
LIFTING THE MISTS OF METAPHOR¹ - PIERCING THE CORPORATE VEIL: A COMPARATIVE ASSESSMENT OF INDIAN AND CHINESE LEGAL PRACTICES

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ABSTRACT

This paper aims to provide a comparative perspective on the doctrine of piercing the corporate veil in India and China, with respect to the grounds invoked for piercing the veil, its application with regard to the categories of companies, the scope of parties allowed and parent-subsidiary company relations. The differences in the civil and common law systems of China and India indicate the prominence accorded to the statutory application of corporate veil doctrine in the former and judicial interpretation in the latter. The lack of the use of stare decisis or precedential value in Chinese courts indicates the need for a coherent judicial trend in the application of the doctrine, preventing reliance on clarifications by the apex court. On the other hand, Indian common law tradition confers greater flexibility upon the court to decide matters and shape future decisions. Thus, both jurisdictions require a balanced approach which involves the consolidation of clear legislative provisions concerning the grounds for piercing the veil and the standard for the same while leaving adequate space for application on a case-by-case basis.

¹ In *Berkey v. Third Ave. Ry.*, 244 N.Y. 84, 155 N.E. 58 (1926), Benjamin Cardozo critiqued the doctrine of corporate veil as "enveloped in the mists of metaphor".

Introduction

A central principle guiding company law is that the company possesses a legal personality distinct from its shareholders. However, in specific instances laid down by the law governing companies, the separate personality of the company is set aside and the corporate veil is lifted.

China is an emerging economy with significant investment potential, a high rate of growth and access to a large market and cheap labour.² Company Law in China developed out of scattered regulations put in place post the adoption of a planned economy in 1949 and consolidated in 1994. The legislation was reformed in 2005 to align it with other international jurisdictions and remains enforced currently.³ India is a middle-income emerging economy with rapid growth but a high rate of poverty and inequality.⁴ Indian companies are primarily regulated by the Companies Act, 2013, which governs the incorporation and functioning of companies and by the SEBI Act, which safeguards the interests of investors.

A comparative analysis of both the corporate law jurisdictions in China and India flows from the historical evolution of the legal doctrine in both systems. Owing to the recent reform of company law in China in 2005, the provisions and application of the concept remain ambiguous and underdeveloped. This is in contrast to India, where despite the lack of independent development, the doctrine of the piercing of the corporate veil has been borrowed and applied in keeping with its English origins. Acknowledging these differences, this paper aims to provide a comparative perspective on the doctrine with respect to the grounds invoked for piercing the veil, its application with regard to the categories of companies, the scope of parties allowed and parent-subsidary company relations.

Grounds for Piercing the Corporate Veil

Article 20 of the Companies Law of China provides for a three-pronged approach in applying the corporate veil doctrine, constituting abuse of corporate form, intention to evade contractual or legal obligations, and the seriousness of the damage caused to the creditor. An additional element comprising the causal link between the shareholder's abuse and the damage caused to

² G.K. Fogel, *Business Environment in China: Economic, Political, and Cultural Factors*, LAWRENCE TECHNOLOGICAL UNIVERSITY, 1, 1 (2010).

³ Colin Hawes, *Interpreting The PRC Company Law Through The Lens Of Chinese Political And Corporate Culture*, 30 UNSW LJ 813 (2007).

⁴ Ajay Chhibber, *View: India needn't worry about the 'middle-income trap'*, THE ECONOMIC TIMES, 19 July, 2019.

the creditor has been identified by some scholars.⁵ Based on these standards, the four causes of commingling, undercapitalization, fraud or improper conduct and undue control have been identified as the primary reasons for judicial application of the doctrine. Operating on a principle of trust and the importance of preserving the interests of the creditors, it has been observed that the piercing of the veil is carried out in a liberal manner to attribute misconduct and fraud. In *Wuhan Vegetables Co v. Wuan Jiutian Trade Development Co.*, the defendant corporation had transferred part of the plaintiff's equity interest to a shareholder, allowing her to gain majority stake in the firm and institute subsequent transfers.⁶ The court held that the shareholder had abused the corporate form to defraud the creditor, although criticisms can be levelled against the decision on account that the ground of commingling of assets would require a trend of activity instead of merely a single transfer.

In India, the grounds for the piercing of the veil can be derived from statutory provisions or judicial interpretation such concerning reduction in members, fraudulent conduct, misrepresentation or *ultra vires* acts. Through case law, further factors such as the real character of a company, prevention of fraud, evasion or abuse can also be ascertained. Moreover, concerns surrounding public interest are also accorded space in the decision, as seen in the case of *State of Rajasthan v. Gotan Limestone Khanij Udyog*, wherein a mining lease was transferred during the transfer of shareholdings and change in directors in a newly formed company.⁷ The Court lifted the veil on the grounds that the corporate entity had been used to conceal the real transaction to the detriment of the State and the public.

In both the legal systems, an intentional misuse of the corporate form or fraud is a ground for the application of the doctrine. However, it has been observed that Chinese law effectively treats fraud as a necessary prerequisite for the piercing of the veil as it becomes an embedded element within the abuse requirement. In India, the veil may be pierced without the element of fraud and for other purposes including the determination of the character or ownership of the company as in the *Renusagar* case or the reduction of members under S.45 of the Companies Act. Secondly, the ground of undercapitalization, wherein a breach of capital maintenance requirements occurs, is not a factor accorded consideration in Indian law. However, although the ground carries significance in the statutory guidelines in Chinese law, it is rarely applied in

⁵ Tan Cheng Han et al, *Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives*, NUS Law Working Paper Series 2018/025, 45 (2018).

⁶ *Wuhan Vegetables Co v. Wuan Jiutian Trade Development Co.* [1991] [Wu Min Shang Chu Zi No. 66, Wuhan Interm. People's Ct.].

⁷ *State of Rajasthan v. Gotan Limestone Khanij Udyog* A.I.R. 2016 S.C. 510 (India).

cases and remains the least important ground. The other factors concerning commingling, improper conduct or undue control feature prominently in both jurisdictions, indicating the shared motivations behind the doctrine of corporate veil to minimize the abuse of the separate legal personality of a corporation.

Parties

The Chinese legal system enables only creditors to proceed against shareholders to lift the corporate veil, with Article 20(3) applying predominantly to matters regarding debt. Governmental agencies remain beyond the pale of the legislation. Shareholders of the company cannot institute cases that seek to pierce the corporate veil, rendering reverse piercing an impossibility.⁸ As held in *Morris v. New York State Department of Taxation and Finance*, reverse piercing occurs when the company is held liable for the shareholder's acts.⁹ Further there is also a paucity of commentary regarding creditors suing to pierce the corporate veil against directors. In *Rosin Factory of Wuzhou v. Huajin Materials and Vill*, while the corporate veil was pierced and the shareholder was held liable, the director was not proceeded against.¹⁰ Companies are deterred from proceeding against directors as this can appear as a defiance of the state, given that the Chinese government closely monitors company decisions.¹¹ Thus, both statutory provisions and judicial pronouncements have eschewed liberal interpretations of which parties possess locus standi in cases regarding lifting the corporate veil.

Indian jurisprudence has been far more expansive. For instance, while there is legislative silence on reverse piercing of the corporate veil, in *Punjab and Sindh Bank v. Skippers Builders Pvt. Ltd.*, the court reasoned that once the corporate veil had been pierced the reverse doctrine would be applicable.¹² Further, in India, governmental agencies can pursue cases pertaining to piercing of the corporate veil, as attested in *Commr. of Income Tax v. Meenakshi Mills*, where the court upheld the government's authority's plea to pierce the corporate veil as tax evasion had been committed.¹³ Indian law also enables a wider conception of permissible defendants, as Sections 34, 447 and 35 of the Company Act enable plaintiffs to proceed against the director

⁸ Hui Huang, *Piercing the Corporate Veil in China: Where is it Now and Where is it Heading*, 60 AM. J. COMP. L. 743, 763 (2012).

⁹ Vijay P. Singh, *The doctrine of reverse piercing of corporate veil: its applicability in India*, 27 TRUSTS & TRUSTEES 108, 110 (2021).

¹⁰ *Rosin Factory of Wuzhou v. Huajin Materials and Vill*. [1991] [Gazette of the Supreme People's Republic of China].

¹¹ Tham, Szu-Shen, *Piercing the corporate veil: Australia and China*. Murdoch University (2014).

¹² Vijay P. Singh, *supra* note 9, at 115.

¹³ *Commr. of Income Tax v. Meenakshi Mills*, A.I.R. 1967 S.C. 819 (India).

of the company to pierce the corporate veil. Thus, piercing of the corporate veil is not pigeonholed to matters regarding debt.

A textualist interpretation of Chinese law affirms that it defines litigants narrowly. Hence, the scope of law regulating corporate veil piercing is at best ambiguous, or at worst, procrustean. In contrast, in both statutory form and judicial practice, Indian law is far broader in envisioning the bounds of who can sue and be sued to pierce the corporate veil.

OPCs

Law governing one person companies (OPC) in China differs considerably from India, as the presumption is in favour of piercing the corporate veil rather than in upholding the separate legal personality of the company. Article 64 of the Company law provides that in case of an OPC, if the shareholder fails at establishing the distinction between his personal assets and those of the company, then he will be held jointly liable for the company's debts. Hence, Article 64 effectively shifts the burden of proof to the defendant shareholder from the plaintiff creditor. While the statutory provision does not spell out the evidence required to prove absence of commingling of assets, in *Zhao Yongyin v. Quzhou Weini Chemical Industrial Ltd Co.*, the court, without permitting the defendant to rebut the statutory presumption, held that because the matter pertained to an OPC the corporate veil could be lifted.¹⁴ Thus, judicial pronouncements have consistently eroded the separate legal personality of one-member companies, with the veil being pierced in every case concerning OPCs from 2006 to 2010.¹⁵

In India, the prevalent legal position remains that merely because the sole member is an alter ego of the one person company, this is inadequate to pierce the corporate veil.¹⁶ There are no statutory provisions specifically applicable to OPCs, and in *Cotton Corporation of India Ltd. v. G.C. Odusumath*, the court observed the corporate veil could not be lifted indiscriminately, and could only be pierced by invoking the statute.¹⁷ In *Wittman v. Wittingham*, the court clarified that if the sole shareholder maintains a distinct bank account, does not execute business operations in his personal name and does not appropriate company funds as if they

¹⁴ Hui Huang, *supra* note 8, at 765.

¹⁵ Hui Huang, *supra* note 8, at 765.

¹⁶ K. S. Ravichandran, One Person Company – Need For Granting Exemptions and Removing Limitations, ONE PERSON COMPANIES: INDIAN LAW IN A GLOBAL PERSPECTIVE (August, 2014).

<https://www.icsi.edu/media/webmodules/companiesact2013/Annexure-G.pdf>.

¹⁷ *Cotton Corporation of India Ltd. v. G.C. Odusumath*, (1999) ILLJ 19 Kant (India).

were his own, then the corporate veil could not be lifted.¹⁸ Thus, in India, there is no niche carved out specifically for OPCs, and they are equally governed by provisions applying to other companies.

In China because the statute does not lay out the particulars necessary to establish commingling, this has prompted the judiciary to fill the chasm. Hence, judicial activism has been expansive and unabashed in piercing the corporate veil. Whereas, in India, judicial evolution has largely fallen within the statute's bounds. Thus, the countries differ primarily because piercing the corporate veil in cases of OPCs, in practicality is the norm in China, in contrast to India where it constitutes the exception.

Public Companies

A peculiar trend emerges in China, namely that the corporate veil has never been pierced in the case of public companies.¹⁹ This is primarily because of the prevalence of the legal presumption that companies consisting of more shareholders are less likely to abuse the corporate form. Courts may be tentative in disregarding the separate legal personality of the company because of the significant economic advantages limited liability confers upon public companies. Limited liability promotes economic efficiency as it reduces the costs incurred in regulating agents, enables free transfer of shares and engenders optimum investment decisions.²⁰ Thus, in pursuance of economic stability, Chinese courts have never pierced the corporate veil of public companies, to curb a dip in share prices arising from holding shareholders personally liable.

Indian law does not avert its gaze from public companies, subjecting them to equal scrutiny. In *Ajay Surendra Patel v. Deputy Commissioner of Income Tax* the court held that the corporate veil could be lifted even for public companies.²¹ The court conducted a double application of the doctrine, based on both S.179 of the Income Tax Act and the facts disclosed, which affirmed that the company was a smokescreen to evade legislation. Thus, the judicial evolution of the doctrine of corporate veil has accounted for both statutory prescriptions and practical exigencies.

The fact that there was no case where the corporate veil was pierced in the case of a public

¹⁸ *Wittman v. Wittingham*, 85 Cal App 140 (1927).

¹⁹ Hui Huang, *supra* note 8, at 752.

²⁰ FRANK E ASTERBROOK & DANIEL FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 41-44 (Harvard University Press, 1991).

²¹ *Ajay Surendra Patel v. Deputy Commissioner of Income Tax*, (2017) 293 CTR (Guj) 249 (India).

company whereas there was piercing of the corporate veil in all cases for OPCs reveals how the evolution of Chinese law is specifically attuned to the interests of shareholders of larger companies. In contrast, in India, as the judiciary seeks to secure the ends of justice, it pierces the corporate veil of even public companies.

Piercing the Veil in Parent-Subsidiary Relationships

The evolution of the doctrine of veil-piercing in Chinese corporate law is grounded in the parent-subsidiary relationship. In 2003, a judicial interpretation was issued by the apex court stating that a parent company would bear unlimited liability for the debts of the subsidiary if it fraudulently shifted the assets of the latter in an attempt to evade debts.²² While Article 14 of the Companies Law recognizes the status of subsidiary companies as legal persons, independently bearing civil liabilities, its distinction from the parent company remains a matter of judicial interpretation.²³ In *Hainan Rifa Co. v. Hainan Shengtai Garden Co.*, the Court lifted the veil to hold the parent company liable for the debts of its subsidiary and laid down four factors to be considered when piercing the veil, namely, the lack of independent legal personality, the confusion of property, of personnel, and of business. Statistical research shows that the veil piercing rate was 85.71% in cases where the creditor of a subsidiary sought to pierce the veil of the parent company.²⁴

In India, a subsidiary company is statutorily defined in S.2(87) of The Companies Act, 2013 as one in which the parent, or holding, company controls the composition of the Board of Directors and controls more than 50% of the total share capital. The conditions for the piercing of the corporate veil have been outlined through case law, beginning with *LIC v. Escorts*, where the Court held that in order for the veil to be fully lifted, the parent and subsidiary company must be inextricably connected as to be part of one concern.²⁵ In the *Renusagar* case, the Court lifted the veil to hold the parent and subsidiary companies as one concern based on the grounds that the wholly-owned subsidiary lacked any independent volition and was controlled by the parent company to the extent of its day-to-day affairs.²⁶ Moreover, in *Vodafone v. Union of India*, the Court held that the separate legal status of the subsidiary could be ignored only if its

²² Lynne Chan, *Corporate Veil-Piercing In China: Current Practice, Future Challenges, & Suggestions For A Robust Enforceable Regime*, Tsinghua University LL.M. Juris Doctor Thesis Paper (2014).

²³ *Hainan Rifa Industrial Development Co. v. Hainan Shengtain Garden Industrial Co.* [2007] [RenminGongsiLian 2008 Nian Di 16 Qi].

²⁴ Hui Huang, *supra* note 8, at 755.

²⁵ *Life Insurance Corporation of India v. Escorts Ltd.*, A.I.R. 1986 S.C. 1370 (India).

²⁶ *State of U.P. v. Renusagar Power Company*, A.I.R. 1988 S.C. 1737 (India).

decision-making was entirely subordinate to the holding company or if the parent company had made an indirect transfer without reasonable business purpose, by abusing legal form.²⁷

The majority control of share capital, lack of independent decision-making as well as the presence of a mala fide purpose behind the operation of the subsidiary are common factors required in both legal systems. However, the extent of parental control necessary for the corporate veil to be pierced is based on a more expansive criteria in the Chinese context as the test for ascertaining complete subordination in Chinese law includes distinctions of property and personnel, in addition to business, between the parent and subsidiary. Despite the higher standard, the success rate for vertical piercing is also higher in China as courts exhibit greater willingness for piercing the veil to impose liability on the parent company. In the Indian case law mentioned, the Courts hesitated to fully pierce the veil or lifted the veil only where the matter concerned a reduction in tax liability for the parent company. Moreover, the extent of liability imposed on the parent under Chinese law is not limited to the debts owed by the subsidiary. This issue has not been discussed in India, yet, it may be inferred that such decisions would be a rarity and qualify as judicial overreach.

Analysis Table

Subject Area	China	India
Grounds for Piercing	<ul style="list-style-type: none"> ● Fraud forms an essential component for piercing ● Undercapitalization is one of the 4 primary factors 	<ul style="list-style-type: none"> ● Fraud is not essential for piercing ● Undercapitalization is not a factor
Parties	<ul style="list-style-type: none"> ● Only creditors can sue shareholders. 	<ul style="list-style-type: none"> ● Government agencies can sue to pierce the veil and directors can be held liable.

²⁷ Vodafone International Holdings B.V. v. Union of India (UOI) and Ors. (2012) MANU SC 0051 (India).

OPCs	<ul style="list-style-type: none"> ● Burden of proof is shifted to the company. ● Veil piercing is the norm. 	<ul style="list-style-type: none"> ● Burden of proof is not shifted to the company. ● Veil piercing is the exception.
Public Companies	<ul style="list-style-type: none"> ● Corporate veil has never been pierced 	<ul style="list-style-type: none"> ● Corporate veil has been pierced
Parent-Subsidiary Relationship	<ul style="list-style-type: none"> ● Criteria for extent of parental control is more expansive ● Courts exhibit greater willingness to impose liability on parent ● Extent of liability is unlimited and beyond the debts of the subsidiary 	<ul style="list-style-type: none"> ● Criteria for extent of parental control is not detailed ● Courts are not as willing to impose liability ● Extent of liability may be limited to debts of the subsidiary

Solutions

In China and India, the evolution of the doctrine of piercing the corporate veil has been ambiguous and prone to judicial activism. This engenders an atmosphere of uncertainty which detrimentally impacts economic efficiency and constrict market freedom. Hence, there is an urgent necessity to codify the doctrine in concrete terms and limit its scope. This argument stems from both the statutory arbitrariness of legislation as well as the mixed trends in its application. Emulating the strict approach that the UK adheres to,²⁸ both countries can restrict the doctrine, thereby allowing businesses to function effectively and judges to apply the law uniformly. The necessity of the doctrine in performing a restitutive function and preserving the interests of creditors also provides support for a rigid approach to provide legal certainty and

²⁸ Lynne Chan, *supra* note 22.

encourage foresightedness amongst potential investors.

Chinese law construes the parties in cases to pierce the corporate veil exceedingly narrowly. Given burgeoning tax evasion, consumer disputes and violation of environmental law provisions, Article 20(3) must be amended to permit a wider definition of plaintiffs. In the interests of equity, government agencies and individuals whose rights have been blatantly violated by the company but who do not stand in contractual relationship with it, must be empowered to pursue a suit to pierce the corporate veil.

Concerns regarding the criteria for piercing the corporate veil in the case of parent-subsidary relationships can be better resolved in both jurisdictions through a shifting of the burden of proof to dispute control onto the parent company once the definitional criteria for a subsidiary relationship has been satisfied. In India, this would entail satisfaction of S.2(87) of the Act while it would necessitate the inclusion of a statutory definition of a subsidiary within Chinese law. Drawing from the latter, Indian courts can also seek to increase the extent of liability beyond the debts of the shareholder and take into account the revenue of the parent as well.

Conclusion

The differences in the civil and common law systems of China and India indicate the prominence accorded to the statutory application of corporate veil doctrine in the former and judicial interpretation in the latter. The lack of the use of stare decisis or precedential value in Chinese courts indicates the need for a coherent judicial trend in the application of the doctrine, preventing reliance on clarifications by the apex court. On the other hand, Indian common law tradition confers greater flexibility upon the court to decide matters and shape future decisions. In explaining these fundamental contrasts in Chinese and Indian application of the doctrine of piercing the corporate veil, as per the interest group theory it is essential to examine the political demands of stakeholders. In China, where the statute confines lifting of the corporate veil to debt situations, there is a distinct tilt in favour of the rights of creditors. Whereas, in India, where the pressures of political democracy are more palpable, the judiciary and Parliament have sought to cater to a variety of demands, centring public interest. However, this tendency of privileging judicial activism may also lead to diverging trends and a lack of clarity. In light of this, a balanced approach is required which involves the consolidation of clear legislative provisions concerning the grounds for piercing the veil and the standard for the same while leaving adequate space for application on a case-by-case basis.