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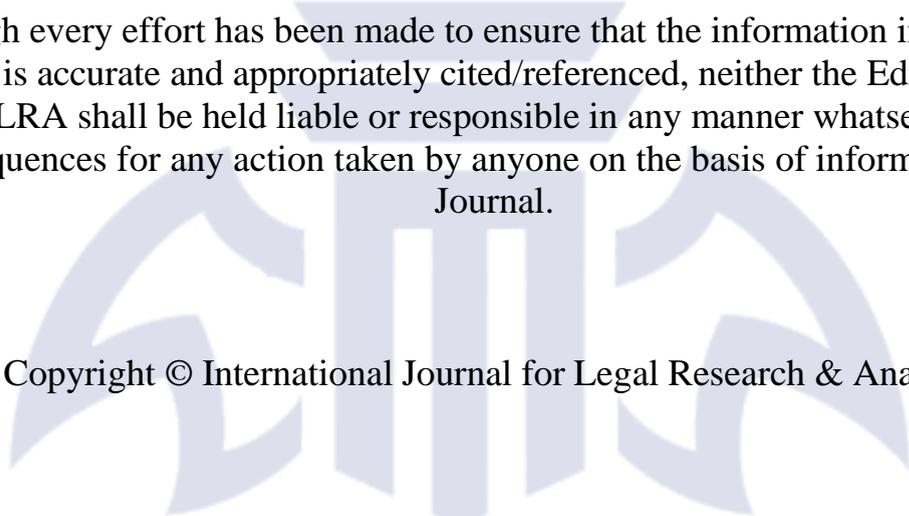
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Understanding The Lifting Of Corporate Veil

And Its Intricacies

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Abstract

From the decades-long decision of the House of Lords in the case of *Salomon v. A Salomon & Co. Ltd*, [1896] UKHL 1, it was established that the company is a separate entity from its owners and members. The doctrine of the lifting of the corporate veil or piercing the veil safeguards and protects the principle of corporate personality which serves as one of the fundamental principles of Company Law. The Authors in the present article have mentioned the various key concepts which may help in a clear understanding leading to the doctrine. The landmark cases of *Salomon v. A Salomon & Co. Ltd*, [1896] UKHL 1 and *Lee v. Lee's Air Farming Ltd (1961) AC 12* have been cited in brief to provide a better insight into the principle of corporate personality. The need for the doctrine of the lifting of the corporate veil which is further classified into the statutory and judicial provisions has been mentioned towards the penultimate stages of the paper. The article then concludes with a brief analysis of the case of *Vodafone International Holdings B.V. v. Union of India*, (2012) 6 SCC 613 along with the personal views of the author on the doctrine of the lifting of the corporate veil.

Keywords: Company, Corporate personality, Incorporation of company, Corporate entity, Lifting of the Corporate Veil.

Introduction

The introductory aspect of the paper gives a brief overview of the principle of the company as a separate entity and the doctrine of the lifting of the corporate veil.

The years 1844 and 1855 are of immense significance in the field of Company Law. The concept of incorporation of a company by registration (1844) and the doctrine of limited liability (1855) have established themselves as the fundamental principles of Company Law. It was due to these enactments that the House of Lords applied these principles in the case of *Salomon v. Salomon* which created the roots for the doctrine of the lifting of the corporate veil.

Corporate personality has been described as one of the fundamental principles of Company Law in almost all the countries around the globe. The principle establishes a company as a separate entity from the shareholders. Once a company is incorporated it serves as a distinct entity in the eyes of law and no promoter, director or shareholder of the company shall be personally liable for any done on behalf of the company. The company has the legal capacity to purchase any property and sell the property in its own name. The Company can sue and can be sued in its own name.

However, with the passing of time situations arose when the doctrine of corporate personality was being misused by the members of the company through wrongful acts. In such cases, it was laid down that the members of the company who committed the wrongful acts can be personally held liable for the same. Therefore, in order to prevent the misuse and safeguard the principle of a company as a separate legal entity, it led to the establishment of a doctrine called the 'Lifting of Corporate Veil'. The doctrine enables the smooth functioning of the business and holds the persons accountable for the wrongful acts done on behalf of the company.

Lifting Of The Corporate Veil: An Explanation Of The Concepts Leading To The Doctrine:

The Authors in the present paper have provided a general explanation of the concepts related to the lifting of the corporate veil. The concepts are explained in brief and conclusively lead to the doctrine.

- **Company:**¹ Originated from the French word 'compainie', the English word 'company' has been derived. A company means an establishment incorporated under the Companies Act, 2013, or under any previous laws. A company may be formed under a certain structure, such as partnership, proprietorship or corporation. This structure also denotes the ownership of the company. It can either be a private or a public company. In common law, Company is a legal person or a legal entity separate from its members, that is capable of surviving by itself. Companies are generally established with the aim to earn profit. Black's Law Dictionary provides a general definition of the term corporation which can be used along the same lines as that of a company. According to the dictionary, " a corporation is an entity having authority under law to act as a single person distinct from the shareholders who owe it and having rights to issue stock and exist independently, a group of succession of persons established in accordance with legal rules into a legal or juristic person that has legal personality distinct from the natural persons who make it up, exist independently apart from them and has the legal powers that its constitution gives it". Therefore, the definition sets up the meaning for a company as a separate entity which is a universally accepted principle and is explained in detail below²
- **Incorporation of a company:** Incorporation refers to the legal process of formulating a company or a corporate entity. It becomes a legal entity which has separate assets and income from that to have its owners, shareholders and investors. This is also known as a limited liability over the shareholders. Incorporation results in protecting the owner's assets against the company's liability. It also allows transferring of ownership. The incorporation of a company eventually results in protecting all the shareholders from the company's liability, often referred to as a corporate veil.

¹ Shittu A. Bello and Ogwezzy C. Michael, *Piercing the Veil of Business Incorporation: An Overview of what Warrants It*, 3, Review of Contemporary Business Research, 117, 117-138, (2014)

² B.A Garner, (ed), Blacks Law Dictionary, 7th edn, St Paul, MINN, West Group Publishing, 2000, p.276.

- The Doctrine of Corporate personality: A company at the time of its incorporation gets marked as a separate entity in the eyes of the law. It establishes its own legal identity and enjoys its own independent status. However, in reality, a corporation or a company is a group of persons who are the beneficial owners of the body corporate.³This doctrine mainly states that a company has a different legal identity from its members. This doctrine is recognised under Indian and English law. This again refers to the limited liability principle over the shareholders. The creditors can demand recoveries from the company only and not its members. This also means that the company has no right over the member's individual debts and assets. Being a corporate personality, the company enjoys its rights over rights and assets in its name.

A. The theory of Corporate personality is the basic and pivotal principle which sets the foundation for the law of corporation and there lay several instances where the courts have managed to lift the corporate veil⁴.

B. The doctrine of the lifting of the corporate veil has its roots embedded in the principle of corporate personality and without the principle, the doctrine will be left incomplete. Therefore, the authors have mentioned two leading cases on the principle of the company as a separate entity which creates the foundation for the doctrine of the lifting of corporate veil. *Salomon v Salomon*⁵ stands its ground as one of the landmark judgments of Company law and is applied even today in courts all around the globe. There was a businessman called Aron Salomon, who was involved in the business of leather and shoe manufacturing. He made a company called Salomon and co ltd. and sold his business to the company at 38,000 pounds. The company had 7 subscribers comprising of Salomon, his wife, daughter and 4 sons. The total share capital of the company was 40,000 shares and the value of the share was 1 pound each. Salomon himself had 20,001 shares and debentures worth 10,000 pounds. Due to unforeseen circumstances, the company goes into a state of liquidation after a year. On assessment, it is found that the company had 6,000 pounds worth of assets and 17,000 pounds worth of liabilities. The main issue at hand was as the company was being administered by Salomon and his family whether it fails to have any legal identity of its own and therefore Salomon can be exposed to unlimited personal liability. The Court of Appeal declared the company to be a myth and hence held Salomon personally liable for the debt incurred. However, the House of Lords on Appeal reversed the above decision and held that the company was not a sham and Salomon shall not be

³ Gallagher v. Germania Brewing Co., (1893) 53 Minn. 214

⁴ Avtar Singh, Company Law, (15thedn, Eastern Book Company, 2007)

⁵ Salomon v. A Salomon & Co. Ltd, [1896] UKHL 1

liable towards the debts of the company as the company at the time of incorporation establishes itself as a separate entity, therefore, becoming an independent person possessing its own rights and liabilities. The principle of the company as a separate entity adopted in the *Salomon v Salomon* case was further affirmed in another leading case of *Lee v Lee's Air Farming Ltd*⁶. There existed a company called Lee Air Farming co ltd. whose total share capital was 300 shares from which Lee had 2999 shares. Lee was the managing director and a pilot for the company which made him a salaried employee as well. However, he lost his life in an air crash and his wife sought compensation under the Workmen's compensation act. The case at hand demonstrates the relationship between master and servant in the company. The court held that the widow has the right to seek compensation as the principle of the company as a separate legal entity is invoked which creates a master-servant relationship at the same time⁷.

- The doctrine of Corporate Veil: Becoming a corporate personality, a company has its own name and company seal under which it is recognised apart from its owners and members. It becomes a juristic person. The corporate veil becomes an important aspect of such companies, as after becoming a separate legal entity, the veil protects the members from the actions of a company. In other words, the doctrine safeguards against those individuals who misuse and take shelter behind the principle of corporate personality. If any violations occur or if any liability is imposed on the company, the veil protects its members from suffering as they will not be held liable due to the limited liability principle⁸. Therefore, piercing the corporate veil is the judicial act of imposing liability on the otherwise immune members for the company's wrongful acts.

Need For The Doctrine Of The Lifting Of Corporate Veil:

In layman's terms, though a company and its members are separated through a curtain, a company is dependent on its members for smooth functioning. At times, it is found that the members use the term corporate personality to their own benefit through fraud, illegal activities, and improper conduct in order to safeguard themselves from the wrongs committed. For instance, in a case, it was held by the Supreme Court that the courts can look beyond the corporate character of the company if the company is being used for the purpose of committing fraud⁹. The doctrine of the lifting of the corporate veil is one of the most utilised doctrines by the courts. However, the courts

⁶ Lee v. Lee's Air Farming Ltd (1961) AC 12

⁷ Parag Agarwal, *The Landmark case of Salomon v Salomon and Co Ltd, 1897*, <https://www.judicere.in/salomon-v-salomon-co-judicere/>

⁸ Ashu Bala, *Lifting of Corporate Veil: Indian Scenario*, <http://www.legalservicesindia.com/article/1876/Lifting-of-Corporate-Veil:-Indian-Scenario.html>

⁹ Delhi Development Authority v. Skipper Construction Co. (P) Ltd., 1996 4 SCC 622

do not follow any precise strategy for its invoking. The authors in the present paper have mentioned the circumstances under which the court may pierce the corporate veil in order to safeguard the principle of corporate personality:

A. Judicial Provisions:^{10 11}

1. Fraud or Improper Conduct: There are numerous cases which have prepared the Courts to pierce the corporate veil if it is realised that there has been some fraudulent activity, or where the shareholders of the company have been indulged in a fraudulent act. By virtue of such cases, it is understood that the corporate veil can be lifted in case of a criminal act and any misrepresentation. The Courts will refuse to uphold the separate legal existence of the company where it is formed to defeat or circumvent the law, defraud creditors and avoid legal obligations. For instance, in the case of *Gilford motor company ltd v. Horne*¹², Mr Horne was an ex-employee of the Gilford motor company. As per the terms of his employment contract, he could not solicit the customers of the company. However, Mr Horne failed to abide by the terms of the contract as he incorporated a company in his wife's name through which he solicited the customers of the company. The Court of Appeal held that in the present case the company was formed as a device to mask the effective carrying on business and it was clear that the main purpose of incorporating the new company was to perpetrate fraud. Thus the court pierced the corporate veil and held it as a mere sham to hide the wrongdoings. Fraudulent conduct was witnessed in another leading case of *Jones v. Lipman*¹³ whereby Lipman enters into a contract with Jones to sell properties. However with the passing of time, Mr Lipman changes his views and in order to safeguard the performance of the contract, he transfers the properties to his company. Russell Judge relies on the judgment of *Gilford v. Horne* and held that Mr Lipman used the company as a mask which is thereby an illegitimate use and an attempt to avoid recognition. He, therefore, awarded specific performance against Mr Lipman and the company.
2. Tax Evasion: Court has the power to lift the corporate veil if members of the company are using the name of the company for illegal gains by evasion of taxation or circumventing tax

¹⁰ Adv. Paarth N. Chanchlani, *An Analytical Study on Lifting of Corporate Veil* (With Special Reference in Fraudulent Transactions and Criminal Liability for Misstatements in Prospectus), 16, PEN ACCLAIMS, 1-23, (2021)

¹¹ Manish Kumar Singh, *Analysis of lifting of corporate veil*, 6, International Journal of Law, 109,109-115 (2020)

¹² *Gilford motor company ltd v. Horne*

¹³ *Jones v. Lipman* [1962] 1 All ER 442

obligations. In the case of *Sir Dinshaw Maneckjee Petit Re*¹⁴, the assessee was a wealthy man enjoying huge dividends and interest on his income. He formed four private companies and credited all the income received in the account of the companies. This amount was then handed back to the assessee in the form of a loan from the company. This way he divided his income and reduced his tax liability. In this scenario, Court had lifted the Corporate veil in order to rule the case.

3. Company as an Agent: Vicarious Liability can be imposed when the agent is acting on behalf of the shareholders. The court determines the liability on the fact whether the Agent was acting for the shareholders or not. In such cases, it becomes necessary to determine the character of a company in order to ascertain if the company is an enemy or not. Court will pierce the Corporate veil in order to understand the true character of the Company.

4. Determination of enemy character (war): The provision is applicable when a country goes into a war with any other country, those citizens ipso facto acquire the position of alien enemies and hence the normal law will fail to be applicable. In the case of *Daimler Company Ltd v. Continental Tyre & Rubber Co*¹⁵, a German company incorporated a company called *Daimler Company Ltd* in London for the purpose of selling tyres and expanding their business. The company incorporated in London composed of a majority of German shareholders. *Daimler Ltd* was involved in a series of transactions with *Continental Tyre and Rubber Co*. A war was declared between Germany and England, and *Daimler* demanded the payment from *Continental Tyre*. The claim of *Continental Tyres* was that any transaction with *Daimler* will result in a transaction with an alien enemy though the company was incorporated in England. The court held that despite the fact that *Daimler* was incorporated in London is composed of a majority of German shareholders who controlled the company. The trade was dismissed on the ground that any transaction between the two companies would account for business with an enemy company.

5. The company as a cloak: The courts will pierce the corporate veil if it is of the opinion that the company is incorporated for the purpose of restraining the performance of a contract or

¹⁴ Sir Dinshaw Maneckjee Petit, Re AIR 1927 Bom. 371

¹⁵ Daimler Company Ltd v. Continental Tyre & Rubber Co[1916] 2 AC 307

is a bogus company or has any fraudulent motive. The afore-mentioned case of *Gilford motor company ltd v. Horne*¹⁶ provides a detailed understanding of the provision.

B. Statutory provisions in Lifting of Corporate Veil¹⁷

1. Officers in Default: Section 5 of the Companies Act, 2013¹⁸ provides a list of officers including a managing director or a whole-time director who shall be liable for punishment or penalty on account of any default in the company.¹⁹
2. Failure to comply with the requirements necessary for incorporation: Section 464²⁰ of the Companies Act, 2013 comes into effect when the conditions necessary for incorporation are not maintained.
3. Minimisation of members below the Lawful Limit: According to the Companies Act, 2013, seven and two are the lawful limit of the members of the company in Public Company and Private Company respectively, but if in any case, the company fails to have the prescribed number of members and still decides to continue with its business for more than six months then it's a well-settled principle of law that the members who concealed this fact from the competent authorities will be responsible for all the debts of the company incurred during the period where the company had fewer members. The members will be forced to take personal responsibility for the debts of the company.
4. Misrepresentation in Prospectus: If there is any kind of falsification in the Company's prospectus then every person who approved such misleading prospectus including directors,

¹⁶ *Gilford motor company ltd v. Horne* [1933] 1 CH 935

¹⁷ R. Judith Priya, S. Susmitha, Subhicksha, B. Thenmozhi, *A Descriptive Study of the Doctrine of Lifting of Corporate Veil*, 3, INTERNATIONAL JOURNAL OF ADVANCE RESEARCH AND DEVELOPMENT, 6, 6-9,

¹⁸ The Companies Act, 2013, § 5, No.10, Acts of Parliament, India (2013)

¹⁹ P. Shanthini, MS. Arya. R, A study on lifting of corporate veil with reference to case laws, 120, INTERNATIONAL JOURNAL OF PURE AND APPLIED MATHEMATICS, 121, 121-130, (2018)

²⁰ The Companies Act, 2013, § 464, No.10, Acts of Parliament, India (2013)

promoters etc will be liable to pay compensation to the investors who fell prey to such prevarication in the prospectus²¹.

5. Inquiry relating to Proprietorship of Company(Section 216): When one person gains profits regardless of the Company incurring profit or loss, then it becomes essential to find out such person for smooth functioning of the Company, in such cases, the Central Government has the power to appoint one or more than one investigating officers to inquire about the real owner of the company who takes decisions which are further implemented in the Company policy²².
6. Misdescription of Company's Name (Section 12): As the name suggests if there is any misdescription of the Company's name in any contract, agreement etc then the person who has wrongly used the company name will be personally responsible for such wrongful use of the Company's name as it is an obligation on Companies to use the Company name properly on contracts, letters, negotiable instruments etc. ²³
7. Responsibility for unscrupulous business conduct (Section 339)²⁴: While winding up of any Company, if it is discovered that the Company was cheating the investors/creditors then in such cases the Court has the discretion to hold people involved in such fraudulent business to be liable for the damages caused by their conduct to the investors/creditors.
8. Ultra Vires Act: If the director of any company decides to exercise his power beyond the Memorandum of Association signed by him, then that director is held responsible for such actions even if such acts were done on behalf of the company.

²¹ The Companies Act, 2013, §62, 63, No.10, Acts of Parliament, India (2013)

²²The Companies Act, 2013, § 216, No.10, Acts of Parliament, India (2013)

²³ The Companies Act, 2013, § 12, No.10, Acts of Parliament, India (2013)

²⁴ The Companies Act, 2013, § 339, No.10, Acts of Parliament, India (2013)

The Vodafone International Holdings B.V. Vs Union Of India

Case²⁵

Amongst other laws, the case of *Vodafone v. Union of India* serves as an important case towards the understanding of the concept of piercing of corporate veil. The authors have given a brief analysis of the case.

- **Brief Facts:**

In May 2007, Vodafone incorporated in the Netherlands, acquired from Hong Kong-based Hutchinson Group, the entire share capital of CGP Investments Limited (CGP), a Company incorporated in the Cayman Islands, which controlled a 67% share of the Hutchinson-Essar Limited (HEL), Hutchinson's Indian mobile business. The Indian Income Tax Authorities contended that capital gains were made by Hutchinson in India and that Vodafone was, therefore, liable to pay tax, amounting to approximately INR 110 billion.

Vodafone challenged the tax demand in the Bombay High Court, which ruled in favour of the income tax department, holding that the essence of the transaction was a change in the controlling interest in HEL, which was the source of income in India.

- **Appeal in front of the Supreme Court:**

After the Bombay High Court ruled against Vodafone, an appeal was made in front of the Supreme Court, where the SC overruled the High Court's decision and held that the transaction fell outside India's territorial tax jurisdiction and was hence not taxable. This judgement was important from the Principle of Lifting of Veil point of view, as it states the circumstances where it may be lifted, also mentioning commercial cross-border transactions and tax avoidance. The Hon'ble Court recognised the fundamental principle of the corporate veil by taking a note that the approach of corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on a separate entity principle, i.e. company is treated as a separate entity. The Income Tax Act, 1961 in the matter of Corporate taxation is founded on the principle of the independence of companies and other entities subject to income tax.

The Supreme Court stated that as the companies were in 2 different countries, section 9 of the Income Tax Act, which states that it is mandatory to pay the tax in the territory where one earns, is

²⁵ Vodafone International Holdings B.V. v. Union of India, (2012) 6 SCC 613.

not applicable. If the case would have been where the assets were located in India, and the income was also accrued in India, then taxes would have been paid in India. But, firstly there was no direct transaction between Vodafone International and HEL, and even though the assets were located in India, the transaction and income were generated outside India. There was no transfer of ‘towers’.

• Observations:

It was observed that in the context of parent/subsidiary relationships, it is generally accepted that the parent company would guide the subsidiary, but that by itself would not justify piercing the veil or imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. A subsidiary and its parent are 2 different taxpayers. Six factors which needed to be focused on to understand whether the transaction was bogus in this case are:

1. The concept of participation in investment
2. The duration of time during which the Holding Structure exists
3. The Period of business operations in India
4. The generation of taxable revenues in India
5. The timing of exit
6. The continuity of business on such exit.

In finality, the Supreme Court decided against the lifting of the corporate veil in Vodafone, as the tax authorities failed to establish that the transaction was a bogus or a tax avoidance scheme.

Conclusion

We are on the brink of a revolution and with the advancements in the current world, there shall be a time where the doctrine will need to evolve as well. If one considers the time from *Salomon v Salomon*, we can see how far the subject of Company Law has evolved. From the recognition of the concepts of corporate personality to the piercing of the corporate veil, the subject keeps on evolving with the passing of time. The doctrine serves as a protector of the principle of corporate personality, however, soon there shall be multiple provisions and exceptions that will be needed in order to safeguard the principle. The Companies Act, 2013 which is the act governing Company Law in India may enact amendments that will be required to prevent misuse of the principle of corporate personality. However, for now, the doctrine of the lifting of the corporate veil remains to be an interesting subject of study and concluding the paper, one can safely term it as the protector of the principle of corporate personality.

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