

Corporate veil in Australia

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If you currently operate a company or are thinking of registering a company, you might have heard of the term ‘corporate veil’. In this article, we will explore the following:

What the corporate veil is and what it means practically speaking;

Piercing the corporate veil; and

What the consequences are that a company might need to confront if they are required to lift their corporate veil.

What is the ‘corporate veil’?

In a nutshell, the corporate veil refers to the limited liability that members, shareholders and directors of a company enjoy.

Under Australian law, registered companies are recognised as separate legal entities to their individual members, shareholders, and directors. For directors and shareholders, this means that no personal liability will be incurred if the company encounters legal liability. Importantly, however, that personal liability does not cover all forms of liability, and certain company structures will establish other forms of liability.

The absence of personal liability is the reason why some people may choose a company structure over some other business structures. You can read more about different company structures in our earlier blog, “Limited vs unlimited liability – considerations when choosing a business structure”.

As a result of this separate legal status, companies are by default granted the benefit of operating without surveillance of all the company's inner workings and operations.

This concept is known as the 'corporate veil'. The corporate veil separates the company as an entity from those individuals who make up the company.

However, there are circumstances where the benefit of a company's distinct legal status may not apply, and the courts seek to hold members personally accountable for the company's actions. If this has happened to you, you should seek urgent legal advice.

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What does 'piercing the corporate veil' mean?

Piercing the corporate veil is where a court may 'pierce' or 'lift' the corporate veil in situations where members of a company engage in certain (generally illegal) activities such as:

- setting up a company to cause mischief;
- fraud – for example, when the company entices investors with fraudulent information or members use investor funds for their own personal use;
- failure to undertake reporting obligations (e.g. tax returns or other reporting obligations); or
- otherwise setting up a company to avoid legal obligations – for example, if the members transfer funds to another entity in order to avoid the requirement to pay debts.

This means that upon claims of illegal activity, courts can pierce or lift the corporate veil to get more information about the activities. Importantly, this means that courts can impose personal liability directly and personally on members upon assessment or determination of members who abuse the protections of a company's limited liability.

Aside from these common law grounds for piercing the corporate veil, there are also statutory exceptions to the limited liability status offered by registered companies.

Generally, these surround director's duties and maintaining company obligations. Any conduct where members may be avoiding or failing to meet statutory duties (such as disclosures, fraud, or otherwise avoiding statutory obligations) could potentially result in the courts lifting or piercing the corporate veil to impose a personal liability on those members.

When might a court pierce the corporate veil?

A 2021 high-profile case that addressed whether the court should lift the corporate veil was determined in the case of Australian Securities and Investments Commission v Caddick [2021] FCA 1443 ('Caddick'). One of the questions for the court was whether the sole director and shareholder, Ms Caddick, used the company, Maliver Pty Ltd to operate fraudulent business practices.

Of the many authorities the court considered, it relevantly highlighted a finding from another case, Trustor AB v Smallbone and Others (No 2) [2001] EWHC 703; [2001] WLR 1177, that:

> '…the court was *entitled to "pierce the corporate veil" […]* ***if the company was used as a device or façade to conceal the true facts*** *and thereby* ***avoid or c*****onceal any liability** of that individual.' (emphasis added)

In the case of Caddick, the court found that Ms Caddick's actions were sufficient evidence to conclude that Maliver Pty Ltd was "…a vehicle through which Ms Caddick operated and was able to perpetrate a fraud on investors." Particularly, the court highlighted that Ms Caddick took all necessary steps, provided advice, and operated the fraudulent scheme.

Key cases where courts lift or pierce the corporate veil involve situations where owners or directors of the company attempt to conceal illegal activities behind the guise of the company. However, there are less extreme examples where business conduct may be interpreted as avoiding legal obligations and thus grounds to pierce the corporate veil.

Consequences of illegal activity by company directors or members

Breaches or illegal activity by a company's directors or members can result in significant consequences. Typically, remedies will be in the form of seeking orders for fines, however, depending on the statutory offence, regulators may seek alternate remedies in addition to penalties, depending on the nature of the case.

In some cases of illegal activity by company directors or members, criminal prosecution may be possible.

Get help from a commercial lawyer

It is critical for companies in Australia to understand the potential scope of their liability. Ultimately, the benefit of limited liability is not absolute, and whenever a company is suspected of conducting suspicious activity behind the guise of an otherwise compliant and operational company, the court may pierce the corporate veil.

IM Lawyers are experienced commercial lawyers. If you have concerns surrounding your legal obligations as a company member, or concerns surrounding a company's obligations, reach out to IM Lawyers. It costs you nothing to find out where you stand.

This article is of a general nature and should not be relied upon as legal advice. If you require further information, advice or assistance for your specific circumstances, please contact us.