of this scheme, thirteen companies, all owned by the Caparo Group owned by Mr. Swraj Paul invested 1% each in Escorts Ltd. When this was brought to court's notice, the court held that the in order to understand the ownership in the investment, the corporate veil should be lifted.

The Companies Act, 2013 has several enabling provisions under which the petitioners can approach the courts in order to lift the corporate veil. The first section is Section 7(7)^{xvi} where the court is expected to fix liability in case of false information being given during the incorporation of the company. In order to determine this liability, the court may lift the corporate veil. Sections 34^{xvii} and 35^{xviii} of the Act are two more sections where the court is expected to hold someone liable in the company for the misrepresentations in the prospectus issued by the company. The court may lift the corporate veil to hold the person responsible liable.

There are several reasons for which a petitioner could approach the court and request for the lifting of the corporate veil. However, it is not always necessary that the court would give in to these requests. Even though no new circumstances have been added to the lifting of the corporate veil, there has been the development of a relatively new concept which is called as the reverse piercing of the corporate veil. Like the former, this concept also disregards the separation of the company from its shareholders, however, the purpose for the same is different i.e. the creditors or other parties of the shareholders want to hold the company liable and responsible for any personal debts and liabilities of the shareholders. It is controversial because it is not a widely accepted notions across all jurisdictions and the creditors of the shareholders would have an added advantage to their situation which wouldn't ideally be without this concept.

The first case where the theory of reverse piercing arose in the landmark judgment given by Judge Learned Hand in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*^{xix} The facts of the case state that a ship belonging to the subsidiary of Champlain was repaired by Kingston. Both the companies were two separate entities with independent decision making powers but a nearly identical board. When Champlain defaulted on the payment, Kingston attached the boats to satisfy the same. The trial court approved the attachment, however, the judge in this case reversed the judgment in order to minimize the potential scope of the theory. He further stated that the parent company can be held liable for the actions of the subsidiary but the possibility of such cases should be rare.

Although the facts of the facts clearly represent the concept of reverse piercing, the term was not used in this judgment. It was used in *W.G. Platts, Inc. v. Platts*^{xx}, a marital property case that was decided nearly 30 years after the first case. Only two years after this case, Colorado's district court utilized this theory in *Shamrock Oil & Gas v. Ethridge*.^{xxi} The court held that the company incorporated by the defendant was an alter ego of the defendant because the latter had shifted his assets to the corporation and was combining his funds as well. The court emphasized that a corporate entity should not be incorporated with the mere intention to hide the real and obvious truth.

In the later years of the development of the theory as a well-established theory, it had begun to be used as a strategy by the government to obtain tax payments that were owed by the individuals.^{xxii} Its first attempt with reverse piercing was in 1976 in *G.M. Leasing Corp. v.*

United States.^{xxiii} The court allowed reverse piercing even when the individual was only an equitable owner and not an incorporator, director or officer of G.M. Leasing. This standing and applicability of reverse piercing was upheld in *Valley Finance, Inc. v. United States*^{xxiv} where the court stated that reverse piercing of the corporate veil could be ordered if the individuals of the companies have been unable to satisfy the legitimate tax debts.

These cases display the wide acceptance of reverse piercing of the corporate veil as a theory and its wide usage as a remedy by the governments of various countries to recover tax debts from individual shareholders^{xxv} and in marital property disputes. The aim of this paper is to establish the connection between divorces and reverse corporate piercing through several case laws around the world. It is worth noticing that such cases haven't yet been brought to courts of India.

UNITED STATES OF AMERICA

There are several marital property dispute cases that have gone to court where the litigants have approached the court to apply reverse piercing of corporate veil. The first case of this category was *W.G. Platts, Inc. v. Platts*^{xxvi}. The court allowed the reverse piercing of the corporate veil on the demand of the wife in order to satisfy her share of property post their divorce because the company was held to be an alter ego of the ex-husband.

Another case that was brought up on similar grounds is *Lifshutz v. Lifshutz*.^{xxvii} The court has been approached in order to appeal to trial court's decision, which awarded only 25% of the marital estate to the wife upon the divorce. This 25% included shares and interests in several companies. The trial court gave this decision stating that the companies were the alter egos of the ex-husband and therefore the wife had a spousal right on the assets held by the companies. The appellate court, however, reversed the judgment stating that there wasn't enough evidence in order to imply that the companies were alter egos of the ex-husband.

In *Giетtmann v. Giетtmann*^{xxviii}, an Illinois case, the appellate court reversely pierced the corporate veil when the wife demanded past due support from the ex-husband. The court looked at the doctrine of separate legal entity of the company and decided that it was merely a legal

fiction and an extension of the husband's personal interests. Therefore, the wife could claim her dues from the company as well.

In *Saeks v. Saeks*^{xxix}, the ex-husband had agreed to pay a certain amount as permanent alimony to the wife after the dissolution of their marriage. The husband didn't want to use his company as an attachment for the alimony but the court held that the company was an alter ego of the husband. The court reversely pierced the corporate veil to understand that he was the sole shareholder of the company and the company was only serving his personal interests. The court, hence decided that the wife could claim alimony from the company as well.

UNITED KINGDOM

A case that allowed reverse piercing of the corporate veil in United Kingdom when the property of the party was in dispute is *Prest v. Petrodel*^{xxx}. The wife in this case claimed that her ex-husband was a sole shareholder in the company and therefore the shares of the same should also be divided between the spouses. The court rejected the idea of piercing the corporate veil stating that if the party is not evading any liability behind the separate identity of the company, the corporate veil cannot be pierced. However, indirectly, the company allowed the wife to take half the assets of the company from the husband.

In *Nicholas v. Nicholas*^{xxxi}, the court has dwelled into the question of whether. The property of a company which had minority shareholders as well should be transferred to the wife of the majority shareholder in a marital divorce dispute. The court held that it would not have. Thought twice if there were no minority shareholders present in the company to reverse pierce the corporate veil and transfer the property to the wife however the presence of the minority shareholders meant that the company was not incorporated merely as an alter ego of the husband and therefore the company's property could not be transferred to the wife.

Applying these rulings of the court in their matters, the judges of the Family Division who were dealing with the ancillary financial relief matters were passing orders for transfer of properties owned by a company to the spouses where the other spouse was a. single or sole shareholder in the company like in *Green v. Green*^{xxxii} and *Mubarak v. Mubarak*^{xxxiii}. The latter case added

the 'just and reasonable' circumstance to the list of situations where reverse piercing of the veil could be done by. Courts apart from the situations where the company was created as a sham.

The principle was similarly upheld in the case of *Kremen v. Agrest*^{xxxiv}. In this case, the court disregarded the pre-nuptial agreement between the spouses and granted the wife a huge amount of money as alimony which formed part of the wealth that was earned by the business committed by the company owned solely by the husband. The court justified the decision by stating that the wife had given immense support to the husband due to which the business had flourished and therefore she deserved a part of the same.

In *Miller v. Miller*^{xxxv}, Lord Nicholls held that in a short marriage it may be fair only to divide marital property that is the property acquired during the marriage. In *Miller* this meant that the wife was awarded £5 million after a marriage of under three years: the couple generated about £15 million during the short marriage and she was entitled to a fair share of that.

INDIA

The doctrine of reverse piercing of the corporate veil has taken a considerable amount of time to be noticed by the courts of India. Until 2005, mostly the Indian courts were deciding cases that dealt with the shareholders or officers being accused and held liable on behalf of the companies. The Indian courts reason that the companies, not being natural persons, cannot be held completely liable for any offences it is charged with and therefore the people making decision for such a company should also be held liable for the same. The Supreme Court, in its judgment given in *Standard Chartered Bank v. Directorate of Enforcement*^{xxxvi}, digressed from this justification to state that a company can be solely held responsible for payment of fines, irrespective of the mandatory penalties stated in the statutes. This case laid down the foundation for the concept of the reverse piercing of the corporate veil in India which is still in its early stages and is yet to develop as a principle.

It will be extremely interesting to analyse and understand the application of this principle in the marital divorce cases in India. Presently, the wife can ask for a maintenance from the husband under several statutes including Section 18^{xxxvii} of the Hindu Adoption and Maintenance Act, 1956 (specifically for Hindu females), Section 125^{xxxviii} of The Code of

Criminal Procedure, 1973 and others. The debate and discussion will become interesting when the courts will have to pick a justification that they would follow that is whether they will continue to believe that the company cannot be held solely responsible because it is not a natural person or whether they would follow the thinking of the Supreme Court that was laid down in the *Standard Chartered Bank* case.

CONCLUSION

The paper through the cases cited proves that there have been several cases where the parties attempt to adopt the doctrine of reverse piercing of corporate veil in order to gain maintenance or share in a matrimonial dispute. These cases display the development of this doctrine and its wide application in familial disputes. Where company law and family law are seen as two distinct and distinguished fields of civil law, they are integrated through this doctrine.

ENDNOTES

ⁱLegal India, 'Company Laws In India' (*Legalserviceindia.com*, 2020)
<<http://www.legalserviceindia.com/company%20law/com.htm>> accessed 22 April 2020.

ⁱⁱSection 2(20) of the Companies Act, 2013 -“company” means a company incorporated under this Act or under any previous company law.

ⁱⁱⁱ*National Bank v. Lakshmi Industrial & Trading Co. Ltd.*, 2000 (4) AWC 3013.

^{iv}[1897] AC 22.

^vALAN DIGNAM & JOHN LOWRY, *COMPANY LAW* (6th edn., Oxford).

^{vi}Id.

^{vii}[1916] 2 A.C. 307.

^{viii}[1933] Ch. 935.

^{ix}[1962] 1 W.L.R 832.

^x[1969] 1 W.L.R 1241.

^{xi}[1990] Ch. 433.

^{xii}*Woolfson v. Strathclyde Regional Council*, [1978] U.K.H.L 5.

^{xiii}(1927) 29 BOMLR 447.

^{xiv}(1986) 1 SCC 264.

^{xv}Supra.

^{xvi}Section 7(7) of the Companies Act, 2013 - (7) Without prejudice to the provisions of sub-section (6), where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—

(a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

- (b) direct that liability of the members shall be unlimited; or
- (c) direct removal of the name of the company from the register of companies; or
- (d) pass an order for the winding up of the company; or
- (e) pass such other orders as it may deem fit:

Provided that before making any order under this sub-section,—

- (i) the company shall be given a reasonable opportunity of being heard in the matter; and
- (ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

^{xvii}Section 34 of the Companies Act, 2013 - Where a prospectus, issued, circulated or distributed under this Chapter, 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 authorises 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.

^{xviii}Section 35 of the Companies Act, 2013 –(1) 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 of the company at the time of the issue of the prospectus;
 - (b) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time; (c) is a promoter of the company;
 - (d) has authorised 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.

^{xix}31 F.2d 265 (rtd Cir. 1929).

^{xx}298 P.2d 1107 (Wash. 1956).

^{xxi}159 F. Supp. 293 (D. Colo. 1958).

^{xxii}Nicholas B Allen, ‘Reverse Piercing of the Corporate Veil: A Straightforward Path to Justice’ 85 ST. JOHN’S LAW REVIEW 43.

^{xxiii}429 U.S. 338 (1977).

^{xxiv}629 F.2d 162, 172 (D.C. Cir. 1980).

^{xxv}*United States v. Scherping*, 187 F.3d 796, 803 (8th Cir. 1999).

^{xxvi}298 P.2d 1107 (Wash. 1956).

^{xxvii}61 S.W.3d 511.

^{xxviii}467 N.E.2d 297.

^{xxix}493 N.E.2d. 280.

^{xxx}[2013] UKSC 34.

^{xxxi}[1984] FLR 285.

^{xxxii}[1993] 1 FLR 326.

^{xxxiii}[2001] 1 FLR 673, 682C.

^{xxxiv}[2001] 2 FLR 490.

^{xxxv}[2006] UKHL 24.

^{xxxvi}Appeal (civil) 1748 of 1999.

^{xxxvii}Section 18 of the Hindu Adoption and Maintenance Act, 1956 - Maintenance of wife. —

(1) Subject to the provisions of this section, a Hindu wife, whether married before or after the commencement of this Act, shall be entitled to be maintained by her husband during her life time.

(2) A Hindu wife shall be entitled to live separately from her husband without forfeiting her claim to maintenance—

- (a) if he is guilty of desertion, that is to say, of abandoning her without reasonable cause and without her consent or against her wish, or wilfully neglecting her;
- (b) if he has treated her with such cruelty as to cause a reasonable apprehension in her mind that it will be harmful or injurious to live with her husband;
- (c) if he is suffering from a virulent form of leprosy;
- (d) if he has any other wife living;

(e) if he keeps a concubine in the same house in which his wife is living or habitually resides with a concubine elsewhere;

(f) if he has ceased to be a Hindu by conversion to another religion;

(g) if there is any other cause justifying living separately.

^{xxxviii}Section 125 of The Code of Criminal Procedure, 1973 - Order for maintenance of wives, children and parents.

(1) If any person having sufficient means neglects or refuses to maintain-

(a) his wife, unable to maintain herself, or

(b) his legitimate or illegitimate minor child, whether married or not, unable to maintain himself, or

(c) his legitimate or illegitimate child (not being a married daughter) who has attained majority, where such child is, by reason of any physical or mental abnormality or injury unable to maintain himself, or

(d) his father or mother, unable to maintain himself or herself, a Magistrate of the first class may, upon proof of such neglect or refusal, order such person to make a monthly allowance for the maintenance of his wife or such child, father or mother, at such monthly rate not exceeding five hundred rupees in the whole, as such Magistrate thinks fit, and to pay the same to such person as the Magistrate may from time to time direct: Provided that the Magistrate may order the father of a minor female child referred to in clause (b) to make such allowance, until she attains her majority, if the Magistrate is satisfied that the husband of such minor female child, if married, is not possessed of sufficient means. Explanation.- For the purposes of this Chapter,-

(a) " minor" means a person who, under the provisions of the Indian Majority Act, 1875 (9 of 1875); is deemed not to have attained his majority;

(b) " wife" includes a woman who has been divorced by, or has obtained a divorce from, her husband and has not remarried.

(2) Such allowance shall be payable from the date of the order, or, if so ordered, from the date of the application for maintenance.