Lesson 01

Features of a Company and Organizational Personality

1. Introduction

The term 'Company' can be simply defined as an association of a group of persons for a common purpose. The legal features of a Company are determined by Company Law.

Company law in Sri Lanka is governed by the Companies Act No. 07 of 2007, which came into force on 3rd May 2007, replacing the earlier Companies Act No. 17 of 1982.

The new Act repealed the following three previous Acts which were based on English law.

i. Companies Act No. 17 of 1982 (as amended)
ii. Companies (Special Provisions) Law No.19 of 1974
iii. Foreign Companies (Special Provision) Law No. 09 of 1975

The new Act introduced several fresh concepts and also redirected the foundation of Sri Lankan company law from English law to principles drawn from New Zealand and Canadian legislation.

The Companies Act has been amended on several occasions;

- Companies (Amendment) Act No.13 of 2019;
- Companies (Amendment) Act No. 23 of 2024 and
- ………………………………………………………………………

The 2025 amendment introduces several significant reforms to the Companies Act, aimed at strengthening corporate transparency, enhancing safeguards against money laundering, and ensuring closer alignment with evolving international regulatory standards.

2. Features of the Companies Act No.07 of 2007

i. Incorporation of a company made convenient

Under the new Companies Act, a company can be incorporated simply by submitting an application form, eliminating the need for a separate memorandum of association. Instead, companies may choose to adopt the full set of model articles provided in the Act or selectively adopt only specific provisions from those model articles.

At present a company can be incorporated online through the eROC website of the Registrar of Companies.

ii. Single shareholder companies

Under the previous law, a public company was required to have a minimum of seven shareholders, and a private company was required to have a minimum of two shareholders.

In terms of Section 4(2) of the Companies Act (as amended),

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a. be a natural person;
b. be a body corporate; or
c. be the Secretary to the Treasury holding shares on behalf of the Government of Sri Lanka."

iii. Simplified internal operating procedures

The new Companies Act permits the incorporation of single shareholder companies (vide Section 4(2) of the Companies Act) and permits companies to carry out its affairs with a single director. It also dispenses with certain administrative and reporting requirements for private companies with the unanimous consent of its shareholders, thereby reducing the expenses of the company. (Section 31 and the Second Schedule of the Act).

iv. Simplified formal procedures

The formal procedures on major matters of the company such as capital reductions (Section 59) and amalgamations (Part VIII of the Act) have been simplified by dispensing with the requirement of court approval.

3. Features of a Company

i. Separate legal personality

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As an independent legal person, the company alone is responsible for its acts and liabilities, and its members cannot be held personally liable—even if one member holds a majority of the shares.

ii. Limited Liability

The company, being a separate entity, leading its own business life, the members are not liable for its debts. Limited liability in effect means that the liability (namely the contribution a member will have to make once the company is being wound up) of the members of the company is limited to the contribution made to the assets of the company up to the value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him. The liability of members is limited by shares; each member is bound to pay the value of shares held by him/her and his/her liability ends there.

iii. Perpetual Succession

Perpetual succession means a company continues to exist regardless of changes in its membership. The death, insolvency, or departure of shareholders does not affect the company's life. The incorporated firm will continue to exist unaffected by the death of any of its owner(s) or the transfer of its shares to a new entity.

iv. Separate Property

A company is a distinct legal entity. The company's property is its own and such ownership is independent of the members of the company. A member cannot claim to be the owner of the company's property during the existence of the company. When a company is wound-up, its assets would be sold to settle its creditors and/or other statutory liabilities and only the remaining assets (if any) can be shared amongst the members.

v. Transferability of Shares

Company shares can generally be transferred freely, meaning shareholders are not permanently tied to the company. When shares are transferred, the new holder (transferee) assumes all the rights and obligations previously held by the former shareholder (transferor).

vi. Capacity to sue and to be sued

A company can sue and be sued in its own name as distinct from its members. Thus, members are not named as parties in a case when a company institutes action or is sued by a third party.

4. Legal Status and capacity of a company (Section 02)

A company is a **body corporate** identified by the name by which it has been registered.

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Subject to the laws of Sri Lanka or of any other country, a company has all the rights, powers and privileges, necessary for the aforesaid purpose of carrying on or undertaking any business or activity, doing any act or entering into any transaction within or outside Sri Lanka

5. Separate legal personality

A company is a separate legal entity, distinct from its members — that is, its shareholders who own it. It is also independent from those who manage and direct its operations, such as directors and employees.

This legal separation means that the company's existence is unaffected by changes to its shareholders, directors, or employees. It enjoys perpetual succession, meaning it continues to exist regardless of internal changes. The company ceases to exist only through formal processes such as liquidation, winding up, insolvency, or bankruptcy.

All assets, liabilities, and contractual obligations are owned by the company itself—not by its shareholders, directors, or employees. Importantly, the company can take legal action even against its own directors or employees if their actions result in harm or financial loss to the company.

"One consequence of the artificial nature of a company as a legal person is that inevitably, decisions for and actions by it have to be taken for it by natural persons, which include its primary organs (Board of Directors or members in its general meeting) or by its officers, agents or employees".

Gower and Davies, Principles of Modern Company law, p151

This concept of separate legal existence is a foundational principle of company law. It was firmly established in the landmark decision of Salomon v. Salomon & Co. Ltd. (1897) AC 22 by the House of Lords, England's highest court. This ruling is famously known as the Salomon principle.

Facts of the case

Salomon was a successful leather merchant operating as a sole trader. He incorporated Salomon & Co. Ltd., transferring his business to the company. Salomon held the majority of shares with the remaining shares held by family members. The company issued £10,000 in debentures (secured loans) which were held by Salomon. The company later became insolvent. On the winding up of the company it was found that its remaining assets were insufficient to satisfy both its debenture holders and its trade creditors. The unsecured creditors argued that Salomon who controlled the company was effectively the same legal person as Salomon & Co. Ltd., so he shouldn't be prioritized as a creditor.

Judgement

The House of Lords unanimously held that the company was validly incorporated and had a separate legal personality. Salomon was not personally liable for the company's debts. The court emphasized that once statutory requirements are met, the company is distinct from its shareholders.

Lee v. Lee's Air Farming Ltd. [1961] AC 12

Geoffrey Lee owned nearly all shares in his company and served as both managing director and chief pilot. He died in a plane crash while performing company duties. His widow sought workmen's compensation, arguing Lee was an employee of the company. The insurance company denied liability, claiming Lee couldn't be both employer and employee of a company he controlled.

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Macaura v Northern Assurance (1925) A.C. 619

Mr. Macaura owned a timber estate. He sold timber from this estate to Irish Canadian Sawmills Ltd., a company in which Mr. Macaura was the sole owner with nominees. He took out insurance policies on the timber against fire with Northern Assurance in his own name and not in the name of the company.

A fire destroyed the timber, Northern Assurance refused to pay because the timber was owned by the company and not by Mr. Macaura. Since the company was a separate legal entity, it was not bound to pay Mr. Macaura any money.

The House of Lords held that the insurers were not liable on the contract, since the timber that was destroyed in the fire did not belong to Mr. Macaura in whose name the insurance policy was held.

6. Lifting of corporate veil

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The doctrine established in Salomon's case casts a "veil" over the personality of a company, creating a legal separation that generally prevents outsiders from scrutinizing the individuals behind it. This corporate veil shields shareholders from personal liability. This general principle established in the Salomon case stands good and unimpaired to date except in very exceptional circumstances where the veil of incorporation can be lifted by courts of law.

Courts may lift or pierce the corporate veil when a company's separate legal personality is misused for fraudulent or dishonest purposes. In such cases, the court disregards the company's independent status and holds the individuals behind it personally liable for the company's actions.

According to experts, It is difficult to rationalize the case law on the lifting of the veil of incorporation except under broad headings of 1. Agency, 2. Fraud, 3. Group enterprises, 4. Tort, 5. Enemy, 6. Tax, 7. Companies legislation and other legislation.

Certain key cases can be summarized as follows;

Case Law

i. **United States V. Milwaukee Refrigerator Co. (1905)**

The "transit company' was organized to operate refrigerator cars on Wisconsin Central Railway Co. (railway company) and other lines. The 'brewing company' is a Wisconsin Corporation operating a large brewery, and selling and shipping beer. It has a capital of$10,000,000 or 10,000 shares. An Act was introduced to prohibit Common carriers, and the officers of such corporations, receivers, agents, etc. from giving rebates, preferences, and advantages, and making unjust discriminations.

After the Act came into effect, the brewing company was no longer able to directly secure rebates and cast about for some device to evade the statute, and Gustav and Fred Pabst and another officer named Howe, formed the transit company. Of its 1,500 shares, 1,340 were issued to the two Pabsts, 35 shares to Fred Pabst's wife, and the balance to dummy directors, in order to falsely show that its stock was not owned by the brewing company. After an investigation was commenced, Gustav Pabst transferred his stock in the transit company to Fred Pabst, and had some person elected as director in his place; but he still retained a large pecuniary interest in the corporation, and participated in its control. All the defendant carriers well knew that the transit company was established in the interest of the brewing company, and for the purpose of evading the law, and paid such rebates with the like purpose and intent.

Held: "A corporation will be looked upon as a legal entity as a general rule but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will regard the corporation as an association of persons."

This case is one of the earliest and most frequently cited U.S. authorities for the proposition that courts may disregard the corporate entity (pierce the corporate veil) when the corporation is used to: defeat public convenience, justify wrongdoing, protect fraud, or defend crime.

ii. Littlewoods Mail Order Stores Ltd V. Inland Revenue Commissioners [1963]

This is one of the key authoritative cases on piercing the corporate veil in tax avoidance contexts.

The Appellant Company, Littlewoods Mail Order Stores, carried on business as chain stores. Littlewoods obtained a lease through Fork Manufacturing Co. Ltd, a wholly owned subsidiary of the company. The deal was designed to allow Littlewoods to deduct the full rent from their profits and to evade tax. At the end of the lease, Littlewoods would get the entire freehold by paying extra rent every month.

Littlewoods Company attempted to pass off a capital purchase as a running cost. The Inland Revenue (IRC) claimed that in reality Littlewoods was acquiring the freehold whilst having it assessed as tax deductible because rent was tax deductible as a running expense whereas the purchase of a tangible asset was not. The court determined that the company, which is a fully owned subsidiary of Littlewoods, was not a separate and independent entity and the extra rent was paid only to enable Littlewoods to acquire the freehold. Therefore, the rent was not deductible.

Held: "The doctrine laid down in Salomon v. Salomon and Co. Ltd, has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited liability company through which the courts cannot see. But, that is not true. The courts can and often do draw aside the veil. They can and often do, pull off the mask. They look to see what really lies behind.

iii. Kosmopoulos v. Constitution Insurance Co. of Canada, [1987] 1 S.C.R. 2

Mr. Kosmopoulos incorporated his leather goods business and became the sole shareholder, sole director, and effective controller of the company. However, the fire insurance policies were issued in his personal name as if he were the sole proprietor, even though the insurance agent knew the business was actually operated by the corporation. A fire in an adjoining building caused damage to: the company's assets, and the leased premises.

When Mr. Kosmopoulos made a claim, the insurer refused to indemnify him, arguing that: the corporation, not he personally, owned the damaged property, therefore he had no insurable interest in the assets. He could not recover for the business assets, because they belonged to the corporation. But he could recover for the damage to the building, because he had an insurable interest as the named insured.

Held: To pierce or lift the corporate veil is to disregard the separate personality of a company and to deal instead with the economic interests lying behind the legal facade of the company. Courts can pierce the corporate veil and affix liability on shareholders, directors or other persons in effective control of the corporation.

iv. Gilford Motor Co Ltd V Horne [1933] Ch 935
(The company has been used as a cover for deliberate wrongdoing)

Horne was employed as a salesman and, under his contract of service, was bound by a clause prohibiting him from soliciting his employer's customers after leaving employment. Upon resigning, he sought to start his own business and formed a limited company in which the shares were held by his wife and a friend, while he claimed merely to be an employee of the company. Through this company, he solicited the customers of his former employer.

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v. Jones v Lipman and Another CHD [1962]1 All ER 442
(To prevent fraud)

The defendant had contracted to sell his land. He changed his mind, and formed a company of which he was owner and director, transferred the land to the company, and refused to fulfil the contract. The plaintiff sought relief.

Held: An order for specific performance was made against both the director and the company. The company could not escape from or divest itself of its knowledge gained through the director. The company was: 'A creature of [the controlling director], a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity.'

vi. **Daimler Company Ltd Vs Continental Tyre and Rubber Company Ltd**
(To promote the interests of national security, or to ensure conformity with public Policy)

During World War I, Germany and the United Kingdom were enemy nations. Prior to the outbreak of the war, a UK citizen had borrowed money from the Continental Tyre Company. Although the company was incorporated in the UK, all of its shares—except one held by a UK citizen—were owned by German nationals. The issue was whether the UK borrower remained liable to repay the debt during wartime.

The court held that trading with the enemy is prohibited during war. Therefore, if a company is effectively controlled by enemy nationals, the court may lift the corporate veil to identify its true controllers. Since the Continental Tyre Company was, in substance, under German control, the court ruled that the UK citizen was not required to repay the debt.

vii. **DHN food distributors' Ltd v Tower Hamlets London Borough Council [1976] 1 WLR 852** (The court may treat the group as one entity)

DHN was the holding company in a group of three companies. There were two subsidiaries, wholly owned by DHN. One subsidiary owned land used by DHN, the other owned vehicles used by DHN.

DHN Food Distributors Ltd held all the shares in both subsidiaries, and the directors were the same in all three companies, i.e. ownership and control were consistent throughout all three companies. Tower Hamlets London Borough Council made a compulsory purchase order to acquire the company's land. DHN sought compensation for disturbance of its business. The subsidiary that owned land was to be compensated for loss of land but not for business, as its only business was holding the title to the land.

However, DHN Food Distributors had no property interest in the land and so Tower Hamlets refused to pay compensation for its loss of business. Compensation for disturbance of business could only be granted if the veil between each company was removed and the business was viewed as one single economic unit that possessed both the land that was being compulsorily purchased and the business that was being disturbed.

Held: The veil would be pierced, stating that the group was virtually the same as a partnership in which all three companies are partners. This group is virtually the same as a partnership in which all the three companies are partners. They should not be treated separately.

However, this is likely to only be followed where the subsidiaries are wholly owned and serve no purpose other than to own the parent company's assets.

Other grounds for lifting the corporate veil

i. …… ……

ii. To prevent deliberate evasion of contractual obligations.

7. Advantages and Disadvantages of Incorporation

Advantages

i. Separate legal personality (Independent corporate existence)

A company, once registered under the relevant Companies Act, gains a separate legal personality distinct from its members. It can sue and be sued in its own name, and its shareholders are protected from personal liability for the company's actions. Even majority shareholders are not responsible for the company's debts or wrongful acts, as the company's obligations remain its own.

ii. Perpetual succession

iii. Ease of raising capital
An incorporated company can raise capital more easily by issuing shares and tends to attract investors because of limited liability. It is viewed as a more stable business structure than partnerships or sole proprietorships, making lenders

more willing to provide financing. This stability and access to diverse funding options help incorporated companies grow, develop, and manage their debts more effectively.

iv. Transferability of ownership

v. Limited liability of shareholders

Disadvantages

i. Expense

Incorporating a business takes more time and involves higher start-up costs than simpler structures like sole proprietorships or partnerships. Expenses include filing fees, professional services, and ongoing compliance costs. Because a corporation is a more complex legal entity, it is both costlier and more complicated to establish and maintain.

ii. Complex procedure

An incorporated business will need to take care of detailed books, take notes and minutes at meetings, as well as create and maintain reports, a share register, tax return files, a share transfer register, bank account records and audit books.

iii. Lack of control

Once incorporated, a company becomes a separate legal entity identified by its corporate name. Shareholders own the business but delegate control to a board of directors, except in matters requiring shareholder approval. In contrast, sole proprietors and partners directly manage and control their businesses.

iv. Difficulty in Dissolving

While perpetual existence is a benefit of incorporating, it can also be a disadvantage because it can require significant time and money to complete the necessary procedures for dissolution.

Test Your Knowledge

1. Mr. Perera intends to form a limited company under the Companies Act, No. 07 of 2007 (Act) to export cinnamon to the Mexico. He requires information on the following.

i. Whether the Act recognises the concept of 'corporate personality'.

ii. The concept of 'separate legal personality' as discussed in the decided case of Lee v Lee's Air Farming Ltd (1960) 3 All ER 420.

2. Which of the following best describes the concept of separate legal personality of a company?

a. The company and its shareholders are jointly liable for all company debts.
b. The company is recognized as a distinct legal entity, responsible for its own rights and liabilities.
c. Shareholders must personally guarantee the company's contractual obligations.
d. The company ceases to exist when all its original shareholders resign.

3. Which statement BEST reflects the principle applied in Daimler Company Ltd Vs Continental Tyre and Rubber Company Ltd?

a. A company's separate legal personality can never be disregarded, regardless of ownership or control.
b. The corporate veil may be lifted to identify the true controllers of a company when national security or statutory policy requires it.
c. A holding company and its subsidiaries must always be treated as a single economic unit for all legal purposes.
d. The corporate veil is lifted automatically whenever a company owns property used by another company.

4. Ruwan is employed as the Regional Sales Manager of Crystal Beverages (Pvt) Ltd. His employment contract contains a clause prohibiting him from soliciting any of the company's major retail clients for a period of one year after resignation. Six months later, Ruwan resigns and immediately forms a new company, AquaPure Distributors (Pvt) Ltd. The shares of AquaPure are held by his sister and a close friend, while Ruwan claims he is "only a consultant."

Soon after, AquaPure begins approaching Crystal Beverages' key retail clients using confidential pricing information Ruwan had access to during his employment. Crystal Beverages files action seeking an injunction and argues that AquaPure is merely a façade created to circumvent Ruwan's contractual obligations.

Question:

Which of the following is the MOST appropriate legal outcome based on established case law principles?

a. The court will refuse to intervene because AquaPure is a separate legal entity and cannot be held liable for Ruwan's contractual obligations.
b. The court is likely to pierce the corporate veil, treating AquaPure as a sham entity created to evade Ruwan's restrictive covenant, and grant an injunction.
c. The court will hold AquaPure liable but cannot impose any restrictions on Ruwan personally.
d. The court will treat AquaPure and Crystal Beverages as a single economic unit and order both companies to share client lists.