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Lifting of the Corporate Veil - The Public-Private Company Conundrum under Section 179 of the Income Tax Act, 1961

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A company is founded upon the precept of a separate legal personality. The foundation of modern company law rests on the concept of the fictitious legal personality of a company which effectively separates the liability of the members of the company from the company itself. This helps facilitate and further entrepreneurial activity as the concerned stakeholders can invest and manage the company without the apprehension of being held personally liable for the debts of the company. Without limitation of liability via a separate legal personality, it would be difficult for companies to raise capital and take commercially expedient business decisions. This doctrine has been recognized by the Courts in the 19th century itself vide the Calcutta High Court's judgment in the case of [*In Re: Kondoli Tea Co. Ltd \(1886\) ILR 13 Cal 43.*](#) Subsequently, in the landmark case of [*Salomon v. Salomon & Co. Ltd.*](#) the House of Lords held that a company is a legal entity separate from its members and shareholders and therefore the debts of the company are its own.

The corporate personality of the company could in many instances be used to commit fraudulent and malicious acts; as the company being an artificial person is incapable of committing fraudulent and illegal acts, the veil of corporate personality might have to be removed to ascertain and find out the people who are guilty. This concept is known as 'lifting of the corporate veil'. As propounded in the case of [*Cotton Corporation of India Ltd. v. G.C Odusumathd \[1999\] SCL 228 \(Kar.\)*](#), the circumstances where the corporate veil could be lifted should either be provided by clear words of a statute (under statutory provisions) or compelling reasons should be made out such as in the case of fraud (under judicial interpretations). In the case of [*State of U.P v. Renusagar Power Co. \[1991\] 70 Comp. Cas. 127*](#), the Hon'ble Supreme Court opined that the lifting of a corporate veil is an ever changing and dynamic concept. In modern jurisprudence the corporate veil is becoming increasingly transparent and its frontiers are unlimited.

The corporate veil may be lifted in certain exceptional circumstances. In short, there are two considerations for piercing the veil:

1. *Where any evidence points to the fact that the company is not in fact a separate legal entity*

2. Where the company has been improperly used as a cloak for wrongful purposes e.g. fraud, improprieties, tax evasion etc.

In the Indian context, the landmark case of [LIC v. Escorts Ltd.](#) established that the corporate veil can be lifted if provided for under the statute or in circumstances where there has been an element of gross misconduct, impropriety, **evasion of tax** and/or fraud or for any other reason as the Court may deem appropriate.

Analysis of Section 179 of the Income Tax Act, 1961:

Sec. 179 of the Income Tax Act, 1961 (hereinafter referred to as 'Act') provides that where any tax is outstanding to a private company, with respect to any income of any previous year or from any other company in respect of any other income or any previous year during which such other company was a private company cannot be recovered, then every person who was a director of such company shall be jointly and severally liable for the payment of due taxes, unless it is proved that the non-recovery is not attributable to any gross neglect, misfeasance or breach of duty on their part in relation to the affairs of the company. This provision basically attaches vicarious liability to the director(s) and makes them personally liable for tax payment for the due amount if any during any of the years when they served in that capacity. In cases when this provision is triggered, the director(s) cannot hide behind the façade of corporate veil.

The controversial point in this regard is that the section only mentions '**private company**' which means that the statutory provision of lifting the corporate veil is technically available only for the private companies and not for the public ones. The provision does not apply to companies treated as public companies under the Companies Act. However, there has been development in this regard through the other method of lifting the corporate veil, which is through judicial pronouncements as discussed above. It is imperative to understand these pronouncements for ascertaining the applicability of Sec. 179 for public companies.

Judicial Pronouncements and Critical Analysis:

The leading case in this regard is the judgment in the case of [Pravin Bhai M. Kheni v. Assistant CIT \(2013\) 353 ITR 585 \(Guj\)](#). Therein, the public company had defaulted to the tune of ₹155 crores and the directors had created the public company only to route funds and amass property in their favour under the garb of the company. The Court held that there was no reason why the '**double application**' of the corporate veil could not be resorted to. The interpretation of '**double application**' was adopted as Section 179 already provided for the lifting of the corporate veil but not for a public company. Hence the double application theory was used by the Court to extrapolate the piercing of the veil to even a public company under Section 179 itself.

Another important case in this regard is [Ajay Surendra Patel v. DCIT \(Special Civil Application No. 6580 of 2016\)](#) in which the Gujarat High Court included a public company under the ambit of Sec. 179. In this case the petitioners had contended that this Section ex-facie is not applicable to a public limited company but the respondents proved with material on record that there was a systematic design adopted by the petitioner and the company was wrongfully used to fulfill their personal motives. The later part of Sec. 179 is also very important to note and where from material on record it can be established that there was no gross neglect, misfeasance or breach of duty in relation to the affairs of a company, then the director(s) will not be held vicariously liable for the

alleged act. This was also affirmed in the case of [*Jashvantal Natvarlal Kansara v. ITO \(2014\) ITR 115 \(Guj.\)*](#).

In most cases, the factual matrix is considered to ascertain the liability of the directors, to find out whether there was any gross neglect or misfeasance or breach of duty in relation to the affairs of the company. The Supreme Court held in the case of [*Juggilal Kamlatpat v. Commissioner of Income Tax, U.P., 1964 \(52\) ITR 811*](#) held that the Court is entitled to lift the corporate veil if the same is used for tax evasions. In another case of [*Commissioner of Income Tax v. Sri Meenakshi Mills Madurai, AIR 1967 SC 819*](#), the same was affirmed that the corporate veil of a company must not be used to circumvent tax obligations. Generally, a director is not personally held liable for debts of the company unless a Court of competent jurisdiction finds him guilty for the above three ingredients, i.e. gross neglect, misfeasance and breach of duty. Under the Act, such liability can be imposed even without the interference of Courts, by the Assessing Officer. However, the burden is on the director to prove innocence.

Now, it is clear that the scope of Sec. 179 of the Act is not just limited to private companies. However, in these cases, why these companies even though they were not private in nature were held to be considered under the purview of Sec. 179 is because they practically acted as Private companies and the conduct was detrimental. Therefore, the Courts are well within their powers to pierce the corporate veil of even a public company under section 179 but whether or not they will cannot be determined as there is no indication of whether the public company has been used to evade taxes or whether the directors have acted in a fraudulent capacity in furtherance of the same.

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