

Company :Definition and Features

The concept of 'Company' or 'Corporation' in business is not new but was dealt with, in 4th century BC itself during 'Arthashastra' days. Its' shape got revamped over a period of time according to the needs of business dynamics. Company form of business has certain distinct advantages over other forms of businesses like Sole Proprietorship/Partnership etc. It includes features such as Limited Liability, Perpetual Succession etc.

A registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

A more precise, global and modern *definition of a company* could be:

A business entity which acts as an artificial legal person, formed by a legal person or a group of legal persons to engage in or carry on a business or industrial enterprise.

Few points that should be noted in this definition:

Legal Person: A *legal person* could be human or a non-human entity which is recognised by law as having legal rights and is subject to obligations.

A person or a group of persons: It is no more required to be an association of persons to form a company. A company can also be started as a single person company (one-person company).

Features of company

1. Incorporated Association:

Company is an incorporated association of persons created by the law of the country. In India companies are formed and registered under the Companies Act 1956. Incorporation of a company requires registration of formal documents with the Registrar of Companies.

Memorandum of Association is the important document which contains the fundamental conditions and purposes for which a company is formed. In fact, a company does not have its existence beyond its memorandum of association. The other important document is the Articles of Association which lay down the rules and regulations for governance of the company. The 'Registration Certificate' or the 'Certificate of Incorporation, grants a legal entity to a company enabling it to discharge functions such as entering into contract, purchasing, owning and holding of properties. A company may be held liable for breach of law. It can sue and be sued in its name.

2. Independent Legal Entity:

A company has a legal entity distinct and separate from its constituent members (shareholders). It is an autonomous body, self-controlling and self-governing. It can hold and deal with any type of property of which it is the owner, in any way it likes. It can enter into contracts, open a bank account in its own name, sue and be sued by its members as well as outsiders.

The rights and obligations of a company are distinct from its constituent members. "Shareholders are not, in the eyes of the law, part owners of the undertaking. The undertaking is something different from the totality of the shareholders." Shareholders cannot be held liable for the wrongs or misdeeds of the company.

A company has a nationality, domicile and residence but cannot ask for the enforcement of those fundamental rights which are exclusively available to national citizens. The nationality of the company, however, does not depend upon the nationality of its shareholders.

A company can enter into partnership with one or more individuals or another company. It can buy shares or debentures of another company. A company can form other companies by subscribing to their Memorandum of Association.

A director of a company can be the office bearer of the trade union of the workers of the same company. A shareholder, if qualified as a chartered accountant, can be the auditor of the same company.

A director or a managing director cannot be held personally liable for the payment of arrears of taxes or salaries of employees due by the company. A company can sue for libel or slander effecting its business reputation.

A company can be held liable for criminal acts. It can be held liable for breach of law and can be made to pay fine. However, no imprisonment of a company is possible. It can be charged with conspiracy to defraud or may be convicted of making use of false documents with intent to deceive. It can also be held liable for torts committed by its employees in the course of their employment.

On account of this independent corporate existence the creditors of a company are creditors of the company alone and their remedy lies against the company and its property only and not against any of its members. Law recognizes the existence of the company quite irrespective of the motives, intentions, scheme or conduct of the individual shareholders.

The principle of separate legal entity of the company was judicially recognized by the House of Lords in 1867 in the case of *Oakes v. Turquand and Hording* (1867). It was then held that since an incorporated company has a legal personality distinct from that of its members, a creditor of such a company has remedy only against the company and not against an individual shareholder.

Thus, a creditor of an incorporated company has remedy only against the company for his debts and not any of the members of whom it is composed. The position was further clarified by the House of Lords in the famous case of Salomon v. Salomon & Co. Ltd.(1897) The facts of the case are as follows:

Mr. Salomon was the owner of a prosperous shoe business. He floated a company 'Salomon & Co. Ltd.' with only seven shareholders – himself, his wife, daughter and four sons. The newly formed company purchased the sole proprietorship business of Mr. Salomon for £40,000.

The purchase consideration was paid by the company by allotment of £ 20,000 shares and £10,000 debentures and the balance in cash to Mr. Salomon. The debentures carried a floating charge on the assets of the company.

The company went into liquidation within a year due to trade depression. On winding up, assets of the company were running short of its liabilities by £11,000. The unsecured creditors of the company contended that the company, though incorporated under the Act, had never an independent existence; it was in fact Salomon under the name of a company.

On this ground, the creditors claimed priority for the payment of their debts over the debenture-holders (Mr. Salomon). Debentures had a floating charge on the assets of the company.

The plea of the unsecured creditors that Mr. Salomon and Salomon & Co. are one and the same was not accepted by the court. It was held that the existence of a company is quite independent and distinct from its members. Shareholders may also be the creditors of the company. Court recognized the separate and independent personality of the company.

“The company is at law a different person altogether from the subscribers to the memorandum, and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee.

There is nothing in the Act requiring that the subscribers to the Memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertaking, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of the company.”

The concept of separate corporate entity was again confirmed in the case of Lee v. Lee's Air Farming Ltd. (1961).

Lee formed a company for the purpose of carrying on his own business of aerial top-dressing. He was the beneficial owner of the shares and also the sole “governing director” of the company.

He also got himself appointed as the chief pilot of the company and under statutory obligations caused the company to insure him against liability to pay compensation under the Workmen's compensation Act.

He was killed in a flying accident. In a suit by his widow for compensation, the Privy Council held that Lee and his company were distinct legal entities which had entered into contractual relationships under which he became, qua chief pilot, a servant of the company.

In his capacity of governing director, he could, on behalf of the company, give himself orders, in his other capacity of pilot, and hence the relationship between himself as pilot, and the company was that of a servant and master. In effect the magic of corporate personality enabled him to be a master and servant at the same time and to get all the advantages of both—and of limited liability.'

The Indian Courts have also unequivocally upheld the independent legal entity of a company in various cases, a few of which are cited below:

Re. Kondoli Tea Co. Ltd. (1886):

Some persons owned a tea estate. They transferred it to a company. They claimed exemption from ad valorem (according to value) duty on the ground that it is simply a transfer from them to themselves under a different name.

The court did not accept this contention and observed, "The Company was a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of property, as the shareholders had been totally different persons."

Abdul Haq v. Das Mai (1910):

Abdul Haq was an employee in a company. He had not been paid his salary for several months. He sued Das Mai, a director of the company for recovery of the amount of salary due to him. It was held that he would not succeed, because "the remedy lies against the company and not against the directors or members of the company.

The liability of an individual member is not increased by the fact that he is the sole person beneficially interested in the property of the company and that the other members have become members merely for the purpose of enabling the company to become incorporated and possess only a nominal interest in its property or hold it in trust for him.

The concept of independent corporate entity may under certain circumstances be disregarded. This is explained later in the book while explaining the circumstances under which the corporate veil may be pierced, or lifted up.

3. Separate Property:

The corporate property is clearly distinguished from the members' property and members have no direct proprietary rights to the company's property but merely their 'shares'. Change in the constitution of the company's membership will not cause any realization or slitting of its property.

Company cannot be the property of the person who owns all the shares in the company, nor can it be considered to be his agent. No member can either individually or jointly claim any ownership rights in the assets of company during its existence or on its winding up.

"No shareholder has any right to any item of property owned by the company, for he has no legal or equitable interests therein." A member cannot have any insurable interest in the property of the company. The leading case is:

Macaura v. Northern Assurance Co. Ltd. (1925):

Mr. Macaura was the holder of nearly all the shares, except one, of a timber company. He was also the substantial creditor. He insured the company's timber in his own name.

The timber was destroyed by fire. It was held that the insurance company was not liable to compensate as Macaura had no insurable interest in the property which belonged to the company only.

4. Perpetual Existence:

A company has a perpetual, succession. It has no allotted span of life. The mode of incorporation and dissolution of a company and the right of the members to transfer shares freely guarantee the continuity of the existence of the company quite independent of the life of the members. The existence of a company can be terminated only by law.

Being an artificial person, it cannot die irrespective of the fact that its members, even the founders or subscribers to the Memorandum, may die or go out of it. Moreover, in spite of the changes in the membership of the company, it can perform its contracts and enter into future agreements. Thus, members may come and go but the company can go on forever.

5. Common Seal:

Though a company has an artificial personality, it acts through human beings, who are called as directors. They act as agents to the company but not to its members. All the acts of the company are authorized by its "common seal". The "common seal" is the official signature of the company. A document not bearing the common seal of the company will not be binding on the company.

6. Separation of Ownership and Management:

A company is owned (de facto) by a number of shareholders which is too large a body to manage the affairs of the company. Shareholders set the objectives of the company and appoint their representatives or agents (known as directors) to manage the affairs of the company on their behalf to pursue their objectives.

The directors, in turn, hire professional managers (executives) to run the day-to-day operations of the company under their supervision and control. This striking feature of separation of ownership and management has raised many issues which give rise to evolution of corporate governance as the focal point of modern corporations.

7. Limited Liability:

The liability of shareholders of a company is different from the liability of the company. Shareholders generally have limited liability- limited to the extent of unpaid value of shares held up. Shareholders have no obligation to the company once they have paid full amount on the shares held by them. In cases of losses, shareholders are not called upon to make good the losses.

Creditors cannot claim from the personal wealth of the shareholders. In the case of a guarantee company, the members are liable to contribute a specified agreed sum to the assets of the company in the event of the company being wound up.

8. Transferability of Shares:

One can sell one's share of ownership rights to an interested buyer as the shares of a company are transferable. While in case of public companies shares are freely transferable which is provided by the law, there are some restrictions in the transferability of shares of private companies. In fact transferability of shares and limited liability are the enabling factors for the tremendous rise of companies all over the world.

LIFTING OF CORPORATE VEIL

The word company is derived from the Latin word *Com* meaning with or together and *panis* meaning bread, and it originally referred to an association of persons who took their meals together. Today the business matters have become more complicated and word "Company" has assumed greater importance. Company is thus a voluntary association of people who come together to for carrying on some business and sharing profits therein. Members contribute capital and the profits are distributed among various stakeholders. Thus, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. It can be for profit or it can be for a charitable purpose. A company is a body and a legal person having status and personality distinct and separate from that of the members constituting it.

A Company is a not a 'person' in the layman's language. It is an organisation created by a group of individuals who come together for the purpose of business. It is thus the personification of group or series of individuals making it a legal person. By the provision of law, a corporation is clothed with a distinct personality. A company being an artificial person, does not have a mind of its own and thus cannot act on its own, it can only act through natural persons or the people who are members of it. The business is carried on by real person, and for the benefit of, some individuals, i.e. some human beings are the real beneficiaries of the corporate advantages[i].

However, sometimes the corporation may commit certain fraud or misrepresentation and in such a case, the façade of corporate personality might be removed to identify the persons who are really guilty. As it has been earlier elucidated that Courts usually follow the principle of *separate entity* as laid down in the Solomon's Case however, it may be in the interest of the members or the general public to identify and punish the persons who misuse the medium corporate personality.

Thus where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate cloak and will look behind the corporate body as if there is no separate existence of the company from its members. Further, if found guilty of any misconduct, it can penalise the members for actions of the company including any pending debt. This is known **lifting the corporate veil**.

Circumstances in which courts may lift the corporate veil

The conditions under which the courts may pierce through the corporate veil can be classified under the following two heads:

Under Statutory Provisions:

The Companies Act, 2013

The Act provides for certain cases in which the directors or members of the company may be held personally liable. Herein, the entity of the company is overlooked and the constituent members such as directors are held liable personally along with the company. These cases are as follows:

Misstatements in Prospectus(Section 34-35)

In case of misrepresentation in a prospectus, the company and every director, promoter, expert and every other person, who authorised such issue of prospectus shall be liable to compensate the loss or damage to every person who subscribed for shares on the faith of untrue statement. Besides, these persons may be punished with imprisonment for a term which shall not be less than six months but it may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud .

Failure to Return the Application Money (Section 39):

In case of issue of shares by a company to the public, if minimum subscription, as stated in the prospectus has not been received within 30 days of the issue of prospectus or such other period the application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers shall jointly and severally be liable to pay that money with fifteen percent per annum. In addition, the company and its officer who is in default shall be liable to penalty of one thousand rupees for each day during which such default continue or one lakh rupees, whichever is less.

Misdescription of Name (Section. 121):

As per section 12, a company shall have its name printed on hundis, promissory notes, bills of exchange and such other documents as may be prescribed. Thus, where an officer of a company signs on behalf of the company any contract, bill of exchange, hundi, promissory note or cheque or order for money, such person shall be personally liable to the holder if the name of the company is either not mentioned or is not properly mentioned.

For Example; where on a cheque, the name of a company was stated as "LR Agencies Limited" whereas the real name of the company, was "L&R Agencies Ltd", the signatory directors were held personally liable.

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 the creditors or any other person, or for any fraudulent purpose, if the Tribunal thinks it proper so to do, be made personally liable without limitation to liability for all or any debts or other liabilities of the company. Liability under this section may be imposed only if it is proved that the business of the company has been carried on with view to defraud the creditors.

Ultra-Virus Acts:

Directors and other officers of a company will be personally liable for all those acts which they have done on behalf of a company if the same are ultra vires the company.

Under Other Statutes:

Besides the Act, directors and other officers of the company may be held personally liable under the provisions of other statutes. For example, under the *Income-tax Act, 1962* where any private company is wound-up and if tax arrears of the company in respect of any income of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally liable for payment of tax. Similarly, under *Foreign Exchange Regulation Act, 1973*, the directors and other officers may be proceeded individually or jointly for violation of the Act.

Under Judicial Interpretation:

Though initially court using the principle and the concept of separate entity and a distinct corporate personality refused to lift the corporate veil, however, with the growth of corporations and the increasing conflict between companies and its various stakeholders, court have adopted a pragmatic approach and lifted the corporate veil.

It is very difficult to enlist each and every decision of courts in which they have lifted the veil, however, the following paragraphs try to give an idea as what are the different circumstances under which the façade of corporate personality can be removed and persons behind the corporate entities may be identified and penalised.

Prevention of Fraud and Improper Conduct:

Where the medium of a company has been used for committing fraud or improper conduct, courts have lifted the veil and looked at the realities of the situation.

In ***Gilford Motor Company v Horne***, Horne had been employed by the company under an agreement that he shall not solicit the customers of the company or compete with it for certain period of time after leaving its employment. After ceasing to be employed by the plaintiff, Horne formed a company which carried on a competing business and caused the whole of its shares to be allotted to his wife and an employee of the company, who were appointed to be its directors. It was held that since the defendant, i.e Horne in fact controlled the company, its formation was a mere cloak or sham enable him to break his agreement with the plaintiff. Accordingly, an injunction was issued against him and against the company he had formed restraining them from soliciting the plaintiff's customers

Similarly, in ***Jones v. Lipman***, seller of a piece of land sought to evade specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose. Initially the company was formed by third parties, and the vendor purchased the whole of its shares from them, had the shares registered in the name of himself and a nominee, and had he and the nominee appointed directors. It was held that specific performance of the contract cannot be resisted by the vendor by conveyance of the land to the company which was a mere 'facade' for avoidance of the contract of sale and specific performance of the contract was therefore ordered against the vendor and the company.

Formation of Subsidiary to act as Agents:

If Company A forms a subsidiary Company B for carrying out its functions there exists no difference between the two companies as both perform the same functions in such case, the court can pierce the corporate veil and penalise the entities.

In ***Merchandise Transport Limited v. British Transport Commission***, a transport company wanted to obtain licences for its vehicles, but it could not do so if it made the application in its own name. It, therefore, formed a subsidiary company and the application for licences was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary. Held, the parent and the subsidiary company were

one commercial unit and the application for licences was rejected. In ***State of U.P. v. Renusagar Power Co.*** the Supreme Court held that where the holding company holds 100% shares in a subsidiary company and the latter is created only for the purpose of the holding company, corporate veil can be lifted. In ***JR Exports Ltd, v. BSES Rajdhani Power Ltd*** the appellant No. 1 company acquired entire share capital of appellant No. 2 company, which was a registered consumer of electricity connection granted at its factory premises and on finding that electricity was being consumed by appellant No. 1, Electricity Board passed impugned order demanding sub-letting charges from appellant No. 2. Court held that by applying principle of piercing of corporate veil, both companies appeared to be same entity and, therefore, there was no question of sub-letting.

Protection of Revenue:

Many a time, a company is formulated in to get an ostensible benefit in the garb of loans and revenue. To tackle such problems, the court may pierce the corporate veil.

In ***Sir Dinshaw Maneckjee Petite*** the assessee was a millionaire earning huge income by way of dividend and interest. He formed four private companies and transferred his investments to each of the companies in exchange of their shares. The dividends and interest income was received by Sir Dinshaw as a pretended loan. It was held that the company was formed by the assessee purely and simply as a means of avoiding tax and company was nothing more than assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interest and to hand them over to the assesses as pretended loans.

Similarly in ***CIT v. Sri Meenakshi Mills Ltd***, where the veil had been used for evasion of taxes and duties, the court upheld the piercing of the veil to look at the real transaction.

Economic Offences

In case of economic offences a court is entitled to lift the veil of corporate entity and pay regard to the economic realities behind the legal facade.

In ***Santanu Ray v. Union of India***, it was alleged that the company had violated *section 11(a) of the Central Excises and Salt Act, 1944*. The Court held that the veil of the corporate entity could be lifted by adjudicating authorities so as to determine as to which of the directors was concerned with the evasion of the excise duty by reason of fraud, concealment or wilful misstatement or suppression of facts or contravention of the provisions of the Act and the rules made there under.

Company Avoiding Welfare Legislations:

Welfare Legislations especially in country like India hold a profound role and importance since the working class are often subjected to exploitation at the hands of the corporations. Thus any attempt to evade and escape the responsibility entrusted by the statute is a gross violation of law and must be punished with the strictest of the hand of the court.

The Supreme Court in ***Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd*** held that where the sole purpose for the formation of the new company was to use as a device to reduce the amount to be paid by way of bonus to workmen, the Court can rightfully pierce of the veil to look at the real transaction.

Company used for Illegal/Improper Purpose:

Courts have shown immense willingness to lift the veil where device of incorporation is used for some illegal or improper purpose. In ***PNB Finance Limited v. Shital Prasad Jain*** pursuant to a request made by 'S', the financial advisor of a financing public limited company, granted a loan of Rs. 50 lakhs to 'S' on his representation that he would utilise the said amount for the purchase of immovable property in Delhi and the directors of the plaintiff company sanctioned the loan, on the condition that the loan would be secured by deposit of the title deeds of the property. S also executed a promissory note. However, he didn't pay a penny on the loan or its interest. Instead, he diverted the amount of the loan to three public limited companies floated by him and his son. He in fact in the garb of the companies used the loan amount for purchasing immovable properties at New Delhi. The question that arose was whether the defendants could be restrained from alienating the properties purchased. The court granted relief to the plaintiff by piercing the corporate veil and restraining the defendants from any alienation, transfer, disposal or encumbering of the properties in question

Company Acts a Mere Sham or a Cloak:

If any Corporate entity is a mere sham and a trick to escape the illegal acts done by the person behind the veil, the corporate personality and entity shall seem to be non-existent and the veil can be broken.

The Supreme Court in ***Delhi Development Authority v. Skipper Construction Company***, held that the directors and members of the family had created several corporate bodies did not prevent the court from treating all of them as one entity belonging to and controlled by the director and his family if it was found that these corporate bodies were mere cloaks and that the devise of incorporation was really a ploy adopted for committing illegalities and or to defraud people.

Conclusion

A company is a legal person which has been given personification by law. It acts not according to its own whims and fancies being an artificial person but according to the men behind the curtains of the corporation. This curtain or veil when is overlooked to understand the true nature and real beneficiaries of company is called lifting of Corporate Veil. This doctrine has primarily emerged to strike a balance between the needs of corporate independence and public interest. Originally the court was quite stringent in applying this doctrine to preserve the model of corporate structure however with the growth of conflicts between companies and its stakeholders and in the interest of justice, courts have now adopted a liberal approach. However, a rule of caution must be adopted by the courts in applying this doctrine. Though the horizons are expanding, it can't be applied in every situation. It depends upon situation to situation and therefore a standardised rules can't be made by court.