PIERCING THE CORPORATE VEIL IN MATTERS OF TAXATION: THE SEARCH FOR UNIFORMITY

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The doctrine of piercing the corporate veil has been an exception to the concept of separate legal personality for decades. This exception was carefully crafted to ensure that corporate entities could not circumvent their obligations in matters of welfare and tax legislation. Keeping in mind the individual facts and circumstances surrounding the case, this doctrine is applied in an exceptional manner. In India, this lack of a uniform stance in the application has created ambiguity in the law, violating the predictability principle of the Rule of Law. This article elucidates the doctrine of lifting the corporate veil with special emphasis on taxation cases. It briefly traces the common law origins of the doctrine and conditions of its applicability thereto. It glosses through the relevant jurisprudence available to analyze how Indian Courts have interpreted it. Finally, it seeks to highlight the lack of a straightjacket formula for the doctrine's application and consequently, the impact on the debate between tax-planning and tax-avoidance.

Keywords: Corporate Veil, Rule of Law, Taxation Matters, Separate Legal Entity, Incorporation, Double Taxation Avoidance Agreement, Tax Planning, Tax Avoidance, Welfare Legislation

INTRODUCTION

The incorporation of a company has many advantages, chiefly that a separate legal entity is bestowed upon the company. This advantage is a creation of law and has limited the liability of those who incorporate and manage the company affairs.[1] Thus, there exists an artificial veil, called the corporate veil, between the company and those who manage and/or have a majority stake in the company. The separate legal personality of a company is one of its most fundamental characteristics and can only be derogated from under extraordinary circumstances to determine the true controller of the company. *"The doctrine of lifting of the veil postulates the existence of dualism between the corporation or company on the one hand and its members or shareholders on the other."*[2] This duality is created to maintain a separate artificial personality of the company independent from that of the management and shareholders. A separate legal personality is not a blanket rule that can be utilised to circumvent obligations under the law and to ensure this, a doctrine of lifting the corporate veil was developed. Accordingly, Courts look can beyond the separate personality, and hold the shareholder(s) as personally liable for the company's business. This principle of lifting

[1] A Ramaiya, Guide to the Companies Act, (ed. 17th,2010).
[2] Tata Engineering & Locomotive Company Ltd v. State of Bihar, AIR 1965 SC 40.

the corporate veil is, therefore, an exception to the separate legal identity of the company.[3] As quoted in the judgment of *Renusagar*[4], piercing of the corporate veil is an ever-growing concept that continues to be relevant in current times. Through common law jurisprudence, the courts have identified certain situations where the corporate veil may be lifted, *inter alia*, in cases of prevention of fraud or improper conduct, or in cases where the character of the company is in question. This doctrine evolved outside India, especially in the United Kingdom in the early 1900s, after *Salomon v Salomon*[5] case established the principle of separate legal identity. For example, in the case of *Gilford Motor Company v. Horne*[6], the Court held that the incorporation of the company was a sham and in violation of a non-compete clause, and therefore, the corporate veil had to be lifted. Further, in the case of *Daimler Company Ltd. v. Continental Tyre & Rubber Co.*[7], the corporate veil was lifted to determine the true owners of a company during a wartime situation. Here, a German company had trade relations with an English company. When the First World War broke out, the two companies stopped trading and the resultant breach of contract led the matter to reach Court. The House of Lords was of the opinion that the corporate veil must be lifted to look at the realities of the situation and to verify the *bona fide* intention for its incorporation. The German company was managed and owned by German nationals and as this would amount to trading with an enemy, the lifting of the corporate veil was adequately justified.

The corporate veil can be pierced in other situations as well, for example, when a company is constituted to act as an agent for its shareholders. In *Smith, Stone & Knight v. Birmingham Corporation*[8], it was held that owning 100% shares in a company, does not allow the owner to use the company in the capacity of an agent. Similarly, in certain instances, companies are incorporated as subsidiaries to a holding company, only to act as an agent of the holding company. This was evidenced in the case of *Merchandise Transport Limited v British Transport Commission*[9], where the subsidiary was incorporated for the sole reason of obtaining a transport license for its holding company. In such cases, the Court deems it acceptable to lift the corporate veil. Moreover, a company cannot be used for illegal or improper purposes, as was held in the case of *PNB Finance Limited v Shital Prasad Jain*[10]. It also acceptable to lift the veil in cases where the company has been used to evade taxes[11] or to violate welfare legislations[12] so as to hold those responsible for such transgressions.

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[3] CR Datta, The Company Law (ed. 6th ,2008).
[4] State of U.P. v. Renusagar Co, [1991] 70 Comp.Cas. 127.
[5] Salomon v. Salomon, [1895-99]All ER Rep 33.
[6] Gilford Motor Company v. Horne, (1993) 1 CH 935.
[7] Daimler Company Ltd. v. Continental Tyre & Rubber Co., (1916) 2 AC 307.
[8] Knight v. Birmingham Corporation, (1939) 4 All ER 116 (KB).
[9] Merchandise Transport Limited v British Transport Commission, (1982) 2 QB 173.
[10] PNB Finance Limited v Shital Prasad Jain, (1983) 54 Comp.Cas. 66(Delhi).
[11] Sir Dinshaw Maneckjee Petit, Re AIR 1927 Bom.371.
[12] Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd. (1986) 59 Comp.Cas. 134 (SC).

INDIAN CONTEXT

The concept of separate legal personality and lifting of the corporate veil was developed in the *Salomon* case, as aforementioned[13]. It found its way into the Indian legal system in 1927, even before the Companies Act came into existence.[14] In the case of *Prest v Petrodel Resources Ltd. & Ors.*[15], Lord Sumption's analysis of the corporate veil is still pertinent. Firstly, he differentiated between piercing the corporate veil and peeking behind the corporate veil. While peeking, the economic characteristic of a company may be looked at without lifting the corporate veil. However, when piercing the veil, the standard is much higher, for example, when a company acts fraudulently. He further distinguished between two principles called the concealment principle and the evasion principle, to determine what a 'relevant wrongdoing' could mean. When using the concealment principle, Lord Sumption argues that the corporate veil is not pierced at all. In fact, it is just the concealment of the real actors in a company that the Court tries to unravel. The evasion principle, on the other hand, uses the piercing of the corporate veil to ascertain whether there exists a legal right or obligation on part of the member or the shareholder independent of the company.

These principles of lifting the corporate veil of a company become relevant in taxation matters, especially in reference to Double Taxation Avoidance Agreements. Tax evasion concealed under the separate corporate personality of a company has led to the Supreme Court to widen the scope of doctrine to matters of taxation. The sophisticated devices used to evade tax, for example, incorporation of 'shell corporations' (as employed by Apple in the United Kingdom to flout English taxation laws[16]), force the Court to lift the veil to penalise those responsible.

There is a very nuanced difference between tax-planning and tax-evasion, the latter of which allows the court to pierce the corporate veil. Tax planning may be legitimate if is within the framework of the law. The Court has the "*power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligations*"[17]. The position of law regarding this principle in India has been enumerated in various decisions. However, the Supreme Court has noted that in every case where ingenuity is expended to avoid taxing legislation, it is the duty of the Court to get behind the smokescreen and discover the true state of affairs.[18]

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[13] Salomon v. Salomon, [1895-99]All ER Rep 33.
[14] Mc Dowell & Co. Ltd v. CTO AIR 1986 SC 649.
[15] Prest v Petrodel Resources Ltd. & Ors., (2013) AC 415.
[16] http://www.reuters.com/article/us-eu-apple-taxavoidance-idUSKCN114211> Last visited on 19th Novmeber, 2017, 6.30 pm.
[17] Deputy Commissioner v. Chetan Transport Corp. Ltd., (1992) 74 Comp.Cas. 563 (Mad.)(DB)
[18] Workers Employed in Associated Rubber Industry Ltd., v. Associated Rubber Industry & Anr., (1985) 4 SCC 114.

In the case of *Dinshaw Manackjee Petit*[19] the assessee formed four companies, all with similar *modus operendi*, agreeing with each of the companies to act as an agent and hold a block of investment for them. The dividends and profits were credited to the company's account but immediately handed to the assesse in the form of a loan. No fixed rate of interest was set out for the loan amounts, and the businesses did not carry on any further activity. It was held by the Court that the companies were created for the sole purpose of avoiding super-tax (super-tax rate on individuals was greater than that for companies). *"The company was nothing more than the assessee himself"* and therefore, Court disregarded the corporate entity and held that it was a means of tax evasion. d

Judicial precedent, in the case of *Juggilal Kamlapat v. Commissioner of Income-tax*[20]*,* clearly laid out that this doctrine could be applied by Courts when this garb of corporate veil is tactfully used to mask tax evasion or perpetrate fraud. A Constitution Bench of the Supreme Court, in the year 1985, while discussing this doctrine held that it is not *"desirable or necessary"* to list out the particular cases where the doctrine is permissible. There can be no straight-jacket formula applied in this regard as it will necessarily depend on the relevant statute, the object sought to be achieved, the conduct involved, the probable involvement of public interest, effect on the parties involved and so on. [21] However, the Court observed that this doctrine must be used sparingly, making it abundantly clear that it is the exception and not the rule. "*It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of the public interest, the effect on parties who may be affected, and so on*".[22] This is because the doctrine of lifting the corporate veil as an exception to distinct legal personality is not only well-recognized in the domain of tax evasion, but also as a device to prevent a corporate entity from evading legal obligations when protection of public interest assumes paramount importance.

Furthermore, in the case of *CIT v. Sri Meenakshi Mills Ltd.*, [23] it was clearly enumerated that in matters relating to economic offences, Courts are entitled to use to doctrine to shed light on the economic realities behind the shadows of the legal facade. Notably, this principle was relied on, in the case of *Santanu Ray v. Union of India*[24] to prevent tax evasion of any form. At this stage, it becomes ostensible that with regard to taxation matters, the Court has not adjudicated with any particular uniformity. This is mainly because cases falling under this category constitute highly complex corporate structures. Further, the

[19] In Re: Dinshaw Manackjee Petit Bard, AIR 1927 Bom. 371.
[20] Juggilal Kamlapat v. Commissioner of Income-tax, AIR 1969 SC 932.
[21] Life Insurance Corporation of India v. Escorts Ltd. and Ors. (1986) 1 SCC 264.
[22] State of Rajasthan & Ors., v. Gotan Lime Stone Khanij Udyog Pvt. Ltd. & Anr, (2016) 4 SCC 469.
[23] Commissioner of Income-tax v. Sri Meenakshi Mills Ltd.63 ITR 609 (SC).
[24] Santanu Ray v. Union of India, (1989) 65 Comp.Cas. 196 (Delhi).

Courts are under scrutiny to maintain a balance between separate legal personality vis-à-vis tax-planning schemes.

THE RECENT YEARS

In the recent years, Indian companies have significantly expanded the volume of Mergers and Acquisitions transactions owing to the favourable investment climate. It is implicit in this understanding that there is a certain transaction cost involved, which companies try to reduce. Further, the Government of India has entered into several tax treaties (mostly Double Taxation Avoidance Agreements) to ensure that companies are not disadvantaged in any manner, by being taxed concurrently in two or more jurisdictions. However, this freedom to adopt a mechanism that provides for the least amount of tax liabilities comes with its inherent dangers. The Court in these cases applies the doctrine of lifting the corporate veil to keep a check on the same and obstruct any possible tax evasion. The most significant decisions to this effect have been the Vodafone[25] and Richter Holding[26] judgements.

In the *Vodafone* case[27], the revenue department issued a show cause notice against the company holding that a capital gains tax would be applicable on the indirect transfer of the 67% share of Hutchinson-Essar which was a result of the purchase of another 100% share of an offshore company. This was consequently challenged by Vodafone, arguing that all the transactions took place abroad and the Indian revenue departments had no jurisdiction to this regard. The Court disregarded the plethora of entities that existed to separate the parties and lifted the corporate veil. It further held in the majority opinion that the Courts could only lift the corporate veil if the tax departments could *prima facie* establish that the transaction was a 'sham' in nature, and did not fall within the purview of the law. This judgment sparked the ongoing debate between tax-planning and tax-evading, as the condition to lift the corporate veil was significantly enhanced. Furthermore, the Karnataka High Court, in the *Richer Holding*[28] case used this doctrine to appreciate the true nature of the transaction and ascertain virtual facts. Here, the Court applied the doctrine at a very premature level in order to prevent any possible chance of evasion of tax legislation, clearly marking the intentions of its use in such cases.

Contrastingly, in the case of *Zaheer Mauritius* v. *Director of Income-tax*[29], the High Court of Delhi set aside the ruling of the Authority for Advance Rulings by holding that the transfer of Compulsorily Convertible Debentures(CCDs) to a third-party is taxable as

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[25] Vodafone International Holdings BV v. Union of India (UOI), Ministry of Finance and Asst. director of Income Tax (International Taxation), [2009] 311 ITR 46 Bom.
[26] Richter Holding Limited v The Asst Director of Income-Tax, The Deputy Director of Income-Tax and Union of India, [2011] 199 TAXMAN 70 (Kar).
[27] Vodafone International Holdings BV v. Union of India (UOI), Ministry of Finance and Asst. director of Income Tax (International Taxation), [2009] 311 ITR 46 Bom.
[28] Richter Holding Limited v The Asst Director of Income-Tax, The Deputy Director of Income-Tax and Union of India, [2011] 199 TAXMAN 70 (Kar).
[29] Zaheer Mauritius v. Director of Income-Tax, (2014) 7 HCC (Del) 271.

'capital gains'. In this case, the petitioner, a Mauritian company, was engaged in the business of investment in Indian construction companies. To carry out its business, it entered into a Securities Subscription Agreement (SSA) and a Shareholder's Agreement (SHA) with an Indian company, Vatika, and the 100% wholly owned subsidiary of the same company, SH Tech Park Developers Private Limited, which was a joint-venture company. According to the terms of the SSA, the petitioner acquired 35% ownership in the joint-venture company. The SHA, which recorded the relationship between the petitioner, Vatika and the joint-venture, provided Vatika with a call option to acquire all the impugned securities and a put option to sell all the securities during the period. In addition to this, the joint-venture company and Vatika entered into Development Rights Agreement, by which the exclusive development rights were transferred. On exercise of the call option by Vatika, the question to be determined was whether the purchase of CCDs from a Mauritian company was exempt from tax under the Indo-Mauritius Double Taxation Avoidance Agreement. The crux of the matter lay in whether the corporate veil could be lifted to hold Vatika and the joint-venture company as the same entity. The High Court relied on the decision in the Vodafone case to say that the transaction must be looked at as a whole, and not by dissecting it. By applying the 'look at' test, the corporate veil could only be lifted when it was established that the transaction was overtly a sham. The Court, taking a pro-investor approach, held that the petitioner had sufficient reason to route real-estate investment through CCDs. The premature exit options provided to Vatika were simply commercial matters. The implications of this case were largely in support of tax-planning, which was a stark contrast to earlier decisions of the Court.

The jurisprudence relating to lifting the corporate veil in taxation matters was further diluted after the ITAT Ruling in the *New Delhi Television Ltd. v ACIT*[30], where the assessee was taxed in India, for transactions that occurred outside the territory of India. NDTV, as the assessee, was involved in a host of monetary transactions that occurred outside of India through its subsidiaries. NDTV argued that each of these subsidiaries (NNIH Netherlands and NNPLC United Kingdom) were independent assessees in India. However, the Assessing Officer disagreed and proceeded to pierce the corporate veil to determine that NDTV had evaded taxes in India by acting through its offshore subsidiaries. There were multiple factors that the Assessing Officer took into consideration before lifting the corporate veil- for example, NNPLC United Kingdom was undercapitalised, there were common directors across the companies, NNPLC United Kingdom promoted the interest of the group of companies and there were no fixed assets or offices for the offshore companies. While individually, these factors could not amount to sufficient reasons for piercing the corporate veil, the Officer concluded that together, the corporate personalities of these companies seemed suspicious and proceeded to lift the veil. In the NDTV case, the Assessing Officer used a much lower standard which conflicts with the exceptional nature of the doctrine of piercing the corporate veil. If the holding of the *Zaheer Mauritius* case was strictly applied, the Court could not have lifted the corporate

[30] New Delhi Television Ltd. v. DCIT, 2017 SCC OnLine Del 9817.

veil. However, by deviating from the rulings of both *Zaheer Mauritius* and the *Vodafone* case, as the Court exemplified the ambiguity in the application of the doctrine.

CONCLUSION

The analysis of the aforementioned jurisprudence is indicative of the changing domains of the doctrine of lifting the corporate veil. These cases highlight the need for a standard set of tests to pierce the corporate veil. Currently, the ad-hoc basis for deciding the separate legal personality of a company does a disservice to the *Salomon* principle of ensuring the limited liability of companies. In the initial cases, the Courts reiterated that the doctrine must be used in exceptional cases and must not compromise on the dignity of the separate corporate personality. However, the recent trend has shifted towards a looser application of this doctrine with special regard to taxation matters. There seems to be an unspoken policy to apply a pro-investment approach to tax planning, but the lack of a dogmatic standard allows the Indian judiciary to decide matters arbitrarily.

The many faces of this doctrine, as highlighted above, are illustrative of the non-exhaustive, fluid, and murky interpretations by the Indian Courts. *"The concept of lifting the corporate veil is a changing concept and is of expanding horizons"*[31]. This clearly highlights the dangers of the application of this doctrine - the boundaries are yet to be clearly defined, if ever. Since the Courts cannot propound a hard-and-fast rule, it runs the risk of being interpreted loosely and being susceptible to *mala fides.* It is because of this very truism that no definite line can be drawn between tax planning and tax evasion, leaving the backdoor open *ad infinitum*. The lack of standardization in the interpretation gives way to the dangers of bias and untrammelled judicial freedom. While it is impossible to set a clear interpretation, it is strongly believed that certain uniform guidelines for its application must be crafted.

[31] State of U.P & Ors. v. Renusagar Power Co and Ors., AIR 1988 SC 1737.

