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**“A CRITICAL ANALYSIS OF THE COMMON-LAW REMEDY OF  
PIERCING THE CORPORATE VEIL AND THE ACTIO PAULIANA AS  
DISTINCT FROM STATUTORY REMEDIES PROVIDED FOR BY THE  
COMPANIES ACTS 61 of 1973 and 71 of 2008 IN THE RECOVERY OF  
TAX BY THE SOUTH AFRICAN REVENUE SERVICE”**

**BY**

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**in the University of KwaZulu-Natal**

**School of Law**

**Supervisor: Prof. RC Williams**

**03 November 2017**

## **DECLARATION**

I, Tafadzwa Mbwachena, do hereby solemnly declare that:

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To the best of my knowledge, the dissertation is primarily the student's work and that the student has acknowledged all reference sources.

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## ABSTRACT

This paper aims to critically analyse common-law remedy of piercing the corporate veil and the *actio pauliana* as distinct from statutory remedies provided for by the Companies Acts 61 of 1973 and 71 of 2008 in the recovery of tax by the South African Revenue Service (“SARS”). This will be achieved through a comparison of the common law remedies of piercing the corporate veil and the *actio pauliana* with the statutory remedies which allow for piercing the corporate veil namely section 20 (9) of the Companies Act 71 of 2008, section 424 of the Companies Act 61 of 1973 in relation to a company being wound up as insolvent, section 64 of the Close Corporation Act 69 of 1984 and the Tax Administration Act 28 of 2011 in relation to tax debts. With the aim of establishing that piercing the corporate veil at common law and statutory piercing of the corporate veil although closely related have evolved into two distinct remedies. This dissertation will also explore the differences between the *actio pauliana* and a statutory piercing of the corporate veil, with the aim of establishing whether these common law remedies are still relevant in the collection of tax by SARS.

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## CHAPTER 1

### 1.1. Introduction and Background

The coming into effect of the Companies' Act 71 of 2008<sup>1</sup> (hereinafter referred to as the new Companies Act) heralded the partial codification of the remedy of piercing the corporate veil in South Africa. The new Companies Act added on to the number of statutes which allow for the statutory disregarding of a company's separate legal personality and for piercing the corporate veil<sup>2</sup>. Traditionally creditors relied on the common-law remedy of piercing the corporate veil, the doctrine of notice and the *actio pauliana* to attach personal liability to directors and shareholders who try to hide behind the corporate veil to escape personal liability in cases of fraudulent, dishonest and reckless trading.

This research will be limited to a critical analysis of the *actio pauliana* and the doctrine of piercing the corporate veil as distinct from the remedies provided for by companies' legislation. It will further explore whether these two common law remedies are still relevant to the South African Revenue Service<sup>3</sup> (herein after referred to as "SARS") in recovering taxes in light of the various statutory remedies available<sup>4</sup>. SARS is party to numerous litigation proceedings where taxpayers try to hide behind the corporate veil to avoid personal liability in situations where a company is used as a facade or in fraudulent and dishonest transactions in order to avoid tax obligations. SARS has a statutory mandate to,

*“collect all due revenue, ensure maximum compliance to all the tax and customs laws that SARS administers, provide a customs service that facilitates legitimate trade, protects our borders and optimises revenue collection”*<sup>5</sup>.

For SARS to deliver on this mandate it has to maximise the revenue it collects it has to utilise all methods available to it in the recovery and collection of outstanding taxes.

### 1.2. Rationale and Statement of Purpose

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<sup>1</sup> The Act came into effect on 1 May 2011.

<sup>2</sup> Namely, section 424 of the Companies Act 61 of 1973 in relation to a company being wound up as insolvent, Section 64 of the Close Corporation Act 69 of 1984 also allows for a piercing of the corporate veil and the Tax Administration Act 28 of 2011 allows for attachment of personal liability to responsible 3<sup>rd</sup> parties, directors and shareholders.

<sup>3</sup> Established in terms of the South African Revenue Services Act 34 of 1997.

<sup>4</sup> See note 2, above,

<sup>5</sup> <http://www.sars.gov.za/About/HowTax/Pages/Mandate.aspx> accessed on 03/08/2017 at 10:04 am



This study will explore the common law remedies of piercing the corporate veil and the *actio pauliana* as distinct from the remedies provided under statutory law to SARS in the recovery of taxes. The main aim of the study is to explore whether or not the common law remedies still have a role to play in attaching personal liability to fraudulent, reckless and dishonest directors and shareholders given that section 20(9) of the Companies Act<sup>6</sup> read with the decision of the High Court in *Ex parte Gore and Others NNO*<sup>7</sup> (hereinafter referred to as *Ex parte Gore*), among other statutes which allow for statutory piercing of the corporate veil has expanded the application of the doctrine of piercing the corporate veil by widening the scope and discretion of when the court can disregard separate legal personality and attach personal liability to directors and shareholders

The broad objective of this study is to explore the relevance of common law remedies considering partial codification of the doctrine of piercing the corporate veil and the limited use of the *actio pauliana* by SARS. The study will explore common-law remedies and the new statutory remedies to establish if either of them can be applied in cases to the exclusion of the other. The study will be achieved through a comparison of the of the common law remedies of piecing the corporate veil and the *actio pauliana* to statutory remedies which allow for piercing of the corporate veil under.

### **1.3. Research Questions**

This research will seek to consider the following among other pertinent questions:

- (i) What is the distinction between the *actio pauliana* and the common law remedy of piercing the corporate veil compared to the statutory remedy of piercing the corporate veil as articulated in the different legislations which provide for piercing the corporate veil?
- (ii) Are the common-law remedies of piercing the corporate veil and the *actio pauliana* still relevant to SARS in recovering tax debts?
- (iii) To what extent do the statutory and common law remedies complement each other?
- (iv) Further, can the common-law remedies co-exist with the statutory remedy under the New Companies Act?

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<sup>6</sup> Note 1 above

<sup>7</sup> 2013 (3) SA 382 (WCC).

## 1.4.Literature Review

There are wide-ranging writings and academic sources on the subject matter of this research, this range from academic textbooks, and journal articles to cases which exhaustively cover the topic. These sources will be consulted to establish the principles that govern the application of the *actio pauliana*, with particular reference to the principles set out in *Commissioner of Customs and Excise v Bank of Lisbon International Ltd & another*<sup>8</sup> and the work of Andre Boraine<sup>9</sup> on the *actio pauliana* among other cases to determine the applicability of the remedy to the recovery of taxes by SARS. It will further refer to the principles set out in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>10</sup> in determining the definition of piercing the corporate veil at common law and the requirements which have to be satisfied for it to apply. Academic sources which will be consulted in this dissertation will also refer to writing on the subject matter by leading academics in this area of law<sup>11</sup>.

The primary legislation source for this research will be the New Companies Act<sup>12</sup>, this is because it has introduced a statutory version of the doctrine of piercing the corporate veil at common law. Piercing the corporate veil, the courts disregard the separate legal personality of a company and that of its directors or shareholders in the process attaching personal liability of a company to them. The research will also explore other statutes which allow for piercing of the corporate veil and attaching personal liability to directors and shareholders namely section 424 of the Companies Act 61 of 1973 (hereinafter referred to as the 1973 Act) which still applies in relation to a company being wound up as insolvent, this is despite the fact that in most respects the 1973 Act has been repealed. It will also explore section 64 and 65 of the Close Corporation Act<sup>13</sup>. Although the New Companies Act prohibits the registration of any new close corporation after 1 May 2011<sup>14</sup>, existing close corporations continue to be administered under the Close Corporations Act, 1984 indefinitely.<sup>15</sup> The Close Corporations Act allows for the piercing of the corporate veil in situations of fraudulent and reckless trading.

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<sup>8</sup> 1994 (1) SA 928 (A).

<sup>9</sup> Andre Boraine, Towards *Codifying The Actio Pauliana* (1996) 8 S. Afr. MerL.J. 213

<sup>10</sup> 1995 (4) SA 790 (A)

<sup>11</sup> Cassim FHL... et al Contemporary Company Law 2nd ed (2012), Williams RC *Concise Corporate Law* 2nd ed (2013) and Stiglingh, M *et al. Silke: South African Income Tax* 2013 Durban: Lexis Nexis, (2012)

<sup>12</sup> Ibid

<sup>13</sup> Act 69 of 1984

<sup>14</sup> <https://www.saica.co.za/Technical/LegalandGovernance/Legislation/CloseCorporationsAct/tabid/1910/language/en-ZA/Default.aspx> accessed on 17/05/2017 at 09:11

<sup>15</sup> Ibid

Further it will also explore piercing the corporate veil under the Tax Administration Act<sup>16</sup>. This Act provides for SARS to attach personal liability on the representative taxpayer, shareholders and directors in the event of a juristic person or company defaulting on its tax obligations.

### **1.5.Methodology**

The research method used in this dissertation will be desktop research based on qualitative analysis, to evaluate the underlying issues. The research will be centred on a review of existing literature on the stated subject topic, company law legislation, case law, journal articles, and various reputable internet sources. All these sources will be accessed through the University's online databases. This research will refer to these sources in order to understand how our courts have applied the law in the said cases.

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<sup>16</sup> The Tax Administration Act 28 of 2011 in Sections 152,153,154 and 184 provides for the piercing of the corporate veil and attachment of liability to either the responsible taxpayer, directors, shareholders or liable 3<sup>rd</sup> parties thereby effectively widening the remedies for piercing the corporate veil available to SARS.

## CHAPTER 2: COMMON LAW REMEDIES OF PIERCING THE CORPORATE VEIL AND THE ACTIO PAULIANA

### 2.1. Introduction

This chapter will consist of three discussion points, firstly a discussion on the origins, principles and application of the *actio pauliana*. This discussion will involve an exploration of how this remedy has been applied in practice, and its relevance to SARS as an alternative remedy to common law piercing the corporate veil. Secondly it will discuss the origins and adoption of the common law remedy of lifting the corporate veil into South African law with a bias towards the application of this remedy in corporate law cases, with particular reference to the principles set out in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>17</sup>, in a quest to answer the pertinent research questions raised above. Lastly it will examine the use of the common law remedy of piecing the corporate veil in tax cases by SARS. This will be achieved through examining the principles set out in various cases wherein the courts have applied this remedy in favour of SARS to attach personal liability to shareholders and directors who try to hide behind the corporate veil to avoid their tax obligation.

### 2.2. Actio Pauliana

The *actio pauliana* is a remedy which originates from Roman Dutch law and therefore remains recognised and still applies in its original form in South African law<sup>18</sup>. This remedy is available to SARS for recovering tax from defaulting debtors will be discussed in this section in detail. According to Voet<sup>19</sup>

*“...the actio pauliana is an action for the recovery of a thing alienated by a debtor in fraud of his creditors and that the action arises where the fraudulent alienation has been made with the knowledge of the person to whom the alienation has been made, that is to say, where the latter has shared in the fraud.”*<sup>20</sup>

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<sup>17</sup> Note 11 above.

<sup>18</sup> *De Villiers v Estate Hunt* 1939 AD 532 532.

<sup>19</sup> *Visser v Hull and Others* 2010 (1) SA 521 (WCC) para 13. The Court was making reference to the origins of the *action pauliana*.

<sup>20</sup> *Ibid* para 13

This remedy applies to any transaction aimed at defrauding creditors, in the sense that its application results in the setting aside any such transaction<sup>21</sup>. In *Commissioner of Customs and Excise v Bank of Lisbon International Ltd*<sup>22</sup> the court stated the following:

*“It would appear to me moreover that the actio pauliana finds application in a case such as the present where the debtor pays into his bank account moneys which he has obtained by fraud and which moneys, on being paid into the Bank, becomes the property of the Bank. When Reob obtained the moneys by fraud from the Commissioner it became indebted to the Commissioner in the amount so obtained and became obligated to the Commissioner to repay him a like amount. By paying the 1 moneys to the Bank, Reob diminished its assets which were available to pay its debt to the Commissioner.”*<sup>23</sup>

The remedy is available if the transaction actually defrauds the creditors in that the assets of the person alienating the property are diminished by such alienation<sup>24</sup>. The action can be instituted before or after the sequestration of the debtor<sup>25</sup>. Boraïne<sup>26</sup> states that the following must be proved “

- i. *the alienation must have diminished the debtor's assets*
- ii. *the recipient must not have received his own property or something owing to him;*
- iii. *(the debtor or alienator must have intended to defraud his creditors (if he received value in respect of the alienation, the recipient must also have been aware of the debtor's intention);*
- iv. *(d) The fraud must have caused the loss suffered by the creditors. The intention to defraud still plays a significant role here”.*

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<sup>21</sup> *Fenhalls v Ebrahim* 1956(4) SA 723(N)

<sup>22</sup> 1994 (1) SA 928 (A) at 208H-I

<sup>23</sup> *Ibid* at para 208H-I

<sup>24</sup> *Ibid*

<sup>25</sup> Note 9 above at page 213

<sup>26</sup> *Ibid* at page 225

The fraud being referred in this situation is not 'fraud' in the criminal sense of the term but refers to an act which will have the effect of prejudicing the creditor's ability to recover the debt owed to him<sup>27</sup>.

It is trite law that the action can be only instituted if the alienation caused or increased the insolvency of the debtor<sup>28</sup>. In *Commissioner of Customs and Excise v Bank of Lisbon International Ltd*<sup>29</sup> the action was, however, allowed in a situation where no proof existed that the debtor was actually insolvent<sup>30</sup>. This means that this evolution of the *actio pauliana* has made it a remedy of general application in cases wherein the claimant suffers loss as a result of fraudulent transfers, hence it can be instituted by SARS as a remedy in any situation which involves an intention to defraud by a taxpayer.

The *actio pauliana* forms part of our common law and is available where a debtor “disposes of assets with the intent to defraud, in these cases a court can set aside the disposition, provided that the alienee was a party to the fraud and had acquired the property, even if innocently, *ex titulo lucrativa*, that is to say gratuitously, for no consideration”<sup>31</sup>. In essence any attempt to diminish the value of a transaction whether through a simulated transaction or by a malicious donation will evoke the application of the *actio pauliana*. This action can only be evoked if the person who receives the property is party to the fraud or receives it as a donation for free.

The most obvious situation in which the *actio pauliana* can be invoked is where a person faced with imminent bankruptcy gives away his property to friends and family in order to defeat the claims of his creditors. Mars goes on to state the following:

*“Whenever a debtor enters into a transaction in fraud of or in actual detriment of his creditors if it is proved that the actual disposition diminished the debtor's asset, and that the intention was to defraud the actio pauliana remedy is available to the creditor”*<sup>32</sup>.

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<sup>27</sup> Note that the fraud referred to in insolvency cases differs from its criminal meaning (Boraine (2007) *TSAR* 529fn 105). In insolvency cases the plaintiff must establish that the debtor knew that he was insolvent at the time the disposition was made and intended to defraud his creditors with the disposition (*Hockey* 122; *Scharff v Trustee Scharff* 1915 TPD 463 476).

<sup>28</sup> *Ibid* at page 227

<sup>29</sup> Note 23 above.

<sup>30</sup> Note 27 above.

<sup>31</sup> South African Institute of Chartered Accountants Newsletter 2165

[https://www.saica.co.za/integritax/2013/2165.Piercing the corporate veil.htm](https://www.saica.co.za/integritax/2013/2165.Piercing%20the%20corporate%20veil.htm) accessed on 8 March 2017 at 14:37

<sup>32</sup> Mars the Law of Insolvency in South Africa. 9<sup>th</sup> Edition 2008 Chapter 13 -281

It is not an essential of this common-law remedy that the debtor's estate shall have been placed under sequestration<sup>33</sup>. Thus where a debtor had drawn up but not signed a statement of affairs for the surrender of his estate as insolvent and his principal creditor, knowing this, induced him to withdraw the statement of affairs and to transfer what was virtually his whole estate to him to satisfy his debt and those of certain other creditors, such transaction was held to be a fraud on the other creditors and liable to be set aside at common law<sup>34</sup>. This allows for other creditors leeway to initiate the action even if the debtor has already transferred his entire estate to a single creditor as long as they can prove that the effect of the transfer was to effectively defraud them of their share of the insolvent estate.

In *Commissioner for the South African Revenue Service v Metlika Trading Limited and others*<sup>35</sup> SARS raised the *actio pauliana* as in the alternative to common law piercing the corporate veil. However, in the Court's judgment, the court only applied the remedy of common law piercing the corporate veil to reach the verdict. In this the court in *Commissioner for South African Revenue Services* effectively passed an opportunity to at least provide a guideline on how this remedy is to be applied as an alternative remedy to the doctrine of piercing the corporate veil at common law by SARS in tax cases. It is a misfortune that the court failed to shed more light on of the common law *actio pauliana* in cases of this nature. Although the *actio pauliana* is available, in practice it is rarely used by SARS due to the fact that it is difficult to prove all the requirements. SARS has however used this very same remedy to great effect in matrimonial law cases<sup>36</sup>. This is because in matrimonial cases attempts to defraud SARS usually involve simple transactions which can be easily ascertained to be fraudulent on face of it, for example an attempt to transfer assets from an estate which is owing SARS.

Reported judgments show that common law remedies, like the *actio pauliana*, can be more flexible and powerful weapons against tax avoidance than remedies laid down in legislation<sup>37</sup>. Statutory remedies are confined to the wording used in the Act, while common law remedies are founded on principles, which have a broad application and are not confined by verbal

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<sup>33</sup> Ibid.

<sup>34</sup> Domanski A Piercing the corporate veil-A New Direction (1986) SALJ 224 at page 227

<sup>35</sup> (2004) ZASCA 97

<sup>36</sup> *Commissioner for Inland Revenue v Estate Hulett; 1990 (2) SA 786 (A), Visser v Hull and Others 2010 (1) SA 521 (WCC)*

<sup>37</sup> Tax Avoidance 1296. Assets disposed of to pre-empt attachment and sale in execution May 2005 – Issue 69 [https://www.saica.co.za/integritax/2005/1296\\_Assets\\_disposed\\_of\\_to\\_pre\\_empt\\_attachment\\_and\\_sale\\_in\\_execution.htm](https://www.saica.co.za/integritax/2005/1296_Assets_disposed_of_to_pre_empt_attachment_and_sale_in_execution.htm) accessed on 16 August 2017 at 1317

formulae; this gives them a very wide leeway to be interpreted<sup>38</sup>. In *Commissioner for the South African Revenue Service v Metlika*, the court missed a golden opportunity for the High Court to lay down in what circumstances the *actio pauliana* applies in modern South African law as between SARS and taxpayers<sup>39</sup>.

### 2.3. The Corporate Veil

In the simplest of terms, the corporate veil which is also referred to as the “veil of incorporation” is defined as the is an artificial veil which is created upon incorporation and registration of a company which separates the personality of a corporation from the personalities of its shareholders and directors, and protects them from being personally liable for the company's debts and other obligations. This doctrine originates from the doctrine of limited liability that the British Parliament granted to English companies in the Limited Liability Act of 1855<sup>40</sup>. This doctrine was first tested in relation to the separate legal personality of one-man companies in *Salomon v Salomon*<sup>41</sup> handed down by the United Kingdom’s, House of Lords where the Court stated that: - “*a company is a legal person in its own right and the collonary that its shareholders and directors are not personally liable for its debts*”.<sup>42</sup> In this case the Court further went on to state that:

*“The company is at law a different person altogether from the subscribers to the memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable in any shape or form, except to the extent and in the manner provided by the Act. That is, I think, the declared intention of the enactment”*<sup>43</sup>.

The doctrine of separate legal personality (corporate veil) was adopted in our law by the decision in *Dadoo Ltd v Krugersdorp Municipality Council*<sup>44</sup> by the Appellate Division. In this

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<sup>38</sup> Ibid

<sup>39</sup> Ibid

<sup>40</sup> Halpern P, Trebilcock M & Turnbull S, “An Economic Analysis of Limited Liability in Corporation Law,” U. Toronto L.J. 117, 118–19 (1980)

<sup>41</sup> Judge S and Moore I, Questions & Answers Company Law 4th ed Oxford University Press 2014

<sup>42</sup> Ibid

<sup>43</sup> Ibid at para 51

<sup>44</sup> *Dadoo Ltd v Krugersdorp Municipality Council* 1920 AD 530.



case the court held that the property of the company belongs solely to the company not to its directors and shareholders. Innes CJ went on to say that: -

*“a registered company is a legal persona distinct from the members who compose nor is the position affected by the circumstance that a controlling interest in the concern may be held by a single member”<sup>45</sup>.*

The court further went on to state that: -

*“This conception of the existence of the company as a separate entity distinct from its founders is no merely artificial technical thing. It is a matter of substance; property vested in the company is not, and cannot be, regarded as vested in all or any of its members”<sup>46</sup>.*

The principle of separate legal personality asserts that a company is capable of owning its own property to the exclusion of directors and shareholders. Innes CJ in *Dadoo Ltd v Krugersdorp Municipal Council*<sup>47</sup> giving the judgment of the court held that:

*“Taking the intention then to be the prohibition of ownership of fixed property by the Asiatic and prohibition of the acquisition and occupation of mining rights by the Coloured people, I come to enquire whether the transaction complained of is a contravention of the statutes. In other words, whether the ownership by Dadoo Ltd, is in substance ownership by its Asiatic shareholders. Clearly in law it is not. A registered company is a legal persona distinct from the members who compose it”<sup>48</sup>.*

This principle has further been engraved into our law by the fact that our Constitution<sup>49</sup> recognises the rights of juristic persons as separate from natural persons. Section 8(2) in the Bill of Rights<sup>50</sup> binds a natural or a juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right<sup>51</sup>.

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<sup>45</sup> Ibid

<sup>46</sup> Ibid

<sup>47</sup> Note 41 above

<sup>48</sup> Ibid at page 550

<sup>49</sup> Act 108 Of 1996

<sup>50</sup> Ibid

<sup>51</sup> Ibid

Section 8(4) goes on to state that “*A juristic person is entitled to the rights in the Bill of Rights to the extent required by the nature of the rights and the nature of that juristic person*”<sup>52</sup>.

The effect of the corporate veil is that it creates a separation between the actions of shareholders and that of the company. In that it shields the shareholders and directors from potential liability for the actions of the company merely because they are shareholders or directors. The corporate veil is an important vehicle in world commerce as it limits shareholders’ financial exposure to the amount of money they invested in the corporation by making a clear distinction between the financial and tax obligation of the individual shareholder from the corporation in which they would have invested.

#### **2.4. Piercing of the Corporate Veil at Common Law in South African Law**

Lifting the corporate veil is defined as when the courts disregard the separate legal personality of a company and that of its directors or shareholders and treat the liabilities or activities of a company as the rights or liabilities of its directors or shareholders<sup>53</sup>. The theory underlying this approach is that “*only a 'real' company, a company 'in substance and not just in form' can claim entity status; as a theory it seems hard to fault*”<sup>54</sup>. In *Atlas Maritime Co SA v Avalon Maritime Ltd*<sup>55</sup> the court stated that “*to pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders*”<sup>56</sup>.

M.S Blackman<sup>57</sup>, commenting on the issue is of the opinion that, piercing the corporate veil takes at least two forms, firstly, there are cases where the court disregards the company and treats the members as if they had been acting in partnership, with the consequence that they are, for example, held to be the owners of property otherwise owned by the company, or to be personally liable for its debts and other liabilities.’ Secondly, there are those cases where obligations incurred by shareholders in their personal capacity are treated as if they were incurred by the company<sup>58</sup>. Williams states that the law recognises that in certain circumstances the *Salomon* principle can be over ridden and that the corporate veil can be pierced at common law, he further does on to discuss the traditional categories’ wherein the courts have

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<sup>52</sup> Ibid

<sup>53</sup> FHI Cassim...et al Contemporary Company Law 2nd ed (2012)

<sup>54</sup> Ibid at page 41

<sup>55</sup> (1991) 4 All SA 769 (CA), at 779

<sup>56</sup> Ibid

<sup>57</sup> MS Blackman Companies LAWSA vol 4, Part 1, 1<sup>st</sup> Reissue (1995) para 42.

<sup>58</sup> Ibid

traditionally disregarded the doctrine of separate legal personality<sup>59</sup>. FHI Cassim<sup>60</sup> goes on to state that, “*when lifting the corporate veil, the protection afforded to shareholders and directors is removed the substance rather the form in which the company is cast will be looked at*”<sup>61</sup>.

The corporate veil being referred in this doctrine is a metaphorical veil, in essence a way of simply expressing the difference between directors and shareholders to the company as a distinct entity from its controllers. In defining the doctrine of piercing the corporate veil, Larkin argues that”,

*“It asserts in certain circumstances, a court is empowered to disregard the principle of the separate legal existence of a company and so achieve a more acceptable result. As the metaphor has it, in the appropriate circumstances a court can 'lift', or 'pierce', the 'veil' which otherwise ensures the individuality of a company, careless of the consequences, both by separating it from those connected with it ('the corporators')”*<sup>62</sup>.

This position is reiterated by Williams where he states that” *the metaphorical corporate veil does not however completely obscure the internal workings of the company from public view*<sup>63</sup>”.

The corporate veil has been pierced in a wide range of cases for example where company is used as a mere facade or sham concealing the true intention of the shareholders<sup>64</sup>, in cases of fraud, dishonesty or improper conduct<sup>65</sup> and where there is improper use of a company<sup>66</sup>. This is however not a closed list, as our law has to date failed to formulate a single, coherent principle or test upon which to base decisions to disregard the separate juristic personality of a company as a remedy to an aggrieved party<sup>67</sup>.

The position that the law is far from settled with regards to the circumstances where it would be permissible to pierce the corporate veil was reiterated in *Cape Pacific Ltd v Lubner*

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<sup>59</sup>RC Williams Concise Corporate Law 2nd ed (2013).

<sup>60</sup> Note 46 above at page 42

<sup>61</sup> Ibid at 45

<sup>62</sup> M P Larkin 'Regarding Judicial Disregarding of the Company's Separate Identity' (1989) 1 SA Merc LJ 277

<sup>63</sup> Note 48 above

<sup>64</sup> *Amlin (SA) Pty Ltd v Van Kooij* 2008 (2) SA 558 at 568.

<sup>65</sup> Note 48 above at 553

<sup>66</sup> *The Shipping Corporation of India Pty Ltd v Evdomon Corporation and Another* 1994 (1) SA 550 (A).

<sup>67</sup> Ibid at 53

*Controlling Investments (Pty) Ltd*<sup>68</sup>. The court in *The Shipping Cooperation of India Ltd v Evdoman Corporation and Another*, indicated that it is not necessary to attempt to define the circumstances in which the corporate veil will be pierced<sup>69</sup>. In *Zeman v Quickelberge and Another*<sup>70</sup>, AJ Nicholson stated that:

*“The general principle underlying the lifting of the corporate veil is that when a corporation is the mere alter ego or business conduit of a person it may be disregarded. While the corporate veil is normally lifted to identify the shareholders or individuals who are the true perpetrators of a company’s acts.”*<sup>71</sup>

Traditionally our courts had created categories of when to breach the corporate veil<sup>72</sup>. These categories were rejected in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>73</sup>, by the Supreme Court of Appeal. The rejection of a categorising approach is commendable because categorising could lead to uncertainty in our law and restrictive application as categories do not constitute an exhaustive list of instances in which the corporate veil will be pierced and the authorities tend to differ on the applicable categories.

Thus, it has been suggested that the veil ought to be pierced 'merely on account of equity'<sup>74</sup>. The position that the corporate veil ought to be pierced “on account of equity’ is supported by Domanski<sup>75</sup>, who has argued for an approach in terms of which 'the policies behind recognition of a separate corporate existence must be balanced against the policies justifying piercing'<sup>76</sup>. The court in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>77</sup> in support of the position that equity must play a central role in common law piercing of the corporate veil states that, “*the policies behind the recognition of a separate corporate existence must be balanced against the policies justifying piercing*”<sup>78</sup> Putting the matter of categorised approaches to rest, FHI Cassim goes on to state that the courts have formulated salutary principles which apply to piercing of the corporate veil which are as follows:

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<sup>68</sup> Note 24 above

<sup>69</sup> 1994 (1) SA 550 (A) 566 F-C

<sup>70</sup> *Zeman v Quickelberge and another* 2011 32 ILJ 453 (LC).

<sup>71</sup> *Ibid* at para 54

<sup>72</sup> Domanski, A Piercing the Corporate Veil-A new direction (1986) 103 South African Law Journal 224-227

<sup>73</sup> 1995 (4) SA790 (A).

<sup>74</sup> Note 54 above at page 48

<sup>75</sup> *Ibid* page 226

<sup>76</sup> *Ibid*

<sup>77</sup> *Ibid*

<sup>78</sup> *Ibid* at para 75

- i. *That we do not have a categorised approach when piercing the corporate veil*
- ii. *The court has to adopt a balancing principle of weighing separate legal principle and the principle in favour of piercing the corporate veil.*
- iii. *That the concept of corporate entity is almost inviolable and that they would not easily or readily disregard the principle<sup>79</sup>.*

In the *Cape Pacific* case the court was of the opinion that although the piercing the corporate veil is a special remedy it is however not a remedy of last resort as was the traditional view at common law<sup>80</sup>. The position that piercing the corporate veil at common law is not a remedy of last resort set in *Cape Pacific* was overturned by the same court in *Hülse-Reutter and Others v Gödde* where the Supreme Court stated that if there is another alternative remedy the court will not pierce the corporate veil<sup>81</sup>. It must be noted that at common law piercing the corporate veil is an exceptional procedure and therefore, special or exceptional circumstances must exist before the court could pierce the veil<sup>82</sup>. In the *Hulse-Rutter v Godde* case the court went on to state that:

*“There can be no doubt that the separate legal personality of a company is to be recognised and upheld except in the most unusual circumstances. A court has no general discretion simply to disregard the existence of a separate corporate identity whenever it considers it just or convenient to do so. The circumstances in which a court will disregard the distinction between a corporate entity and those who control it are far from settled, as this will depend on a close analysis of the facts of each case, considerations of policy and judicial judgment. Nonetheless, what is clear is that as a matter of principle in a case such as the present there must at least be some misuse or abuse of the distinction between the corporate entity and those who control*

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<sup>79</sup> Note 60 above at page 54

<sup>80</sup> *Ibid*

<sup>81</sup> 2001 (4) SA 1336 (SCA).

<sup>82</sup> *Cape Pacific Limited v Lubner Controlling Investments (Pty) Limited* 1993 (2) SA 784 (C) 819 821.

*it which results in an unfair advantage being afforded to the latter*<sup>83</sup>”.

From the above arguments it is clear that the separate legal personality between an entity and its shareholders and directors remained 'a cornerstone of our company law' and that the test should be applied 'cautiously and with the protection of the separate personality as a foremost consideration'<sup>84</sup>. However, the doctrine of piercing the corporate veil at common law is difficult to ascertain due to the fact that there are no clear ascertainable universal principles for its application.

## **2.5. Piercing of the Corporate Veil by SARS at Common Law**

SARS has effectively used the common law doctrine of piercing the corporate veil in litigation against companies frequently in tax litigation with relative success. These cases illustrate how shareholders and directors can be held liable for tax debts which ordinarily would be company liabilities in cases of fraud and improper use of separate legal personality. One of the earliest cases in which SARS used this doctrine is in *Ochberg v Commissioner for Inland Revenue*<sup>85</sup>, in this case the court was dealing with simulated transactions. De Villiers CJ, commenting on the doctrine of piercing the corporate veil stated that:

*"The law endows a company with a fictitious personality. The wisdom of allowing a person to escape the natural consequences of his commercial sins under the ordinary law, and for his own private purposes virtually to turn him into a corporation with limited liability, may well be open to doubt. But as long as the law allows it the Court has to recognise the position. But then too the person himself must abide by that. A company, being a juristic person, remains a juristic person separate and distinct from the person who may own all the shares, and must not be confused with the latter. To say that a company sustains a separate persona and yet in the same breath to argue that in substance the person holding all the shares is the company is an attempt to have it both ways, which cannot be allowed.*

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<sup>83</sup> Note 81 above at para 20

<sup>84</sup> Ibid

<sup>85</sup> *Ochberg v Commissioner for Inland Revenue* 1931 AD 215

In *ITC 1611*<sup>86</sup> the tax court held that SARS could attempt to brush aside the entity's legal persona by applying the "piercing of the corporate veil" doctrine" although it is a radical step<sup>87</sup>. The court further went on to state that: "... a court can lift the veil only if that is legitimate by application of established doctrines, such as the *plus valet* rule or the *fraus legis* rule (or in other cases of fraud or dishonesty) or, possibly, the *actio pauliana*, that is if the requirements for such application are present, or a finding of a true relationship of principal and agent. There is, we consider, no self-standing doctrine of piercing the veil."<sup>88</sup>

In the recent case of *Commissioner for the South African Revenue Service v Metlika Trading Limited and others*<sup>89</sup> where SARS initiated an action for the piercing the corporate veil a common law against Metlika and Ben Nevis alleging that the transfer of its assets by Ben Nevis to Metlika Trading Limited had been made with the intention, of dissipating the Ben Nevis assets in order to defraud SARS by rendering Ben Nevis's tax debt irrecoverable.

The Court in *CSARS v Metlika Trading and others*<sup>90</sup> in reaching its judgment applied the principles set out in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>91</sup>, which state the following,

*"It is undoubtedly a salutary principle that our Courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or the improper conduct (and I confine myself to such situations) is found to be present, other considerations will come into play. The need to preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil"*<sup>92</sup>.

The Court held that the way in which Bermuda Trust had conducted the affairs of Ben Nevis "was improper, to say the least" and that "Metlika was based as a façade to hide the tax liability

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<sup>86</sup> 59 SATC 126

<sup>87</sup> *ITC 1611* (59 SATC 126)

<sup>88</sup> *Ibid*

<sup>89</sup> (2004) ZASCA 97

<sup>90</sup> *Ibid*

<sup>91</sup> 1995 (4) SA 790 (A)

<sup>92</sup> Note 89 above at para 58

of Ben Nevis from SARS”<sup>93</sup>. The court held that the on analysis of the facts of the matter before it piercing the corporate veil in relation to the tax liability owed by Ben Nevis to SARS was justifiable, and went on to pierce the corporate veil in its judgment and declaring that the transfer of assets from Ben Nevis to Metlika be set aside paving way for SARS to sale the assets in order to recover the tax debt from Ben Navis<sup>94</sup>.

## **2.6. Concluding remarks**

In conclusion SARS has used the doctrine of piercing the corporate veil at common to attach personal liability to directors and shareholders in cases of fraud, dishonesty and improper conduct to great effect. However, the *actio pauliana* has been used sparingly despite its potential to be every effective remedy in tax cases given that its basis in common principles which can be interpreted to apply in a lot of scenarios wherein SARS will want to pierce the corporate veil and attach personal liability for tax debts.

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<sup>93</sup> Ibid para 63

<sup>94</sup> Ibid para 65



## CHAPTER 3: STATUTORY REMEDIES THAT PROVIDE FOR PIERCING OF THE CORPORATE VEIL

### 3.1.1. Introduction

This chapter will entail a detailed discussion of the various statutes available to SARS which allow for the piercing of the corporate veil. The discussion will involve a critical analysis of section 20 (9) of the new Companies Act which effectively introduced the statutory version of the common law remedy of piercing the corporate veil into our legislation. The discussion will involve examining the application other sections of various legislations which allow for statutory piercing of the corporate veil. The discussion will include an in-depth look at the application of the following statutes to pierce the corporate veil in tax litigation, Close Corporation Act 64 of 1984, Section 424 of Companies Act of 1973 and the Section 180 of the Tax Administration Act 28 of 2011.

### 3.1.2. Section 20(9) of Companies Act 71 of 2008

For the first time in South African law the common law doctrine of piercing the corporate veil has been partially codified, through section 20 (9) of the new Companies Act <sup>95</sup>. Williams notes that the Companies Act does not specifically refer to lifting or piercing the corporate veil in section 20(9)<sup>96</sup>. However the wording of the new Companies Act under the same section permits court to disregard the separate legal personality of a company and to pierce the corporate veil in instances of "an unconscionable abuse" of the juristic personality of the company. Section 20 (9) state that: -

*"On application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may-*

*a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and*

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<sup>95</sup> 71 Of 2008

<sup>96</sup> Note 16 above at page 97

b) *Make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a)."*

The above mentioned section effectively gives a court the general statutory powers and discretion to disregard the separate legal personality between a company and its shareholders and directors thus allowing for the piercing of the corporate veil on application to the court by an interested person, in instances where there has been an "unconscionable abuse of the juristic personality"<sup>97</sup>.

Section 20 (9) however does not go on to define the relationship between this new enactment and the traditional common law remedy of piecing the corporate veil. Unlike section 20(7) and 20 (8) of the same Act, which expressly state that the common law still applies to the sections<sup>98</sup>. It can be concluded that the legislature left it to the courts to act as a guide in construing the relationship between section 20(9) and the common law<sup>99</sup>. In *Ex parte Gore* the court stated that:

*"The introduction of the statutory provision has given rise to some debate on whether the subsection has replaced the common law on piercing the corporate veil. Certainly there is no express intention apparent to that effect...but, equally, there is no express indication that the intention is not to displace the common law...."*<sup>100</sup>

The court went on further to state that

*"The statute enjoins that its provisions be construed with appropriate regard to subsections 5(1) and (2) read with s 7 of the Act (including, to the extent appropriate, a consideration of foreign company law). Approaching the interpretation of s 20(9) of the Companies Act in that manner I am unable to identify any discord between it and the approach to piercing the corporate veil evinced in the cases decided before it came into operation."*<sup>101</sup>

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<sup>97</sup> Kim-Leigh Siebritz "Piercing the corporate veil: A critical analysis of section 20(9) of the Companies Act 71 of 2008" (Unpublished thesis, The University of Western Cape 2017)

<sup>98</sup> Section 20 (8) of Companies Act 71 of 2008 "Subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers".

<sup>99</sup> *Ex Parte Gore* at para. 31.

<sup>100</sup> Ibid

<sup>101</sup> Ibid

Therefore, the courts have an obligation to iron out this relationship and formulate the guidelines on how the section will affect piercing the corporate veil at common law.

### 3.1.3 Unconscionable Abuse.

The phrase ‘unconscionable abuse’ is not defined in section 20(9), in this the section fails to provide any guidance on the facts or circumstances that would constitute an ‘unconscionable abuse’ of juristic personality nor does it try to define the term<sup>102</sup>. According to *The Concise Oxford Dictionary*, the definition of ‘unconscionable’ is conduct that is ‘unreasonably excessive<sup>103</sup>’. The *Free Dictionary* defines ‘unconscionable’ as ‘unusually harsh and shocking to the conscience; that which is so grossly unfair that a court will proscribe it<sup>104</sup>’. Given that this phrase is central in determining on when the Courts can pierce the corporate veil the omission is regrettable<sup>105</sup>

The Court in *Ex parte Gore* asserted that the words “*unconscionable abuse of the juristic personality of a company*’ used in s 20(9) suggest behaviour in relation to the formation and use of companies that is diverse enough to cover all the descriptive terms such as ‘sham’, ‘device’, ‘stratagem’, and conceivably much more”.<sup>106</sup> It further went on to say that this indicates that the remedy may be used whenever the illegitimate use of the concept of juristic personality adversely affects a third party in a way that reasonably should not be countenanced<sup>107</sup>. It has been suggested that the courts should look to section 65 of the Close Corporations Act<sup>108</sup> which is similar in wording to section 20(9) of the Companies Act for a definition of the phrase through an analysis of how the courts have dealt with the former Act. The section states as follows: <sup>109</sup>

*“Whenever a Court on application by an interested person, or in any proceedings in which a corporation is involved, finds that the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate*

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<sup>102</sup> Cassim R Piercing The Veil Under Section 20(9) Of The Companies Act 26 (2014) S. Afr. Mercantile L.J. 307

<sup>103</sup> Thompson D (ed) 9ed (Clarendon Press 1995) at 1519

<sup>104</sup> (<http://legal-dictionary.thefreedictionary.com>, accessed 10/10/2017 at 1114 hrs

<sup>105</sup> Cassim (see 2012 (Aug) *DR* 23(see 2012 (Aug) *DR* 23 for a discussion of the conduct that may constitute ‘gross abuse’)

<sup>106</sup> *Ibid*

<sup>107</sup> *Ibid* at para 34.

<sup>108</sup> 69 of 1984 (‘the Close Corporations Act’)

<sup>109</sup> Note 106 above at page 13

*entity, the Court may declare that the corporation is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the corporation, or of such member or members thereof, or of such other person or persons, as are specified in the declaration, and the Court may give such further order or orders.”*

This is the approach adopted by the court in *Ex parte Gore*, in ascertaining the meaning of unconscionable abuse, the court referred to the Close Corporation Act, stating the following.

*“The provision is closely similar to, but not exactly the same as, that in s 65 of the Close Corporations Act 69 of 1984. Certainly there is no express intention apparent to that effect, as for example to be seen in s 165(1) of the Act (concerning derivative actions), but, equally, there is no express indication that the intention is not to displace the common law, like that to be found in s 161(2)(b) (concerning remedies available to protect the rights of the holders of securities in companies).”*

R. Cassim commenting on the issue under discussion stated that; -

*“in defining unconscionable abuse, the court in Ex parte Gore stated that the words ‘unconscionable abuse’ are less extreme than the words ‘gross abuse’, which are used in s 65 of the Close Corporations Act 69 of 1984 in a similarly worded provision to s 20(9) of the Act”<sup>110</sup>.*

However, a significant difference between section 20(9) of the new Companies Act and section 65 of the Close Corporations Act is that section 65, allows the courts disregard the juristic personality of a company in instances of a ‘gross abuse’, while section 20(9) of the new Companies Act allows the courts disregard the juristic personality of a company where there is an ‘unconscionable abuse’ of the juristic personality by its directors or shareholders.

The court in *Ex parte Gore* ‘defined the phrase “unconscionable abuse”, as follows”

*‘unconscionable abuse of the juristic personality of a company’ postulates conduct in relation to the formation and use of companies diverse enough to cover all the descriptive terms like ‘sham’, ‘device’, ‘stratagem’ and the like*

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<sup>110</sup> Ibid

*used in that connection in the earlier cases, and - as the current case illustrates - conceivably much more.*”<sup>111</sup>

The Court in *Ex parte Gore* left it open for the phrase to be interpreted as wide as conceivably possible. It must be noted that the definition of unconscionable abuse as set out in *Ex parte Gore* does not really help in formulating substantive principles on when the corporate veil can be pierced under the new Companies Act. This is because the use of metaphors and pejorative expressions in this case obstructed the court from formulating obstruct substantive principles on the matter<sup>112</sup>.

Further section 20(9) of the new Companies Act uses the phrase “the court may” which means even if the requirements of the section are fulfilled, a court is not obliged to pierce the corporate veil, but has a discretion whether to do so<sup>113</sup>. R Cassim concludes that Section 20(9) of the Companies Act “*has conferred extensive powers on the South African Courts to pierce the corporate veil, powers that do not exist under common law for example the power to invoke section 20(9) by a court of its own initiative, regardless of whether the litigant in the matter before the court has requested the court to do so*”<sup>114</sup>.

The decision in *Ex Parte Gore* regardless on its failure to establish concrete principles on the meaning of unconscionable abuse is welcome as it provides a guide on how to interpret section 20 (9) of the Companies Act. The approach of the court in *Ex parte Gore* was heavily influenced by the judgment in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>115</sup> specifically by the comments of the Appellate Division on the test for unconscionable injustice laid down in *Botha v Van Niekerk*<sup>116</sup> the court went on to state the following:

*“With due respect to the learned judge I would avoid, in a matter such as the present, what is perhaps too rigid a test and opt for a more flexible approach -one that allows the facts of each case ultimately to determine whether the piercing of the corporate veil is called for.”*

The above quote read together with the interpretation of section 20(9) of the Companies Act, in *Ex parte Gore* and the use descriptive terms such as ‘sham’, ‘device’, ‘stratagem’, and

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<sup>111</sup> *Ex parte Gore* at para 34

<sup>112</sup> Note 102 above at 336

<sup>113</sup> *Ibid* at page 311

<sup>114</sup> *Ibid* at page 327

<sup>115</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* at 805

<sup>116</sup> 1983 (3) SA 513 (W)

‘conceivably much more’ points out to the fact that there is no fixed set of scenarios where the court will establish that there is unconscionable abuse, however it is on a case by case basis and the courts must be very flexible in the way they approach piercing the corporate veil under the new Companies Act.

Section 20 (9) of the new Companies Act represents a new direction and shift in thinking with regards to the scope and application of the remedy of piercing the corporate veil. The legislature has given the courts a discretion to interpret the section broadly, given the language of section 20 (9) does not define ‘unconscionable abuse’. This in light of the precedent set in *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>117</sup> where the court stated: -

*“If interpretation is, as all agree it is, an exercise in ascertaining the meaning of the words used in the statute and is objective in form, it is unrelated to whatever intention those responsible for the words may have had at the time they selected them.”*

Section 20 (9) of the new Companies Act creates a very powerful remedy at the disposal of SARS as the statutory remedy is not bound by any common law limitation and has room to be interpreted as wide as possible as long as it is within the language used in the section.

The court in *Gore*<sup>118</sup> confirmed and stated that the ambit of section 20(9) appears indeed to have broadened the bases upon which South African courts have hitherto under the common law been prepared to grant relief that entails disregarding corporate personality<sup>119</sup>. R Cassim states that section 20 (9) offers certainty and visibility of the doctrine of piercing the corporate veil as a remedy however it creates a rigid test given that the term ‘unconscionable abuse’ is not defined in the new Companies Act<sup>120</sup>. This however will only be seen as more cases on the interpretation of the section come before the courts on whether the section 20 (9) will create a rigid test to the application of the remedy

### **3.2.1. Section 424 of Companies Act 61 of 1973**

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<sup>117</sup> 2012 (4) SA 593 (SCA) at para 18

<sup>118</sup> Cassim R Piercing The Veil Under Section 20(9) Of The Companies Act 26 (2014) S. Afr. Mercantile L.J. at page 336

<sup>119</sup> Ibid

<sup>120</sup> Note 38 above

Section 424 of the old Companies Act<sup>121</sup> is still in force with regards to piercing the corporate veil in the context of winding up in insolvency<sup>122</sup>. This is because the new Companies Act Schedule 5(9)<sup>123</sup> explicitly allows for the survival of the section. The schedule provides that:

*‘when it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor, or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for or all or any of the debts or other liabilities of the company as the Court may direct’.*<sup>124</sup>

The 1973 Companies Act in section 424 stated that someone can be held personally liable for a company’s debt where the individual knowingly was party to the carrying on of the business of the company “recklessly or with intent to defraud creditors of the company<sup>125</sup>.” The purpose of s424 (1) has been interpreted by the courts to be, to attach personal liability to all persons who act in a reckless and fraudulent manner in the conduct of business transactions. In *Pressma Services (Pty) Ltd v Schuttler and Another*<sup>126</sup> Van Schalkwyk AJ held that “*The clear purpose of s 424(1) is to render personally liable all persons who knowingly participate in the fraudulent or reckless conduct of the business of a company*”<sup>127</sup>. In *Philotex (Pty) Ltd & Others v JR Snyman & Others*<sup>128</sup>.Howie JA held that ‘*the legislative intention in enacting s 424 was to broaden the scope of the earlier provision and to extend the remedy by means of which a restraining influence can be exercised on over-sanguine directors*’. Howie JA went on to interpret section 424 in a manner which broadened the scope of liability and provided for

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<sup>121</sup> Act 61 of 1973

<sup>122</sup> Note 16 above at 27

<sup>123</sup> The section provides that “(1) Despite the repeal of the previous Act, until the date determined in terms of subitem (4), Chapter 14 of that Act continues to apply with respect to the winding- up and liquidation of companies under this Act, as if that Act had not been repealed subject to subitems (2) and (3)”.

<sup>124</sup> 69 of 1984

<sup>125</sup> *Philotex (Pty) Ltd and others v Snyman and others* 1998 (2) SA 138 (SCA) at 146G for what would be needed to prove same.

<sup>126</sup> 1990 (2) SA 411 (C)

<sup>127</sup> Ibid

<sup>128</sup> [1997] ZASCA 92

unlimited liability for debts and liabilities against any person who carries the business of the company recklessly or fraudulently<sup>129</sup>.

Achada, argues that “*the intention of s424 (1) is protect creditors and prevent fraudulent and reckless trading of directors of the company as ‘it was enacted to provide a remedy against fraudulent and/or reckless behaviour by directors’*”<sup>130</sup>. Further other authors<sup>131</sup> have argued that the purpose of s424 (1) has two folds namely that it exists to render all those who are knowingly party to the carrying of business of the company recklessly or fraudulently personally liable for the debts or wrongful conduct; and to benefit creditors a ‘meaningful remedy against fraudulent and reckless trading’<sup>132</sup>.

The 1973 Companies Act provided in section 424 that someone could be personally liable for a company's debt where the individual knowingly was party to the carrying on of the business of the company “*recklessly or with intent to defraud creditors of the company*”. The SCA set out the policy considerations underpinning the old section 424 as follows: -

*“In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted. The section retracts the fundamental attribute of corporate personality, namely separate legal existence, with its corollary of autonomous and independent liability for debts, when the level of mismanagement of the corporation’s affairs exceeds the merely inept or incompetent and becomes heedlessly gross or dishonest.”*<sup>133</sup>”

### **3.2.2 Reckless Trading Under Section 424 of the Old Companies Act.**

Acting ‘recklessly’<sup>134</sup> consists in “*an entire failure to give consideration to the consequences of one’s actions, in other words, an attitude of reckless disregard of such consequences*”.<sup>135</sup> In applying the recklessness test to any set of facts the courts must consider all the relevant factors

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<sup>129</sup> Ibid

<sup>130</sup> T Achada ‘Directors’ liabilities for Company debts: another recent decision’ (2003) 10 (4) Juta’s Business Law 199

<sup>131</sup> M Sigwadi ‘Compromise and personal liability of directors under s424 of the Companies Act 61 of 1973’ (2003) 15 (3) South African Mercantile Law Journal 388-389

<sup>132</sup> Ibid

<sup>133</sup> *Ebrahim v Airports Cold Storage (Pty) Ltd* (485/2007) [2008] ZASCA 113 at para 14

<sup>134</sup> *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 143F-G.

<sup>135</sup> *S v Dhlamini* 1988 (2) SA 302 (A) 308D-E, applied in the corporate context in *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 143F-G.



in order to establish recklessness. The court in the case of *Fisheries Development Corporation of SA Ltd v Jorgensen* specified that: -

*“it must give regard to amongst other things the corporation’s scope of operations, the members’ roles, functions and powers, the amount of the debts, the extent of the financial difficulties and the prospects of recovery, plus the particular circumstances of the claim ‘and the extent to which the member has departed from the standards of a reasonable man in regard thereto”.*<sup>136</sup>

Henochsberg<sup>137</sup> state that ‘recklessly’ means carrying business on ‘by conduct which evinces a lack of any genuine concern for its prosperity<sup>138</sup>. The concept of “recklessness” must be ascribed its ordinary meaning, means significantly more than ordinary negligence, at the very least, it means gross negligence. In applying the test for recklessness, the court will also take account of factors such as the scope of operations of the company, the role, function and powers of its members as well as the financial position of the corporation<sup>139</sup>. The SCA held as follows:

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*“In evaluating the conduct of directors, courts should not be astute to stigmatise decisions made by businessmen as reckless simply because perceived entrepreneurial options did not in the event pan out. What is required is not the application of the exact science of hindsight, but a value judgment bearing in mind what was known, or ought reasonably to have been known, by individual directors at the time the decisions were made. In making this value judgment, courts can usefully be guided by the opinions of businessmen who move in the world of commerce and who are called upon to make these decisions in the performance of their functions as directors of companies, and by experts who advise businessmen in the making of such decisions or who evaluate them at the time they are made.”*<sup>140</sup>

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<sup>136</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) 170B-C, per Margo J, adopted in part in *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 144B.

<sup>137</sup> *Henochsberg on the Companies Act*, edited by JA Kunst and others, service issue 27, June 2008, p 916

<sup>138</sup> *Ibid*

<sup>139</sup> Paul Robbertse “Reckless Trading” [www.hhl.co.za/blog/43-reckless-trading](http://www.hhl.co.za/blog/43-reckless-trading) accessed on 19/09/2017 at 0919 am

<sup>140</sup> *Fourie NO v Newton* (562/09) [2010] ZASCA at para 44

A company will be trading recklessly if it carry on to incurring debt honestly when reasonable businessmen in the position of the directors of that company would believe that there is no reasonable prospect of the creditors receiving payment when due. If the debt is incurred dishonestly, for example without an intention to repay it on the due date, the conduct would constitute fraudulent trading<sup>141</sup>.

Section 424 of the old Companies Act is a potent remedy to SARS in the recovery of taxes owed to it by defaulting debtors as gives a wide discretion on the courts on when to pierce the corporate veil. This is because it specifically states recklessness and fraudulent intent have to prove on a case by case basis allowing the courts to apply it very broadly. Section 424 (1) of the old Companies Act is a far reaching provision as it provides that a party to the carrying on of the business of the company in the aforesaid conduct is liable without any limitation<sup>142</sup>. Section 424 is only available to SARS when a company is winding down or in liquidation. In the past in the past SARS has not relied on section 424 of the old Companies Act to establish personal liability. Perhaps it is because the evidentiary burden relating to fraudulent and reckless trading is difficult to prove.

### **3.3. Section 65 of the Close Corporation Act 65 of 1984**

The new Companies Act has not repealed the Close Corporations Act No. 69 of 1984 (‘herein after Close Corporations Act’), nor has it done away with close corporations.<sup>143</sup> This position is supported by a recent notice issued by the Companies and Intellectual Property Commission<sup>144</sup> which expressly state that it is neither the intention of the legislature nor of CIPC to repeal the existing sections of the Close Corporation Act no to convert existing close corporations into companies<sup>145</sup>. This means that SARS can still use section 65 of the Close Corporation Act to recover outstanding tax debts from close corporations. Section 65 state that:

*“Whenever a Court on application by an interested person, or in any proceedings in which a corporation is involved, finds that the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes*

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<sup>141</sup> *Ex Parte: De Villiers and Another NNO: In Re Carbon Developments (Pty) Ltd (In Liquidation)* ZASCA 220; [1993] at para 24

<sup>142</sup> R Naidoo Corporate Governance: An Essential Guide for South African Companies (2009) 180.

<sup>143</sup> <https://www.coxyeats.co.za/FileHandler.ashx?fguid=8a6ce301-0781-407e-90c5> accessed on 09/09/2017 at 1547hrs

<sup>144</sup> CIPC's primary institutional mandate is derived from the Companies Act, 2008, which establishes CIPC as a juristic person

<sup>145</sup> CIPC Notice to Customers 53 of 2016 issued on 31/10 /2016

*a gross abuse of the juristic personality of the corporation as a separate entity, the Court may declare that the corporation is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the corporation, or of such member or members thereof, or of such other person or persons, as are specified in the declaration, and the Court may give such further order or orders as it may deem fit in order to give effect to such declaration”.*

In *Ebrahim v Airports Cold Storage*<sup>146</sup> the court stated that an entire failure to give consideration to the consequences of one’s action will be viewed as recklessness allowing the court to pierce the corporate veil<sup>147</sup>. The court went on to state that:

*“When the concept of recklessness was applied as a test to the running of a close corporation, regard had to be had, inter alia, to the CC's scope of operations, the members' roles, functions and powers, the amount of the debts, the extent of the financial difficulties and the prospects of recovery, plus the particular circumstances of the claim 'and the extent to which the [member] has departed from the standards of a reasonable man in regard thereto”<sup>148</sup>.*

It must be noted however that in *Ebrahim v Airports Cold Storage*<sup>149</sup> the court in its judgment did not apply section 65 of the Close Corporation Act<sup>150</sup>, it relied on section 64 of the same Act<sup>151</sup> to dismiss the appellant’s appeal as it deemed the application of section 64(1) on its own enough to attach liability to the appellants. In the court *aquo* the High Court had pierced the corporate veil of the close corporation in terms of section 65 of the Act<sup>152</sup>. In the recent case of

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<sup>146</sup> 2008 (6) SA 585 (SCA)

<sup>147</sup> Ibid

<sup>148</sup> Ibid at para at 591C - E

<sup>149</sup> Ibid

<sup>150</sup> Ibid at para 25. The Supreme court of Appeal went on to state that *“This conclusion makes it unnecessary to go further and make a finding as to whether the Ebrahims' conduct also amounted to fraud. It is likewise unnecessary to consider the application of s 65 (abuse of separate juristic personality) and s 63(h) (no accounting officer)”.*

<sup>151</sup> s. Section 64 of the Act reads: *“(1) If it at any time appears that any business of a corporation was or is being carried on recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose, a court may on the application of the Master, or any creditor, member or liquidator of the corporation, declare that any person who was knowingly a party to the carrying on of the business in any such manner, shall be personally liable for all or any of such debts or other liabilities of the corporation as the court may direct, and the court may give such further orders as it considers proper for the purpose of giving effect to the declaration and enforcing that liability.”*

<sup>152</sup> The High Court in *Airport Cold Storage (Pty) Limited v Ebrahim and Others* 2008 (2) SA 303 (C) pierced the corporate veil on the bases of s65 of the Close Corporation Act thereby attaching liability to Embraim on the bases of reckless trading. This was the first time in our law the courts had applied section 65 of this Act to attach personal liability to shareholders of a close corporation.

*Basfour 121 CC v M & R Interior Concepts and Others*<sup>153</sup> the Western Cape High Court followed the decision in *Airport Cold Storage (Pty) Limited v Ebrahim and Others* with approval.

Larkin<sup>154</sup> argues that, section 65 of the Close Corporations Act should be approached in a way which avoids any clumsiness or uncertainty. To achieve this, the power of a court to deem a close corporation not to exist in respect of certain rights, obligations or liabilities could be used as a power to see whether or not the corporation existed as a fact for those particular circumstances, for example whether or not the corporation's separate entity status was truly relevant to those rights, obligations or liabilities<sup>155</sup>. This would result in a sensitive, wide, statutory provision which, especially if interpreted widely in other respects as well, would be a very practical and effective statutory version of what company law has at common law<sup>156</sup>. SARS has never used this remedy however it remains available to it as a tool to attach personal liability to directors and shareholders of close corporations who operate their business recklessly or fraudulently.

### **3.4. Piercing the Corporate Veil using the Tax Administration Act 29 of 2011**

Section 180 of the Tax Administration Act<sup>157</sup> (hereinafter referred to as the TAA) has created a further avenue for SARS to pierce the corporate veil. SARS can, under section 180 and section 181 of the TAA hold the financial management and shareholders liable for the company's tax debt to the extent that their negligence gave rise to the company failing to settle its tax debt. Section 180 states that,

*“A person is personally liable for any tax debt of the taxpayer to the extent that the person's negligence or fraud resulted in the failure to pay the tax debt if:*

*(a) the person controls or is regularly involved in the management of the overall financial affairs of a taxpayer; an*

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<sup>153</sup> [2015] ZAWCHC 44

<sup>154</sup> Note 15 above at 337

<sup>155</sup> *ibid*

<sup>156</sup> *ibid*

<sup>157</sup> Act 29 of 2011

*(b) a senior SARS official is satisfied that the person is or was negligent or fraudulent in respect of the payment of the tax debts of the taxpayer”.*

Section 181 goes on to state that

*“(1) This section applies where a company is wound up other than by means of an involuntary liquidation without having satisfied its tax debt, including its liability as a responsible third party, withholding agent, or a representative taxpayer, employer or vendor. (2) The persons who are shareholders of the company within one year prior to its winding up are jointly and severally liable to pay the unpaid tax to the extent that.*

*(a) They receive assets of the company in their capacity as shareholders within one year prior to its winding up; and*

*(b) The tax debt existed at the time of the receipt of the assets or would have existed had the company complied with its obligations under a tax Act.*

*(3) The liability of the shareholders is secondary to the liability of the company.*

*(4) Persons who are liable for tax of a company under this section may avail themselves of any rights against SARS as would have been available to the company.*

*(5) This section does not apply— (a) in respect of a “listed company” within the meaning of the Income Tax Act; or (b) in respect of a shareholder of a company referred to in paragraph (a)”*

Further a public officer of the company may be held personally liable for the company’s tax debt if one of the requirements of section 155 of the TAA is met<sup>158</sup>. If the requirements of s 155 of the TAA are not met then the public officer may not be held liable and SARS may only

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<sup>158</sup> Section 155 of the Tax Administration act state that,” *Personal liability of representative taxpayer.—A representative taxpayer is personally liable for tax payable in the representative taxpayer’s representative capacity, if, while it remains unpaid— (a) the representative taxpayer alienates, charges or disposes of amounts in respect of which the tax is chargeable; or (b) the representative taxpayer disposes of or parts with funds or moneys, which are in the representative taxpayer’s possession or come to the representative taxpayer after the tax is payable, if the tax could legally have been paid from or out of the funds or moneys”.*

recover the tax debt from the company's assets in the possession, management or control of the public officer.

In conclusion the TAA has further expanded the already wide discretion to pierce the corporate veil the courts have at statutory law. In that SARS can effectively hold any company employee liable for a tax debt as long as it can prove negligence or fraud. This position is a radical shift from the common law position that only shareholders and directors can be held personally liable for a company's debts.

### **3.5. Concluding remarks**

To sum it all up although, the above discussed legislation differs in the wording of the provisions which allow for the attachment of personal liability to directors and shareholders in cases of reckless, fraudulent trading and negligence trading, they are similar in that all of them are remedies which allow for creditors and other interested parties to statutorily pierce the corporate veil.

## **CHAPTER 4: COMPARATIVE ANALYSIS OF DISTINCTION BETWEEN COMMON LAW REMEDIES AND STATUTORY REMEDIES PROVIDED FOR BY THE COMPANIES ACTS**

### **4.1 Introduction**

This chapter will critically analyse the relationship between the statutory remedies<sup>159</sup> discussed in Chapter 3 above and the common law remedy of piercing the corporate veil and the *actio pauliana*. This will in an attempt to understand the following, Are the statutory remedies broader or narrower in scope than the common law remedies? What are the practical advantages and disadvantages of the different remedies? To what extent do the common law remedies influence statutory remedies provided by the various legislations dealt with above? To what extent are the common law remedies still relevant given that there is a plethora of statutory remedies available to litigants who want to pierce the corporate veil and attach personal liability to directors and shareholders. It will further explore the distinction between common law remedies and statutory remedies in an attempt to establish whether or not the common law remedies are still relevant to SARS.

At first glance the statutory remedies discussed above seem to expand the application of the doctrine of piercing the corporate veil by effectively widening the scope and reach of the doctrine. However statutory remedies are creatures of legislation in that their interpretation and application is limited to the wording of the specific legislation and the rules of statutory interpretation, while common law remedies like the *actio pauliana* and lifting the corporate veil are grounded in the principle of fairness and justice, which allows for greater flexibility on interpretation. This has allowed the common law to continually evolve with the change in times, beliefs and acceptable conduct from the principles laid down in the Corpus Uris Civilis up to modern times. In general, common law remedies have proven to be more flexible through their ability to evolve through changing times. However, the case with piercing the corporate veil seems to be an exception to this generalisation. This will be discussed in greater detail below, through a comparison of the common law remedies discussed above with the statutory remedies provided in company law.

### **4.2 Distinction between *actio pauliana* and the statutory remedies provided discussed in Chapter 3**

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<sup>159</sup> Close Corporation Act 69 of 1984

The *actio pauliana* is fundamentally different from the statutory remedies<sup>160</sup> discussed in Chapter 3 above. In that the *actio pauliana*, does not aim to pierce the corporate veil nor to disregard the separate legal personality of the company and its shareholders or directors, as in the case of the statutory piercing of the corporate veil. The main aim of the *actio pauliana* is to simply recover goods or property wherein a debtor has transferred property to a third party with the intent to defraud his creditors.

This difference is further highlighted by the fact that the statutory remedies of piercing the corporate veil under both section 424 of the old Companies Act and section 20(9) of the new Companies Act are relatively new legal principles, which originate and the *Salomon*<sup>161</sup> case. This is markedly different from the *actio pauliana* which can be traced back to the Roman times<sup>162</sup>. The *actio pauliana* was then adopted in later Roman-Dutch law, during this time its principles were systemised, however the general principles have remained the rules that evolved in Roman law that were subsequently codified in the Code of Justinian<sup>163</sup>.

The *actio pauliana* is an action for the recovery of a thing alienated by a debtor in fraud of his creditors and that the action arises where the fraudulent alienation has been made with the knowledge of the person to whom the alienation has been made, that is to say, where the latter has shared in the fraud<sup>164</sup>. It will only apply where there is fraudulent disposition; alienation or transfer of assets by debtor in an attempt to permanently deprive the creditors of any recourse at law by effectively reducing the debtor's estate. Unlike the statutory remedies of piercing the corporate veil which were specifically designed to attach personal liability to directors and shareholders whose conduct amount to unconscionable abuse, fraud and reckless in the conducting company business.

The *actio pauliana* is designed to avoid certain transactions that are to the detriment of creditors and was developed in tandem with execution (debt-collecting) procedures of property law,<sup>165</sup> essential elements for successfully invoking the *actio pauliana* against the recipient are that there was a fraudulent disposition of his property by a debtor; the disposition must have caused or increased the alienator's insolvency; and the recipient must have participated in the fraud. If

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<sup>160</sup> Statutory piercing of the corporate veil using the S 20(9) of the new Companies Act, s424 of the old Companies Act, S 65 of the C.C Act and the Tax Administration Act

<sup>161</sup> *Salomon v Salomon 1896 UKHL 1, [1897] AC 22*

<sup>162</sup> *Ibid*

<sup>163</sup> Pothier *Commentarius ad Pandectas* ad D 42.8; Voet *Commentarius ad Pandectas* ad D 42.8 containing the Paulian provisions of the 17th century Roman-Dutch Law.

<sup>164</sup> Boraine A, "Towards Codifying The *Actio Pauliana*" (1996) 8 S. Afr. MerL.J. 213

<sup>165</sup> *Ibid*



the property was obtained by a lucrative title (for example, a donation), the fraudulent intention of the debtor would suffice<sup>166</sup>. On the other hand, the statutory piercing of the corporate veil remedies are based on the powers of the court to disregard the separate legal personality of the company and the imposition of liability on the controllers for their conduct in entering transactions as representatives or the moving forces behind the companies on the basis of fraudulent, reckless or negligent trading by the directors or shareholders.

The statutory piercing of the corporate veil as discussed in chapter 3 above provide for much broader in application. This broad application is exquisitely summed up by the use the phrase was there in “*unconscionable abuse*” and “*gross abuse*” in the new Companies Act and Close Corporations Act respectively. This is unlike the *actio pauliana* which only apply to fraudulent conveying or transfers.

The second requirement that need to be satisfied for the *actio pauliana* to apply is that the recipient must have participated in the fraud. Meaning that the recipient of the property must have known that the transfer was fraudulent and willing took part. This is different from the statutory remedy of piercing the corporate veil in that they do not impose any such onus on a person initiating the action to prove that the recipient or beneficiary of a fraudulent transaction should have known or anticipated the fraud in order to be successful with the action.

For the *actio pauliana* to find application it requires that the fraudulent transfer must have caused the loss suffered by the creditors. This is very different from statutory piercing of the corporate veil in that there is the no such requirement that creditors have to prove a causal nexus between the actions of the debtor and their loss. From this statutory piercing of the corporate veil has a wide and more flexible latitude of application as creditors are not restricted by the requirement that they have to prove the fraudulent transfer caused the loss suffered to them.

At common law, South African courts had a restrictive attitude towards the issue of establishing *locus standi*<sup>167</sup>. In *United Watch and Diamond (Pty) Ltd v Disa Hotels Ltd*<sup>168</sup> where the court outlined the test for determining this right or legal capacity, stating that “*to establish that one has locus standi in judicio, one must show,... that he has an interest in the subject matter of the judgment or*

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<sup>166</sup> Ibid

<sup>167</sup> The principle of *locus standi in judicio* essentially relates to the right or legal capacity of a party to sue or be sued

<sup>168</sup> 1972 (4) SA 409 (C)

order sufficiently direct or substantial....”<sup>169</sup> In *Amalgamated Engineering Union v Minister of Labour*<sup>170</sup> it was elucidated that:

*‘If a party has a direct and substantial interest in the order the court might make in proceedings, or if such order cannot be sustained or carried into effect without prejudicing that party he is a necessary party and should be joined in the proceedings’*<sup>171</sup>

It is generally required under the common law that litigants have to comply with the two requirements for *locus standi*, namely, the necessary capacity to sue and a demonstrable legal interest in the matter at issue<sup>172</sup>. In *TJ Jonck CC h/a Bothaville Vlesimark v Du Plessis*, in relation to the term interest ‘, it was held that the term interest ‘should not be interpreted restrictively, it also shouldn’t be too wide to include an indirect interest<sup>173</sup>. In *Cabinet of the Transitional Government for the Territory of South West Africa v Eins*<sup>174</sup> it was held that an applicant must have a direct interest in the matter<sup>175</sup>. The standing of any person to seek a remedy in terms of the provision should be determined on the basis of well-established principle set out in *Jacobs en ‘n Ander v Waks en Andere*<sup>176</sup> which states that: -

*“On who in general, the requirement of locus standi means that someone claiming legal aid must have an adequate interest in the subject of the proceedings to allow the Court to judge that his claim should be considered. It is not a technical concept with fixed boundaries. The most common way of describing the requirement is to say that a claimant or applicant must have direct interest in the requested legal aid (it should not be removed too far); otherwise, it is also said, according to the coherence of the facts, that there must be a real interest (not abstract or academic)”*

This is true for the *actio pauliana* which affords *locus standi* only to creditors who will have been prejudiced by a fraudulent dispossession of assets of a debtor. This is unlike the company law statutory remedies discussed above which affords *locus standi* to a wide group of interested

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<sup>169</sup> Ibid at at 415A

<sup>170</sup> 1949 (3) SA 631 at 637

<sup>171</sup> *Bunton and Another v Coetzee and Another* [2014] ZAGPPHC 553

<sup>172</sup> *Loots in Woolman* (2009) (1) 7-2.

<sup>173</sup> *TJ Jonck CC h/a Bothaville Vlesimark v Du Plessis* 1998(1) SA 971 (O) 9

<sup>174</sup> 1988 (3) SA 369 (A) at page 388

<sup>175</sup> Ibid.

<sup>176</sup> 1992 (1) SA 521 (A), at 533J-534E

parties from other shareholders to debtors. The *actio pauliana* expressly state that only creditors can initiate the process against fraudulent debtors, this means that shareholders can not directly initiate any action for the recovery of assets of a fraudulent dispossession in their unlike under the statutory piercing the corporate veil. This is because of the use of the phrase “interested person” as used in all the statutes discussed above.

In *Ex parte Gore* the court stated that

*“the phrase should not be interpreted too restrictively, but at the same time it should not be interpreted too widely as to include an indirect interest. This interest is limited to a financial or monetary interest.”*<sup>177</sup>

In *Gore* the court simply approved of and adopted the general principles stated in *Jacobs en 'n Ander v Waks en Andere*<sup>178</sup> is questionable whether it was the intention of *Gore* to extend the scope of section 20(9) of the Companies Act much more widely than that of section 65 of the Close Corporations Act, where a financial or monetary interest is a requirement<sup>179</sup>.

The scope of the application of the phrase interested person unequivocally extends the provides for a wide categories of persons who can initiate an action for statutory piercing of the corporate veil, this is unlike the *actio pauliana* which is restricted by principle and can only be initiated by creditors in the strict sense of its meaning.

#### **4.3 Distinction between the common law remedy of piercing the corporate veil and statutory piercing of the corporate veil.**

The common law notion of piercing the corporate veil and the statutory provisions providing for same in the various Acts under discussion in this dissertation are marked similar. This is because the statutory provisions are an attempt to partially codify and synthesise the common law position with regards to piercing the corporate veil. The common law notion of piercing the corporate veil is applied to protect the interests of a company’s creditors. In many instances this proviso also aims to combat fraud, which is in the public interest.<sup>180</sup> This is the same for S20 (9) of the new Companies Act and all other statutory provisions which allow for piercing of the corporate veil. The main aim of both common law and statutory piercing of the corporate

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<sup>177</sup> *Ex parte Gore* at para 27

<sup>178</sup> *Ibid*

<sup>179</sup> Cassim R Piercing the corporate veil a new direction (2014) 26 SA MERC LJ at page 316

<sup>180</sup> Nicolene Schoeman De Rebus in 2012 (June) DR 10. <http://www.derebus.org.za/piercing-corporate-veil-new-companies-act/> accessed on 10/10/2017 at 1046 am

veil is to avoid the abuse of separate legal personality between a company and its shareholders or directors. Both remedies act as a method of attaching liability to the perpetrators or abusers.

It must be noted that another similarity between the common law remedy of piercing the corporate veil and its statutory cousin with particular reference to section 20(9) of the new Companies Act and section 65 of the Close Corporation Act is that both these remedies have failed to authoritatively define or to ascertain when the corporate veil can be pierced. The statutory provisions which allow for piercing the corporate veil use phrases like “unconscionable abuse and gross abuse” respectively. Just like at common law the two phrases do not list or try to set out principles where the corporate veil must be pierced. Further just like at common law the Courts have failed to interpret the sections to ascertain the principles wherein the corporate veil maybe pierced.

The common law version of piercing the corporate veil is however distinct from the statutory piercing particularly section 20 (9) of the new Companies Act in a number of ways. Firstly, at common law when the corporate veil is pierced both the company and its shareholders or directors remain liable for the principle debt. In essence at common law the courts in cases of abuse of juristic personality will look to attach personal liability on the directors or shareholders while at the same time not exonerating the company from its obligations. The debt is therefore imputed onto the shareholders or directors, by virtue of the piercing of the corporate veil in that they are jointly and severally liable for the liabilities that will be in question.

However, section 20 (9) of the new Companies Act raises an interesting question in that it states that the company will be “deemed not to be a juristic person”<sup>181</sup>. This can be interpreted to mean that when piercing the corporate veil under the new Companies Act the company by implication is unconditionally and absolutely exonerated <sup>182</sup> from the debt and the creditors in this case SARS by implication will only have a recourse against the shareholders or directors. It remains to be seen on how our Courts will interpret this section. It is likely that the courts interpret the wording “deemed not to be a juristic person” without attaching any special significance to it as was illustrated in *Ex parte Gore* therefore incorporating the common law position into the interpretation of statutory piercing effectively attaching liability joint and severally to both the company and its directors or shareholders.

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<sup>181</sup> The Close Corporation Act uses the same phrase.

<sup>182</sup> Williams RC *Concise Corporate Law* 2nd ed (2013) at page 107.

At common law, there is a plethora of case law and academic writing which concludes that it is far from settled on when the corporate veil will be pierced.<sup>183</sup> It is on the discretion of the court to pierce the corporate through a balancing act of the policies behind the recognition of a separate corporate existence and against the policies justifying piercing.<sup>184</sup> This means that at common law piercing the corporate veil will be pierced when it objectively established from the facts on a case by case bases if there has been abuse of juristic personality.

This is unlike statutory piercing under the new Companies Act which expressly state that the prerequisite for statutory piercing of the corporate veil is “unconscionable abuse” of juristic personality.<sup>185</sup> In *Ex parte Gore* the phrase interpreted to mean

*“these words postulate conduct in relation to the formation and use of companies that is diverse enough to cover all the descriptive terms such as ‘sham’, ‘device’, ‘stratagem’, and ‘conceivably much more’”.*

In this the court interpreted the section to be much more flexible, wide and set a low threshold to prove the requirement than at common law piercing of the corporate veil. It literally means that the court will pierce the corporate veil when it subjectively views it necessary, this low threshold set out in *Ex Parte Gore* may lead to abuse and a floodgate of litigation in piercing the corporate veil cases. This very different from the common law position that set out in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>186</sup> and in *Hülse-Reutter and Others v Gödde*<sup>187</sup> where the Supreme Court of Appeal has categorically stated that the courts will not easily pierce the corporate, as the doctrine of separate of legal personality is sacrosanct<sup>188</sup>. In principle under section 20 (9) of the new Companies Act has now made it much easier for litigants such as SARS to initiate an action for piercing the corporate veil that at common law.

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<sup>183</sup> See Chapter 2.1.2 at page 14

<sup>184</sup> Note 71 above

<sup>185</sup> The Close Corporation Act uses the phrase gross abuse of juristic personality, while the 1973 Companies Act and the Tax Administration Act concentrates of reckless and fraudulent trading. Gross abuse of juristic personality has been interpreted in *Ex parte Gore* to be similar to “unconscionable abuse”.

<sup>186</sup> The court in *Cape Pacific Ltd v Lubner Controlling Investments (Pty)Ltd* emphasised, “if the separate legal personality of a company is too lightly disregarded by courts, this would negate and undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach thereto”.

<sup>187</sup> *Ibid*

<sup>188</sup> Note 194 above

Further at common law the remedy of the piercing the corporate veil is evoked only as a remedy of last resort.<sup>189</sup> This is unlike the position under statutory piercing as provided for in the new Companies Act, as In *Ex parte Gore* the court expressly stated that section 20 (9) is not a remedy of last resort .The court remarked that the unqualified availability of the remedy under section 20(9) militates against an approach that the remedy should be granted only in the absence of any alternative remedy<sup>190</sup>. The court went on to state that:

*“The newly introduced statutory provision affords a firm, albeit very flexibly defined, basis for the remedy, which will inevitably operate, I think, to erode the foundation of the philosophy that piercing the corporate veil should be approached with an à priori diffidence. By expressly establishing its availability simply when the facts of a case justify it, the provision detracts from the notion that the remedy should be regarded as exceptional, or ‘drastic’”<sup>191</sup>.*

The position adopted by the court in the interpretation of section 20 (9) of the new Companies Act is the in contradiction to the common law position in *Hülse-Reutter v Gødde* by the Supreme Court of Appeal. The position adopted by the court in *Ex parte Gore* implies that an aggrieved party in this case SARS raises the remedy of piercing the corporate veil under common law, the courts will have to treat it as a remedy of last resort. However, if it raises the same remedy under the new Companies Act it would be treated as an ordinary remedy. In principle the common law remedy and statutory remedies of piercing the corporate veil are slowly evolving into two distinct remedies.

Regardless of these differences it very difficult to try and imagine a situation wherein common law piercing the corporate veil will apply to the exclusion of statutory piercing of the corporate veil under the various company law statutes discussed above in particular to the exclusion of section 20 (9) of the new Companies Act. However, the opposite is true as there are now situations where the court will not pierce the corporate veil under common law but will gladly do so under section 20(9) of the new Companies Act for example where a creditor has another remedy available to them.

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<sup>189</sup> In *Hülse-Reutter v Gødde*, the Supreme Court of Appeal adopted a stricter approach in this respect and stated: *“The very exceptional nature of the relief which the respondent seeks against the appellants requires, in the circumstances of the present case, that he should have no other remedy”*

<sup>190</sup> *Ex parte Gore* at para 34

<sup>191</sup> *ibid*

## **4.4 Relevance of common law remedies to SARS**

### **4.4.1. Relevance of *Actio Pauliana***

The *actio pauliana* is still relevant to SARS as an alternative to section 424 of the 1973 Companies Act to piercing the corporate veil in cases of insolvency. This is because the *actio pauliana* although it is now a remedy of general application in fraudulent transfers, it is fundamentally an insolvency remedy and it finds application in scenarios wherein SARS will be trying to recover debts from companies going which fraudulently alienate there asserts before after sequestration to avoid the consequences of insolvency. The *actio pauliana* is grounded in principle hence it is not limited by the wording as in the case of statutes hence offers a wide and more comprehensive remedy when dealing with fraudulent alienations. It will be most effective when used in pleadings in the alternative to section 424 of the 1973 Companies Act. SARS has however used this remedy sparingly over the years, hopefully it will find more application in the future as it is a very powerful remedy.

### **4.4.2. Relevance of Common law piercing the Corporate Veil to SARS.**

Piercing the corporate veil at common law remains relevant as it forms the core of the doctrine of piercing the corporate veil to which courts refer and try to find answers when interpreting the various statutes which allow for piercing of the corporate veil. Statutes only create a framework for courts to work from, and do not define key phrases to the applications of their provisions<sup>192</sup>, for example in section 20 (9) of the new Companies Act does not define the phrase “unconscionable abuse” and the courts had to do a look to common law piercing of the corporate veil to get to the meaning of the phrase.

The new Companies Act section 20 (9) does not contain any excludes the application of the common law doctrine of piercing the corporate veil. Section 20 (9) simply acts as a supplement the common law position and it plays a central part in widening the application of the doctrine of piercing the corporate veil by removing the stringent restrictions associated with the application of common law doctrines. In *Ex parte Gore* the court went on to state that “*Having regard to the established predisposition against categorisation in this area of the law and the elusiveness of a convincing definition of the pertinent common law principles, it seems that it*

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<sup>192</sup> Section 424 of the 1973 Act does not define the meaning of reckless and negligent trading it leaves it to the courts to give a definition to same. I Section 65 of The Close Corporation Act does not define the meaning of gross abuse of a juristic personality

*would be appropriate to regard s 20(9) of the Companies Act as supplemental to the common law, rather than substitutive*<sup>193</sup>”

In practise given the introduction of the highly flexible statutory piercing the corporate veil under the new Companies Act, which is easier to institute and prove and which is not bound by common law restrictive application principles as in the case of its common law cousin, institutions such as SARS will prefer the statutory route when piercing the corporate veil. This is because it is simpler and less stringent and to some extent easier to ascertain than the case of common law piercing of the corporate veil institutions such as SARS requires an expedient settlement of its cases in order to maximise revenue collection hence statutory piercing of the corporate veil under section 20 (9) of the new Companies Act provides such an avenue .An advantage of the new statutory provision on piercing the corporate veil is that it gives more certainty and visibility to the doctrine of piercing the veil, but a danger is that it may result in the doctrine becoming inflexible, particularly if the courts interpret the provision in a technical way.<sup>194</sup>

The cumulative effect of the various statutes discussed above that allow for statutory piercing of the corporate available to SARS point in a direction where piercing of the corporate veil at common will be used less and less significant. Given that piercing the corporate veil at common law is more stringent and the courts will not easily grant it means that SARS in tax cases depending on the facts and circumstances will rely on section 20 (9) of the new Companies Act, section 424 of the 1973 Companies Act, section 65 of the Close Corporation Act and the Tax Administration Act to pierce the corporate veil as it is simpler and much easier than at common law.

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<sup>193</sup> Ex parte Gore at para 34

<sup>194</sup> (FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev and J Yeats *Contemporary Company law 2012*



## CHAPTER 5: CONCLUSION

### 5.1 Overview

The aim of this research was to establish whether or not the common law remedy of piercing the corporate veil and the *actio pauliana* are different from the statutory remedies under company law that allow for piercing of the corporate veil. It was also aimed at establishing whether or not these common law remedies are still relevant.

Section 20 (9) of the new Companies Act has introduced a statutory version the remedy of piercing the corporate veil, however it is not the only statute under company law which allows for piercing of the corporate veil as section 424 of the old Companies Act is still in force with regards to reckless and fraudulent trading in insolvency, section 64 and 65 of the Close Corporation Act provide for same and lastly the corporate veil can also be pierced under section 180 of the Tax Administration Act. These statutory remedies without doubt are fundamentally different to the *actio pauliana* in terms of the scope of their application and flexibility. This is because in principle the *actio pauliana* does not provide for piercing of the corporate veil but only for recovery of assets from fraudulent dispossessions.

The remedy of piercing the corporate veil at common law is very similar to its statutory cousin in that at present both doctrines are open ended and do not prescribe with certainty when the corporate veil should be pierced and in that both fail to establish a single coherent ascertainable set of principles in the application of this doctrine. This is despite a lot of litigation around this area of law.

There are however some significant differences between piercing the corporate veil at common law and its statutory cousin. Firstly the interpretation of the Court in *Ex parte Gore* where it stated that under section 20(9) of the new Companies Act piercing the corporate veil is no longer a remedy of last resort has expanded and the application of this to statutory remedy to be wider and more comprehensive than its common law cousin which is restricted by the decision in *Hülse-Reutter v Gödde* which expressly state that piercing the corporate veil is a drastic remedy which must be used only as a remedy of last resort.

Further section 20 (9) seemingly unconditionally and absolutely exonerate the company from liability when piercing the corporate veil while at common law when piercing the corporate veil, the directors and shareholders are held joint and severally liable for the debt together with the company.

From the above discussion the common law remedy of piercing the corporate veil and its statutory cousin are evolving to become two distinct remedies, as the requirements one is required to satisfy in order for them to apply are now different. Further the burden of prove and discretion of the Court to pierce the corporate veil under section 20 (9) of the new Companies Act has become much lower than at common law signifying this divergence of the two into very distinct remedies. It remains to be seen how the courts will deal with the issue in future litigation.

In conclusion the common law remedies of piercing the corporate veil and the *actio pauliana* are still very relevant to SARS as tools of attaching personal liability to directors and shareholders who abuse the doctrine of separate juristic personality. These common law remedies have managed to evolve with the changing company law trends to remain very effect remedies. However due the plethora of statutory remedies which allow for piercing of the corporate veil which are less stringent to satisfy these common law remedies will became less and less significant to SARS.

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