How Limited Is Your Liability?

...simplifying the concept of limited liability and the legal veil of incorporation for founders.

The Concept of Separate Legal Entity

A separate legal entity is a company that is created under law to have its own existence from the person who has created it. A “separate legal entity” is a legal form that shields an individual from liability. When a business is deemed separate from its owner, the owner has limited liability for business debts and obligations.

In business law, a separate legal entity is an independent legal person, created and governed by laws and regulations that apply only to it, as opposed to a natural person or a government entity.

A corporation that is treated as a separate legal entity has its own rights and liabilities and enters into contracts in its own name. It can declare bankruptcy, amass debt, and hire employees. This does not impute legal liability to the corporation’s shareholders for any debts or actions taken by the company.

If an entity is separate from its owner, that entity is a legal person or juristic person separate from any of the natural persons who created it in many jurisdictions; that entity can sue or be sued in its own name; and it can do business and own property independently from those of its creators. Many corporations are set up as separate legal entities, which limits the liability of its owners.

"For more than a century, business lawyers have been calling the corporation a "person," and for good reason. Like its human counterpart, a corporation can sue and be sued in court; draft contracts, negotiate deals, get married (to another corporation), adopt children and even die."

- Mojolaoluwa Olaifa

ZYDEN

"When the veil of incorporation is lifted, the shareholders or directors of companies are made liable for the debt of the company."

The Veil of Incorporation

Piercing the Corporate Veil is a legal term used in circumstances that hold company directors liable for the debts of a company or where the shareholders are treated as one with the company. Piercing the Veil of Incorporation refers to circumstances in which shareholders or directors of companies are made liable for the debt of the company or where the shareholders acting as one with the company.

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Effects of The Veil of Incorporation

1. *Insulation from Corporate Debt, Judgement*

Shareholders of a corporation do not share the responsibilities of a corporation. For example, if the corporation is involved in a lawsuit, the shareholders will not be responsible for the debt or consequences of that lawsuit.

The unique characteristics of a corporation provide for "limited liability" to its shareholders. It can insulate them from nearly all liability related to the company.

A corporation is a legal entity separate from the persons that own it. The shareholders, or members, are not personally responsible for the obligations of the corporation except to the extent they may have assumed personal liability in the articles of incorporation or organization.

"The continuity of the corporation is guaranteed by the existence of a separate legal entity. The business will go on; it is essentially immortal."

2. Guarantees Perpetuity of the company

The corporation is nearly immortal despite changes in shareholders, management or financial structure which may occur.

Inevitably, some owners of corporations die, transfer their shares to third parties or corporation management changes. The continuity of the corporation is guaranteed by the existence of a separate legal entity. The business will go on; it is essentially immortal.

SALOMON v. SALOMON

"*It is becoming increasingly difficult to predict whether in any particular case the courts will or will not adhere to the principle of separate corporate personality as confirmed in SALOMON v SALOMON & CO LTD (1897).*"

In this case, Salomon transferred his business of boot making, initially run as a sole proprietorship, to a company (Salomon Ltd.) that included himself and members of his family.

He kept a floating charge on the assets of the company, which meant he secured himself for his investment through the possibility of taking legal actions against the assets in case of defaulting. The case reached the privy council, with appeals from both sides. In other words, Salomon and his unsecured creditors, respectively.

Salomon sued in defence, denying liability on the grounds of the company being essentially an agent. He also alleged that equity intervened in his favour to ensure that he was not set aside of the assets from which he had provided funds as consideration for the shares and debentures.

The principle of separate corporate personality has been firmly established in the common law since the decision in the case of Salomon v Salomon & Co Ltd, whereby a corporation has a separate legal personality, rights and(or) obligations totally distinct from those of its shareholders.

"It is held that the corporate veil should be lifted in circumstances where the persons controlling a company have acted fraudulently, where the company is regarded as a "sham", and where a company is used to avoid an existing legal duty."

Lifting The Veil of Incorporation

The corporate veil may be lifted in various circumstances, often involving the use of a company to undertake something that the persons controlling it do not want to be associated with. Such cases may include fraudulent trading, where the company is regarded as a "sham" or is used to avoid an existing legal duty.

A corporate veil may be lifted if the corporation is a sham, or exists to shield another from liability. It is held that the corporate veil should be lifted in circumstances where the persons controlling a company have acted fraudulently, where the company is regarded as a "sham", and where a company is used to avoid an existing legal duty.

Company directors owe an obligation of care to those to whom they owe duties. The courts will lift the veil if a director is found to be acting fraudulently and has no genuine interest in the company.

The courts will also lift the corporate veil where a corporation is regarded as a "sham" or is being used as a means of avoiding legal obligations and liabilities. Company directors need to be aware that the corporate veil is not a barrier between themselves and personal liability.

The courts will also lift the corporate veil in cases of fraud by one of the directors, where a company has been set up as a front for tax evasion and this will often be revealed in audit, and some jurisdictions will also look at cases where a political actor is using multiple corporate entities to conceal their ownership of assets.

Furthermore, In times of national safety, however,the courts will act to protect the interests of the public. This can be achieved by lifting the corporate veil and treating the corporation as a separate legal entity with limited liability for the actions of its head office, officers or agents.