A COMPARATIVE ANALYSIS OF THE DOCTRINE OF PIERCING THE CORPORATE VEIL: A PERSPECTIVE FROM INDIA

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ABSTRACT

Ever since the wave of capitalism took over the world in the early nineteenth century, the established business multinationals have gained a notorious reputation for the concoction of fraudulent activities along with deceptive actions taken towards the enlargement of the profits generated by them.

Jurisprudentially speaking, the concept of 'company' has grown to incorporate a persona of its own. In recent times, it has been endowed with the status of being an artificial legal person. In addition to this, a company is also recognized as a separate and distinct entity from its owners, shareholders, or members. Acting as a legal persona, a company has specific rights, responsibilities, and legal standing, which allow it to engage in various activities and transactions, such as entering into contracts, owning property, suing someone else in the capacity of a legal entity, etc.

This paper aims to examine the doctrine of piercing the corporate veil through a comparative analysis between India, the United States of America, Japan and Turkey which plays an instrumental role in defying the characteristic of a company being a separate legal entity and aims to hold accountable, all those individuals, who disguise themselves and commit wrongdoings under the veil of the corporate entity.

Keywords: Corporate veil, accountability, company, fraud

INTRODUCTION

A company has the characteristic of being treated as a separate legal entity from its owners. This means that it can sue and be sued, enter into agreements, and conduct business under its own name. This particular notion can result in the company acting as a shield for particular actions of its stakeholders which are barred by law and hence, result into the commission of fraudulent and unethical activities, the onus of which supposedly falls upon the company as a whole and not the individuals behind it due to this principle of 'separate legal entity' and body corporate.

In order to defy this concept and construct a healthier business environment, the doctrine of piercing the corporate veil evolved.

DOCTRINE OF PIERCING THE CORPORATE VEIL

Corporate frauds have plagued the nation in a variety of ways and the decision-makers have attempted to circumvent the law at any given opportunity. There are a lot of ways in which companies can indulge in illegal and misleading activities such as inflating the company's apparent earnings, document falsification, asset misappropriation, corporate identity fraud etc. In order to create a healthy business environment and promote fair competition, the doctrine of piercing the corporate veil evolved which acts as a weapon for the Indian courts to hold those individuals liable who were accountable for making irrational and non-complying decisions of the company, despite being 'shielded' by the characteristic of separate legal entity. Hence, the doctrine of piercing the corporate veil acts as an exception to the concept of separate legal entity.

In *Balwant Rai Saluja v. Air India Ltd.*[i] the Court also observed the same and held that the doctrine of 'piercing the corporate veil' stands as an exception to the principle that a company is a legal entity separate and distinct from its shareholders with its own legal rights and obligations.

The concept of piercing the corporate veil finds its roots in the groundbreaking ruling of the House of Lords in the case of *Salomon v. A Salomon and Co. Ltd.*[ii] In this case, the court, for the first time, acknowledged the concept of revealing the true nature of a corporate entity.

Stemming from the precedent set by Salomon's case, the doctrine of piercing the corporate veil empowers the court to unveil the individuals operating behind the corporate facade and identify those who truly control the company's operations.

Hence, in Salomon v. Salomon, it was established the legal recognition of a company as a separate entity. The Supreme Court, in the case of *Bacha F Guzdar v. Commissioner of Income Tax*[iii], also affirmed the juristic personality of a company. Additionally, the definition of 'person' in S.2(42) of the General Clauses Act includes companies, associations, or groups of individuals.

As a legal entity, a company has the capacity to own and transfer property, initiate or defend legal actions for contract breaches. The crucial aspect of a company's legal personality is that it provides limited liability, safeguarding the personal assets of its shareholders. This means that the corporate veil shields shareholders from individual legal and financial responsibilities arising from the company's activities. Consequently, shareholders are not held personally accountable for actions conducted in the course of the company's business due to this legal distinction.

The corporate veil can be pierced due to various reasons such as when making sure that the business's operations comply with the precise legal specifications of the legislation. In such circumstances, the court may disregard the company's distinct legal status in order to preserve legislative goals of major public significance. Further, when the court is confident that the business committed fraud while it was in operation, the Court may analyse through the 'upliftment of the corporate veil'. An example of this would be if a majority shareholder obtained a loan dishonestly by misrepresenting it as a business debt with the intention of using the money for personal use. Hence, in a situation like this, the particular doctrine would be used.

In addition to that, in order to respect the goals of bankruptcy rules, which seek an equitable distribution of property among creditors, this doctrine may be used. To further avoid the effects of bankruptcy legislation, a shareholder, for example, can attempt to transform corporate assets into personal ones which is also against the law and this might lead to the piercing of the corporate veil in order to hold the individual accountable for the conversion of corporate assets into personal ones.

THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN INDIA

In the context of establishing the legal principles related to piercing the corporate veil, the *LIC v. Escorts Ltd*.[iv] case holds a similar significance in Indian law as the Salomon v Salomon case does in UK law. In 1985, the Hon'ble Supreme Court addressed this issue for the first time and outlined specific criteria for potentially lifting the corporate veil. These criteria encompass, among other things that when a statute itself implies the need to unveil the corporate structure, this doctrine must be upheld. Second, in order to prevent fraud or improper conduct, the same upliftment must be done. For instance, in the case of *Delhi Development Authority v. Skipper Construction Company (P) Ltd. and Ors*.,[v] individuals had used multiple corporate entities to deceive people. The Supreme Court invoked the corporate veil-piercing doctrine, consolidating these companies into one entity under the control of the wrongdoer, holding them directly liable for fraud. Thirdly, when there's an attempt to avoid taxation or exploit beneficent statutes. As illustrated in *Commissioner of Income Tax, Madras v. Sri Meenakshi Mills Ltd.,*[vi] the court has the authority to lift the corporate veil and disregard the corporate identity if it's employed for tax evasion. Fourthly, when associated companies are so closely interconnected that they essentially function as a single entity. In the case of *State of UP v. Renusagar Power Co., where Renusagar Power Co.*[vii] supplied energy to its wholly owned subsidiary, Hindalco, the Supreme Court applied the corporate veil-piercing doctrine, treating Hindalco and Renusagar as one entity, as Hindalco was essentially using its self-generated energy.

The Supreme Court refrained from providing an exhaustive list of circumstances for piercing the corporate veil. Instead, the Court clarified the factors to consider when contemplating veil piercing. These factors include the following;

1) The relevance of statutory or other provisions and the intended objectives
2) The nature of the misconduct
3) The involvement of public interest
4) Potential consequences for affected parties.

THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN THE UNITED STATES

Because the state company laws differ in the United States, the doctrine of penetrating the corporate veil differs from state to state in the United States. Courts typically "pierce" the corporate veil in situations where there is proof of wrongdoing, fraud, or where the company is only the alter ego of the shareholder. States may have different requirements and norms for veil piercings, nevertheless.

The United States of America follows a different mechanism when it comes to the formulation as well as the execution and the application of laws to its matters. However, according to the Connecticut law, the doctrine of piercing the corporate veil was first propounded in the case of *Zaist v. Olsen*[viii] where the similar legal fiction of the principle of a corporate institution being a separate legal entity was disregarded and it was held that "There must be such domination of finances, policies and practices that the controlled corporation has, so to speak, no separate mind, will, or existence of its own and is but a business conduit for its principal."[ix]

In the case of *Spotts Bros., Inc v. Seraphim U.S Mfg., Inc*[x] based upon the laws of Pennsylvania (United States District Court for The Middle District of Pennsylvania), it was held that "Exercising personal jurisdiction based on ". . . piercing the corporate veil is disfavoured because piercing the corporate veil is a disfavoured practice which demands a specific and exacting showing." In Pennsylvania, there is a strong legal precedent opposing corporate veil piercing. In the case of *Lumax Industries v. Aultman*,[xi] it was held that generally speaking, undercapitalization, disregard for company formalities, significant blending of personal and business matters, and the exploitation of the corporate structure to support fraud are the only reasons why courts will consider lifting the corporate veil. The plaintiff in this case, had not presented any proof to meet the aforementioned stated strict standard, despite alleging in its Complaint that the defendants- Parkinson, Shefte, and Sims undercapitalized Hannover and Medallion and exploited the corporate form to serve their personal interests. Hence, it was concluded that personal jurisdiction cannot be exercised in this case. When it comes to the laws applicable in the State of New York, the case of *Walkovszky v. Carlton*[xii] also laid down the doctrine of piercing the corporate veil. The New York Court in this particular case, broke through the corporate veil to find individual stockholders accountable for the debts of the company because they only utilised the company as a means of evading responsibility. When it comes to breaching the corporate veil, Indian courts are more stringent. Usually, it is saved for situations involving fraud or the use of the business for illicit activities. There is a heavy burden of proof, and the courts are reluctant to lift the curtain. The number of cases where the doctrine of upliftment or piercing the corporate veil was applied by the Indian Courts are comparatively less in number whereas, on the other hand, state laws in the United States of America on breaching the corporate veil may differ, although overall they are more permissive. A lack of corporate formalities, the mixing of personal and company assets, and insufficient financing are some of the factors that are taken into account by the American Courts. It can be employed in other situations as well, such as undercapitalization situations or when the corporation form is misused for dishonest or fraudulent ends.

On one hand, The Companies Act, 2013 of India does not expressly address the piercing of the corporate veil doctrine, although it does include several rules pertaining to corporate governance and restricted liability whereas in the USA, state-specific business entity laws and regulations, as well as other state-specific acts, may have an impact on the doctrine's application, even if there is no federal law that governs breaching the corporate veil.

Referring to case laws and precedent, in India, previous rulings and court rulings are major sources of support for the piercing of the corporate veil doctrine in India. Over the years, Indian courts have established principles of the piercing of the corporate veil through a variety of instances. On the other hand, a variety of case law exists in the United States of America that offer advice on whether and how to pierce the corporate veil. Courts frequently base their decisions on past precedents.

Basing the comparison on the criteria of jurisdiction, it can be said that in India, the judge's discretion as well as the particular facts and circumstances of the case may affect how the concept is applied. And hence, in comparison, the Indian law is less standardised.

On the other hand, in the United States of America, there may be some regional variance in how the concept is applied between states and even between federal and state courts within the same state might have their differences.

Therefore, in conclusion, it can be said that in the United States, the legal basis for piercing the corporate veil is more established and has a longer history. It usually requires evidence of fraud or illegal activity. However, Indian courts may be more likely to pull back the veil in cases where there is clear abuse of the corporate form.

THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN JAPAN

The concept of piercing the corporate veil is widely referred to as the upliftment of the corporate veil in Japanese terminology. Although this was first propounded in the case of Salomon v. Salomon, which is governed by the Common Law system and is an integral part of the common law segment of company laws, the Japanese legal foundation, which is based upon the civil law system, largely derives this principle from precedents as well as judicial decisions and this particular doctrine is not explicitly codified in any of the Japanese statutes.

Similar to the previous two jurisdictions, the Japanese Courts also rely upon exercising this doctrine during exceptional circumstances and do not look upon this tool as a regular means of application. Generally, the norm is of applying this doctrine in corporate cases involving fraudulent activity by the business or its officers, or misuse of the corporate structure.

The most common situations where this doctrine of upliftment of the corporate veil may be exercised in Japan are those cases pertaining corporate fraud, evading taxes as well as executing illegal activities. Once applied, the Courts usually follow a procedure of looking for unethical activity such as combining personal and business belongings or neglecting corporate protocols.

The steps for governing the process of executing this doctrine involves the litigation process toi be solely based upon the discretion of the judge as there is no specific statutory provision authorising the existence of this notion.

Despite not being governed by a statutory provision, it must be noted that Japan introduced the principle of Limited Liability Company (LLC) as a recent form of a business entity in 2006 where this particular type of company would propel limited liability to their members and they may also be subject to the theory of lifting the corporate veil if they are employed fraudulently or illegally.

In the case of *Ota Kazuhiro (Alias) v. Morikubo Co., Ltd., Supreme Court of Japan (2002)*,[xiii] the court was presented with the facts the Court analysed the relationship between an individual and a corporation and contemplated upon whether the set Japanese corporate structure was being misused to commit fraudulent acts and practices.

Further, in the case of *Sapporo Service Co. Ltd. v. Taki Electronics Co. Ltd., Supreme Court of Japan (1990)*[xiv], the facts involved a conflict where the plaintiff alleged that a person's actions and improper use of the corporate structure rendered them personally accountable for the debts of a corporation. Hence, the doctrine of upliftment of the corporate veil was also debated and discussed in this Japanese case.

Similar application was contended in the case of *Hirooka v. Ishikawa, Supreme Court of Japan (1990)*[xv] and the doctrine of upliftment of the corporate veil was instrumental in determining the accountability.

Therefore, although the two jurisdictions of India and Japan are based on separate legal systems (Common and Civil law respectively), in both the nations, limited liability is a quintessential principle of corporate law and the corporation's liabilities are often avoided by its shareholders. Nonetheless, there may be differences between the two nations in the conditions in which this liability protection can be ignored, as based on the concept of the doctrine of upliftment or piercing of the corporate veil.

THE DOCTRINE OF PIERCING THE CORPORATE VEIL IN TURKEY

Similar to the aforementioned jurisdiction, the country of Turkey is also based upon the Civil Law system and emphasises more upon the Judges' discretion rather than statutory obligations.

Speaking about the corporate atmosphere in Turkey, the shareholders (whether natural as well as legal entity shareholders) are governed by the Turkish Civil Code and as per Articles 2 and 3/II of the Code, the shareholders may be held liable by veil lifting in the following situations:

(i) illegal fraud;
(ii) contract violation through disguise as the company; or
(iii) bad faith

This particular doctrine of upliftment of the corporate veil may be necessary in cases of

(i) a lack of equity from shareholders;
(ii) grave misbehaviour, such as misusing the corporate structure; and
(iii) combining shareholder and entity assets.

When a shareholder or shareholders own the majority of the voting rights or share capital in a capital firm, they are given the term of 'controlling shareholders' since they have the power to represent and administer the business. The majority of shares held by a different business or individual might also confer control over a corporation. The Turkish courts endeavour to breach the corporate veil and hold the controlling shareholder or shareholders accountable for the company's obligations when they misuse their controlling privileges to the disadvantage of creditors, all in the name of their personal gain. The courts have the authority to penetrate a parent company's veil, for instance, if the parent exploited its subsidiary to do fraudulent actions.

Therefore, in this way, the doctrine of upliftment of the corporate veil is exercised in the Courts of Turkey.

Where in India, this particular doctrine as well as the general regulation of corporations is governed by the Companies Act of 2013, the Commercial Code of Turkey supervises the governance of the corporate entities in the nation.

It can also be said that, even though both the nations recognize this doctrine, the particular threshold for piercing the corporate veil in Turkey tends to be relatively high.

In a case involving 'Yargıtay Hukuk Daireleri Genel Kurulu Kararı'[xvi] (General Assembly decision of the Court of Cassation - Civil Chamber) the Supreme Court of Turkey underscored that breaching the corporate veil ought to be reserved for extreme circumstances and ought to occur only in cases where there is unambiguous proof of fraudulent intent or improper utilisation of the corporate framework. According to the court, breaking the corporate veil is not always justified just because a firm is run by a single person or a small group of people.

In India, during circumstances of fraud, sham transactions, and where the corporate structure is utilised to avoid legal duties or commit an injustice, Indian courts have the authority to pierce the corporate veil whereas on the other hand, when a corporate body is being used to conceal unlawful activity or avoid legal duties, or when fraud occurs, the Turkish law permits the piercing of the corporate veil.

The Indian courts have used this particular doctrine in a number of circumstances, such as when the business is acting as the shareholders' alter ego or front or when the corporate structure is being exploited to defame the public or perpetrate fraud. On the other hand, in Turkey, if there is a blatant abuse of the corporate personality and a clear intention to do harm to creditors or other stakeholders, then the Turkish courts have the authority to pierce the corporate veil.

CONCLUSION

In conclusion, the doctrine of piercing or the upliftment of corporate veil acts as a quintessential weapon in fighting unaccountability and plays a major role in the mitigation or the restraint of white-collar crimes. This particular doctrine, which was first propounded in the case of Salomon v. Salomon, has been a muse for the corporate sector all over the world as countries of common as well as civil law system aim to incorporate it into their legal framework and tend to change the course of the corporate legal undoing by bringing recognition as well as accountability into the bigger picture.

Worldwide, the doctrine of piercing the corporate veil has its intricate variations when it comes to the application and the eligibility of its usage. However, it serves a similar purpose and acts as a weapon in fighting corporate frauds or illegal execution of activities along with unaccountability and abridges the gap between anonymity and accountability.

ENDNOTES

[i] (2014) 9 SCC 407
[ii] [1896] UKHL 1, [1897] AC 22
[iii] 1953 ILR BOM 525
[iv] 984 SCR (3) 643 1984 SCALE (1)821
[v] 1995 CRILJ 2107
[vi] 1967 AIR SC 819
[vii] 1988 AIR SC 1737
[viii] 154 Conn. 563, 573-74 (1967)
[ix] 154 Conn. 563, 573-74 (1967)
[x] No. 18-2235, 2019 U.S. Dist. LEXIS 142131, at *20 (M.D. Pa. Aug. 20, 2019)
[xi] 543 Pa. 38 (1995)
[xii] 276 N.Y.S.2d 585 (1966)
[xiii] Supreme Court Judgment July 17, 2002 Tatsuji No. 421
[xiv] Supreme Court Judgment June 28, 1988 Tatsuji No. 508
[xv] Supreme Court Judgment June 28, 1988 Tatsuji No. 522
[xvi] (*A Recent Decision of the Court of Cassation General Assembly of Civil Chambers on the Conditions of Unquantified Debt Lawsuits*, n.d.)