

UNIVERSITY OF KWAZULU NATAL

# **Piercing the Corporate veil of the Close Corporation with the Tax Administration Act**

PREPARED BY

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MASTERS IN ADVANCED TAXATION

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**DECLARATION**

I, Suellen Ramona Glazer, do hereby solemnly declare that:

- (i) This dissertation is my own original work, unless it is otherwise indicated.
  
- (ii) This dissertation has not been submitted for the purposes of fulfilment of any other degree or examination at any university except for the University of KwaZulu Natal.
  
- (iii) This dissertation does not contain other persons' data, pictures, graphs or other information, unless specifically acknowledged as being sourced from other persons.
  
- (iv) This dissertation does not contain other persons' writing, unless specifically acknowledged as being sourced from other researchers. Where other written sources have been quoted, then:
  - (a) their words have been re-written but the general information attributed to them has been referenced;
  
  - (b) where their exact words have been used, their writing has been placed inside quotation marks, and referenced.

SUELLEN RAMONA GLAZER

November 2015

Signed.....

## **ACKNOWLEDGEMENTS**

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I would like to express my sincere gratitude to my Supervisor Mr Chris Schembri for his enthusiasm and support in the completion of this dissertation.

Thank you to God for his strength during this time.

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## **ABSTRACT**

The topic of piercing the corporate veil has long been a debated phenomenon globally. In the United Kingdom, the landmark case of *Salomon v Salomon and Co Ltd*<sup>1</sup> provided much needed clarity in the application and acknowledgment of the independence of the juristic entity from its key players.

The courts have been mindful of this fundamental rule and have also declared that this separate identity is not absolute as in certain instances the corporate veil will be set aside. Various statutes have been introduced to provide the courts with guidelines as in what instances veil piercing will be acceptable. The most notable statute is the introduction of the Companies Act 71 of 2008 (hereinafter referred to as the “2008 Act”).

Worldwide, tax authorities in their role as tax administrators and collectors have been faced with the veil piercing dilemma. The aim of this dissertation is to determine if the South African Revenue Service (hereinafter referred to as SARS) could use the Tax Administration Act 29 of 2011 (hereinafter referred to as the “Tax Admin Act”) to attach the tax liability of an entity such as the close corporation to its members.

To determine this, an investigation into the variety of sources available to SARS to pierce the corporate veil is required. The practical application by SARS, thus far, in their ability to attach the tax liability of a juristic entity to its key players is essential to determine how the SARS has been dealing with these types of matters.

The enactment of the much needed Tax Admin Act has provided SARS with even further reaching powers when it comes to the collection of taxes.

An evaluation of the definition of a taxpayer, as contained in Section 151 of the Tax Admin Act, will be considered. In particular, the concepts of the Representative taxpayer and the Responsible third person shall be discussed as both these terms empower SARS to attach the tax liability of a juristic entity to a natural person should the tax debt remain unpaid.

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<sup>1</sup> *Salomon v Salomon and Co Ltd* [1987] AC 22 (HL).

The Tax Admin Act provides SARS with even further reaching powers to enforce the collection of the corporation's tax debts against another person. It appears as though the legislature has paved the way even further for SARS to target and hold responsible the key players of a corporation.

From a global perspective, an investigation into how the tax authorities of foreign jurisdictions have been dealing with the concept of lifting the corporate veil will be conducted. In light of the findings, a determination of how South Africa compares globally in its approach to the veil piercing doctrine by the tax authorities shall be made.

In my conclusion I will evaluate my findings.

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## **CHAPTER 1**

### **1. INTRODUCTION**

#### ***1.1 Background***

One of the most controversial aspects of South African company law is the concept of the juristic legal personality and in what instances is it acceptable for a court to ignore the separate existence of an entity and “pierce the corporate veil”. When a court decides to pierce the veil this essentially removes the protective shield of the corporation and attaches the liability to the members of the entity in their personal capacity. Piercing the veil has been one of the most litigated issues in commercial law, yet it still remains the most misunderstood. This lack of clearly defined principles has resulted in a number of overlapping list of factors that the courts must consider.

Traditionally, the common law notion of piercing the veil was applied when the interests of the creditors had to be weighed against the rights and duties of the company’s members. The landmark case of *Salomon v Salomon and Co Ltd*<sup>2</sup> set the precedent that a company has its own legal personality distinct from its members. This fundamental rule has had exceptional influence on decisions involving the piercing of the veil. However, it is not an absolute rule as exceptions do exist and the courts tend to determine matters on a case by case basis.

When to look at the corporation as a separate unit and when to look at it as a “collection of persons” is a question the courts seem to answer judging by the merits of each case. To date, no set rule has existed and the courts appear to have not established a step by step guideline when faced with this decision. This doctrine of piercing the veil appears to be inherently flawed as its application in South African law has proved problematic time and time again.

Legislatures have attempted to curb the issue of its problematic application by introducing statutes that actually provide in what instances the veil may be pierced. Such legislation includes but is not limited to the Close Corporation Act No.69 of

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<sup>2</sup> Ibid.



1984 (hereinafter referred to as the CC Act) and the relatively new 2008 Act which assists with the regulation of close corporations and companies in general.

The introduction of the Tax Admin Act into the current tax law regime has brought about further issues regarding the separate legal personality of a corporate entity. It appears as if this piece of legislation which provides for a more consolidated version of the tax laws, has provide the local tax authorities with the power to target the taxpayer if and when necessary. The Representative taxpayer which was already introduced into tax law in the Income Tax Act No.58 of 1962 (hereinafter referred to as the Income Tax Act) and the Value Added Tax Act No. 89 of 1991 (hereinafter referred to as the VAT Act) has been broadened further with the introduction of the Tax Admin Act. The Responsible third party is another important concept that requires an analysis.

This paper seeks to evaluate whether SARS can apply provisions in the Tax Admin Act to pierce the corporate veil of a close corporation and attach the tax debt owed by the corporation to its members.

### ***1.2 The Aims of the dissertation***

The aims of this dissertation are as follows:

To determine the ability of SARS to hold the members and others who stand behind the close corporation responsible for the tax debts of the close corporation. To assess this, it is necessary to provide an analysis of the close corporation as a juristic entity and its position within the South African corporate sphere. This entails an investigation into the origin of the close corporation as well as the changes instituted with the introduction of new legislation.

This paper seeks to discuss and evaluate the concepts of separate legal personality and the piercing of the corporate veil as this is what prevents SARS from holding others associated with the entity responsible for its tax debts. This will entail a discussion on the common law as well as applicable statutes that have aided in the development of this globally debated topic.

This dissertation will then turn to a discussion on the South African fiscal system. This will involve a discussion on taxation in general and applicable dispute resolution procedures. An overview of the introduction of the Tax Admin Act will commence.

Finally, in light of all this information this research paper will discuss the concept of piercing the corporate veil from a tax perspective. Lifting or piercing of the corporate veil is important since this is one of the tools that SARS may make use of in order to hold persons standing behind the entity responsible for its tax debts. An evaluation of SARS ability to attach the tax liability of the corporate entity to its key players will be investigated. This investigation will entail an overview of the various sources at SARS disposal. For the purpose of this paper, the most influential source is the Tax Admin Act. This Act could indeed enable SARS to argue that where a corporation lacks the financial resources to pay its taxes, such tax liability should be imposed on one of its key players.

### ***1.3 Research Methodology***

This paper is largely based on desktop research, scholar articles as well as case law and prevailing statutory legislation. The findings reached at the end are in no way conclusive and are a matter of opinion reached from conducting this research.

The findings are mainly based on case law and the way the courts have in the past evaluated their decisions and reasons for the way they reached their conclusions.

I have also included a comprehensive list of articles by scholars and colleagues as well as a list of journals.

## **CHAPTER 2**

### **2. THE CLOSE CORPORATION**

The first step in the evaluation of the efficacy of the lifting of the corporate veil doctrine in allowing SARS to hold taxpayers standing behind the close corporation responsible for the tax debt of the close corporation is to consider the make-up of the close corporation, in particular the separate legal personality characteristic of that close corporation. This issue will be dealt with in this chapter.

#### ***2.1 The origin of the close corporation***

A country's economy is significantly affected by the legal framework within which it operates. A country's corporate law impacts on wealth creation and economic prosperity. In order to ensure a prosperous economy, especially in a developing country such as South Africa, it is imperative that corporate law rules are simple, clear and certain. The types of business entities made available by a country's legal system must be flexible, manageable and easily incorporated in order to promote and facilitate economic growth. These business entities must cater for the diverse needs of its entrepreneurs. Entrepreneurship is further promoted by catering for smaller business opportunities.

Corporate law in South Africa had become extremely complex by the end of the 1980's. The prevailing legislation catered primarily for larger companies, often due to the detriment to the small private business owner. Irrespective of the size of the business entity, the prevailing legislation applied uniformly<sup>3</sup>. This legislation was complex, out-dated and had become extremely cumbersome due to numerous amendments. The result was that it became too complicated to run businesses on a small to medium scale. This hindered the economic growth in the country as the entrepreneur was subjected to compliance with onerous legal formalities. A need for corporate law reform proved essential in order to put an end to the suffocating provisions provided for in the prevailing legislation.

In 1981, a proposal was submitted to the Standing Advisory Committee on Company Law which provided for the introduction of a new legal vessel to meet the needs of

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<sup>3</sup> ML Benade et al. *Entrepreneurial Law* 3 ed (2003) 281.

the small businessman. The Standard Advisory Committee on Company Law considered and accepted the proposal. Pursuant to this acceptance, the legislature was tasked with formulating a legal framework which could promote smaller business operations<sup>4</sup>. The result was the introduction of the CC Act which proved to be an important and innovative piece of legislation. This CC Act commenced on the 1<sup>st</sup> January 1985. This piece of legislation was introduced alongside the 1973 Act and was specifically designed to facilitate the incorporation of business entities for the smaller business owner.

The key principles of the CC Act were simplicity, flexibility, and the ability of members to participate in the management and control of their business. Provision was further made for the conversion of existing companies into this new close corporation vessel<sup>5</sup>. The CC Act sought to provide a mechanism for a business entity that was less expensive in incorporation and operation. This was a departure from the stringent legal requirements previously imposed. The close corporation quickly became a popular business vehicle which promoted economic growth.

## ***2.2 Characteristics of the close corporation***

### ***2.2.1 Incorporation***

Close corporations were created by the registration of a founding statement. The founding statement contains detailed information on the corporation itself and the members. For example, the founding statement contained the name of the company and the type of business conducted. The process for registration begins with the lodging of the founding statement with the Companies and Intellectual Property Commission (CIPC). The CIPC would register the close corporation and each close corporation would be issued a registration number. The Registrar of close corporations would then issue a certificate of incorporation and the close corporation was brought into existence.

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<sup>4</sup> ML Benade et al. (note 3 above) 280.

<sup>5</sup> ML Benade et al. (note 3 above) 280.

### ***2.2.2 Framework and structure***

The close corporation is a juristic person that consists of members. Each person who is in control of the close corporation is called a member of the corporation. There is a restriction on how many members a close corporation may be composed of and that is one to ten members. These members form part of the close corporation by owning members interest which are expressed as a percentage. The combined member's interest constitutes 100 percent. Natural persons are only permitted to be members and no juristic persons may hold members interest. However, a close corporation is allowed to be a shareholder and own shares in a company.

### ***2.2.3 Association agreement***

If there is more than one member of the close corporation, the most important document for the close corporation, apart from its founding statement, is called an association agreement. The association agreement regulates the relationship between the members. It regulates matters such as the members' rights and obligations towards each other and towards the close corporation, the percentage of membership and any other relevant matter that pertains to the agreements made between the members. It is preferable for members to enter into an association agreement in order to regulate the resolution of any issue or dispute that may arise. This agreement can be entered into at any time by the members. However, it is advisable that it is drafted and signed before the close corporation is registered.

### ***2.2.4 Legal personality***

#### ***2.2.4.1 Separate legal personality***

As a juristic person, the close corporation is a separate legal entity distinct from its members. Due to the entities separate legal personality, it enjoys the benefits of limited liability, perpetual succession, is able to own its own property, is responsible for its' owns profits, debts or liabilities, and can sue or be sued in its own name.

The separate legal personality of a company is considered the foundation on which company law rests. When a close corporation is formed, a "veil" or a "curtain" hangs between the close corporation and its members. This terminology is purely metaphorical and is a means to illustrate the separate existence of the entity. The

general rule is that the close corporation's members cannot be held personally liable for the debts of the corporation unless they have signed surety in their personal name. A legal "curtain" is drawn between the entity and its members that separate them from each other. This "curtain" is known as the corporate veil.

South Africa's common law contains an English law component. South African corporate law is heavily influenced by the United Kingdom. A leading United Kingdom court case regarding the concept of separate legal personality is undoubtedly the landmark case of *Salomon v Salomon & Co Ltd*<sup>6</sup>. The facts of this case are as follows:- Mr Salomon was a sole trader who had decided to register his business as a company with six of his family members. He was the majority shareholder of the company whilst the other family members held one nominal share each. The company later liquidated and the issue before the court was whether the liability of the debts should fall on Mr Salomon in his personal capacity. The House of Lords found that Mr Salomon was a separate person from the company and could not be held personally liable for the debts of the company. The House noted that:

—once a company is legally incorporated, it must be treated like any other independent person with its rights and liabilities appropriated to it; the motives of the promoter of a company during the formation of the company are irrelevant when discussing the rights and liabilities of such a company".<sup>7</sup>

The House further noted 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 person are managers, and the same hands receive the profits, the company is not in law the agent of 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 for by the Act."<sup>8</sup>

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<sup>6</sup> *Salomon v Salomon & Co Ltd* (note 1 above).

<sup>7</sup> *Salomon v Salomon & Co Ltd* (note 1 above) 50.

<sup>8</sup> *Salomon v Salomon & Co Ltd* (note 1 above) 51.

This case clearly illustrates the courts recognition of the separate legal identity of a juristic person. Once the entity has been incorporated it acquires a separate legal personality independent from the natural persons that incorporate it and that manage it.

One of South Africa's earliest cases dealing with the concept of separate legal personality is found in *Dadoo Ltd v Krugersdorp Municipality Council*<sup>9</sup>. In the Appellate division it was held that the property of the company belongs solely to the company. It was asserted by Innes CJ that:

—A registered company is a legal persona distinct from the members who compose it...Nor is the position affected by the circumstance that a controlling interest in the concern may be held by a single member. 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>10</sup>

The separate legal existence of a company was again confirmed in the constitutional court case of *Airport Cold Storage (Pty) Ltd v Ebrahim*<sup>11</sup>. The court determined that even though a company may not have a physical existence, it is in fact capable of owning its assets and also responsible for its liabilities incurred.

#### **2.2.4.2 Limited Liability**

As a general rule members are not liable for the debts of the corporation. The members therefore enjoy limited liability whilst the corporation is fully liable for its debts.

### **2.3 Close corporations and the Constitution of the Republic of South Africa, 1996**

The Constitution of the Republic of South Africa, 1996 (hereinafter referred to as the 1996 Constitution) is the supreme law of the Republic and all legislation is subject to its provisions.

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<sup>9</sup> *Dadoo Ltd v Krugersdorp Municipality Council* 1920 AD.

<sup>10</sup> Ibid 550.

<sup>11</sup> *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008(2) SA 303 (C).

The 1996 Constitution recognises and provides protection to juristic persons, such as the close corporation, as provided by Section 8(2) of the 1996 Constitution which reads:

–A provision of the Bill of Rights 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”.

What is important to note is that not all of the rights in the Bill of Rights are afforded to the juristic person. An example of such a right is the right to life. This right cannot be claimed by a juristic entity. However, the right to privacy is applicable to a juristic entity. Section 8(4) of the 1996 Constitution provides 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 the juristic person”.

In the *Certification of the Constitution of the Republic of South Africa*<sup>12</sup>, the Constitutional court had to deal with the question of the protection of fundamental rights extending to juristic entities. The court held that:

–Many universally accepted fundamental rights will be fully recognised only if afforded to juristic persons as well as natural persons”.<sup>13</sup>

It was the court’s opinion that juristic persons were not afforded the enjoyment of all the rights in the Bill of Rights. Reference was also made that one should take into consideration the nature of the juristic entity involved to determine if a particular right applied to them.

#### ***2.4 The Companies Act 71 of 2008***

Since the 1973 Act there had been rapid economic development and growth both within South Africa and globally. South Africa had undergone political changes and a

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<sup>12</sup> *Certification of the Constitution of the Republic of South Africa*, 1996 (CCT 23/96) [1996] ZACC 26; 1996 (4) SA 744 (CC); 1996 (10) BCLR 1253 (CC).

<sup>13</sup> *Ibid* Para 57.



new Constitution had been introduced in 1993. The United Kingdom had also undergone rapid changes with the introduction of its new Companies Act in 2006. In addition, the 1973 Act had been amended almost every year since its promulgation. This amounted to approximately 42 amendments over 37 years<sup>14</sup>.

Needless to say, the law had become extremely complex, out-dated and highly technical. Over the years corporate law had also introduced a variety of new concepts. Among these new concepts were the Solvency and Liquidity test; the introduction of corporate governance and accountability, disclosure and transparency; shareholders appraisal rights and company rescue. These concepts desperately needed codification to prevent confusion and to provide for a much simpler form of corporate law rules.

Various processes and forums were undertaken during the development and drafting of the new 2008 Act. These included a Government Policy paper published in 2004, agreements reached at the National Economic Development and Labour Council and opinions of the trade union movement<sup>15</sup>. All of these resources proved pivotal in the creation of the 2008 Act. This was a positive stance to ensure that the new piece of company legislation took practical matters into consideration and the opinions of key economic players. The result was a new approach to company law. The 2008 Act came into effect on the 1<sup>st</sup> May 2011 and repealed certain provisions in the 1973 Act. Further amendments were made to the 2008 Act with the Companies Amendment Act 3 of 2011.

According to the Department of Trade and Industry, “The Act has been simplified for better understanding and application”<sup>16</sup>. Familiar language has been used in order to ensure consistence and harmonization with other important pieces of legislation such as the Promotion of Access to Information Act 2 of 2000. There is now extensive focus on the transparency and accountability of companies as well as providing for less cumbersome regulatory burdens.

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<sup>14</sup> FH Cassim et al. *Contemporary Company law* 2nd ed (2012) 3.

<sup>15</sup> D Davis et al. *Companies and other Business Structures* 3rd ed (2013) 8.

<sup>16</sup> Department of Trade and Industry “The Companies Act” available at <http://www.sanas.co.za/assessorcon/2011/Presentation%206%20%20Companies%20Act%20>, accessed on 15 October 2014.

The 2008 Act signalled an alignment with international corporate law standards and now encompassed principles which provided for and governed a variety of new business entities.

### ***2.5 The Close Corporation Act 69 of 1984 and the Companies Act 71 of 2008***

The 2008 Act adopts a pivotal stance towards the close corporation entity. The 2008 Act does not repeal the CC Act in its entirety. However, the fundamental effect of the 2008 Act on the CC Act is that no new close corporations were permitted to be registered on commencement of Section 13 of the 2008 Act. Section 13 of the 2008 Act reads:

“If a founding statement referred to in section 12 complying with the requirements of this Act is lodged with the Registrar in the manner prescribed at any time before section 13 of the Companies Act comes into operation, and if the business to be carried on by the corporation is lawful, the Registrar shall upon payment of the prescribed fee register such statement in his or her registers and shall give notice of the registration in the prescribed manner”.

This section commenced on the 1<sup>st</sup> May 2011. Close corporations which were already in existence prior to the commencement of the 2008 Act may continue to operate indefinitely.

The apparent reason for the decision not to allow new close corporations to be registered was that the 2008 Act created a newer, simplistic and efficient company structure that still maintained many of the characteristics of the close corporation. Consequently, this rendered the need for the close corporation business entity unnecessary. However, based on the huge economic success of the close corporation business entity the reason provided is a moot point among scholars and academics<sup>17</sup>.

The close corporations still in existence will continue to be governed by the CC Act and the 2008 Act. The 2008 Act therefore provides for measures for both of these Acts to co-exist. However, various amendments have been implemented to the CC Act.

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<sup>17</sup> FH Cassim et al. (note 14 above) 100-101.

Another notable change to the close corporation brought about by the 2008 Act was the provision that allowed for the conversion of companies into close corporations as contained in Section 27 of the CC Act. This provision has now been repealed by Schedule 2 of the 2008 Act which now also facilitates the conversion of close corporations into companies.

Chapter 3 of the 2008 Act introduces accountability and transparency standards for close corporations. This chapter requires the close corporation to have its annual financial statements in line with International Financial Reporting Standards. Furthermore, close corporations can now voluntarily comply with the extended accountability requirements contained in the 2008 Act including but not limited to appointing a company secretary and audit committee. Chapter 6 of the 2008 Act also introduces a new concept into South African corporate law known as Business Rescue. This concept offers assistance to financially distressed companies and also applies to close corporations.

## CONCLUSION

The CC indeed has limited liability and a whole host of other rights, as is the case for a company under the 2008 Act. Given the strength of this limited liability, the means that SARS may employ to overcome this hurdle will now be considered. Attention will be given to the doctrine of the lifting or piercing of the corporate veil.

## **CHAPTER 3**

### **3. PIERCING THE CORPORATE VEIL**

One of the tools at SARS disposal in its quest to recover the outstanding tax debt of a CC from its members is the doctrine of the “lifting or piercing of the corporate veil”. This doctrine has both statutory and common law underpinnings. The nature and extent of this doctrine will now be examined in an effort to determine whether it could indeed be considered a useful tool for SARS.

#### ***3.1 Exceptions to the separate legal personality***

As mentioned earlier, the close corporation is a juristic person with a separate legal personality that exists independently from its members. However, this separate legal persona is not absolute as in certain circumstances it may be disregarded. The corporate “veil” of the juristic entity will be lifted or pierced and the separate persona of the entity will cease to exist. The result of lifting or piercing may culminate in the members of the close corporation losing the protection afforded to them by the juristic entity. Should this happen, the entire company or a particular transaction will be viewed in light of the manner in which the members conducted their business operations.

In the case of *Amlin (SA) Pty Ltd v Van Kooij*<sup>18</sup> it was stated that:

“Piercing the veil necessitates that a court “opens the curtains” of the corporate entity in order to see for itself what is obtained inside”.<sup>19</sup>

It was discussed further that the focus of the issue under review would shift from the close corporation as an entity to the natural person and subsequently the actions of the juristic entity would be viewed as the actions of the natural person.

The court noted further that the piercing of the corporate veil would not readily be undertaken:

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<sup>18</sup> *Amlin (SA) Pty Ltd v Van Kooij* 2008 (2) SA 558 (C).

<sup>19</sup> *Ibid* Para 12.

—At common law, piercing the corporate veil is regarded as a drastic remedy that must be resorted to sparingly and as a last resort in circumstances where justice will not otherwise be done”.<sup>20</sup>

In most instances the courts will uphold the separate existence of the juristic entity. However, the court will pierce the corporate veil when there are compelling reasons to do so. An example of a compelling reason may be when there has been gross misconduct with an element of abuse of the separate legal identity of the juristic entity by the natural person. The courts and the legislature have both provided for exceptions to the concept of the separate identity of a corporation.

In the case of *Ebrahim v Airports Cold Storage*<sup>21</sup> it was observed that:

—It is an apposite truism that close corporations and companies are imbued with identity only by virtue of statute. In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when their objects of their creation are abused or thwarted.”<sup>22</sup>

The common law doctrines of piercing the corporate veil, as well as statutory provisions, are available to those who have been prejudiced by the actions of the natural persons who hide behind their corporate entities.

### **3.2 The Common Law**

The doctrine of piercing the corporate veil originated at common law and gained considerable interest in the 1980's. It provides that in certain circumstances the court is empowered to disregard the principle that the company is a separate juristic entity. The metaphor applicable is that the courts can “lift” or “pierce” the corporate veil when it is deemed appropriate to do so.

As previously mentioned the South African common law is heavily influenced by English company law. This is the reason why the English case of *Salomon v Salomon & Co Ltd*<sup>23</sup> had a considerable influence on South Africa's corporate law.

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<sup>20</sup> Ibid Para 23.

<sup>21</sup> *Ebrahim v Airports Cold Storage* 2009 1 All SA 330 (SCA).

<sup>22</sup> Ibid Para 15.

<sup>23</sup> *Salomon v Salomon & Co Ltd* (note 1 above).

There is an abundance of case law illustrating instances whereby the courts have disregarded the separate existence of the corporate veil. However, at common law there appears to be no specific guidelines as to when the court will pierce the veil. This has tended to be problematic at common law as the courts have not created and followed a single comprehensible system for determining when the corporate veil should be pierced.

According to Domanski<sup>24</sup> there are different categories in which the courts will pierce the corporate veil. He claims that judges investigate the natural persons conduct in order to apply the veil piercing doctrine.

He states that:

–This piecemeal approach on the part of the courts will, for the sake of convenience, be referred to as the –categorizing approach.”<sup>25</sup>

It is his opinion that the various approaches and principles applied in case law have resulted in inconsistency and uncertainty in the law.

An examination of a few cases will provide an understanding on the various approaches applied by the courts and further illustrate the development of the common law doctrine of piercing the corporate veil.

An important case for the judicial affirmation of the doctrine of piercing the corporate veil is *Lategan & Another NNO v Boyes and Another*<sup>26</sup>. Le Roux J stated quite candidly that:

–there was no doubt that our courts would brush aside the veil of corporate identity time and again where fraudulent use is made of the fiction of legal personality.”<sup>27</sup>

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<sup>24</sup> A Domanski –Piercing the corporate veil-A New Direction?” (1986) *SALJ* 224-235.

<sup>25</sup> Ibid 224.

<sup>26</sup> *Lategan & Another NNO v Boyes and Another* 1980 (4) SA 191 (T).

<sup>27</sup> Ibid 201.

The court went further to discuss that it is an acceptable practice that in certain circumstances the court will disregard the company's separate legal personality.

The case of *Botha v Van Niekerk en 'n Ander*<sup>28</sup> involved a dispute arising from a contract for the sale of residential property. The purchaser Mr Van Niekerk was the director and shareholder of a company. A guarantee for the purchase of the house was due by a specific date. The guarantee was not furnished and the seller issued a demand for the guarantee. Mr Van Niekerk claimed that the company had decided to replace him as the purchaser. An application was brought by the seller to enforce the contract and pierce the corporate veil of the company. The court refused to pierce the corporate veil as it could not arrive at a finding of personal liability of the respondent for the amount owed to the seller. The court formulated a test that required that the plaintiff must have suffered unconscionable injustice as a result of improper conduct on the part of the defendant.”

The test applied in the case of *Botha v Van Niekerk en 'n Ander*<sup>29</sup> was rejected in the case of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others*<sup>30</sup> as it was deemed to be far too rigid. A more flexible approach was required to be applied that would allow for the facts of a particular case to be considered in determining the decision whether or not to pierce the corporate veil. It is submitted that the court in the case of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others*<sup>31</sup> reached the correct conclusion in that the test formulated in *Botha v Van Niekerk en 'n Ander*<sup>32</sup> was too rigid in its application.

This court laid down a few principles regarding the circumstances in which the veil could be pierced. These principles are not mandatory as the circumstances would depend on the facts of the case at hand. The Appellate Division referred to the case of *Dadoo Ltd and Others v Krugersdorp Municipal Council*<sup>33</sup> and acknowledged that it is trite law that a registered company is considered to be a separate legal person.

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<sup>28</sup> *Botha v Van Niekerk en 'n Ander* 1983(3) SA 513(W).

<sup>29</sup> *Ibid.*

<sup>30</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others* 1995 (4) SA 790 (A).

<sup>31</sup> *Ibid.*

<sup>32</sup> *Botha v Van Niekerk en 'n Ander* (note 28 above).

<sup>33</sup> *Dadoo Ltd and Others v Krugersdorp Municipal Council* (note 9 above).

The court explained further that the concept of lifting the corporate veil entailed that our attention shifts from the company to the natural persons standing behind the corporation and in control of its activities. These two parties are viewed as if there was no division present in the first place.

The court must uphold the separate legal personality of a corporation unless there are circumstances present that would justify the piercing of the corporate veil. The court refers to the principles of “fraud, dishonesty or other improper conduct”. It does not matter whether the company was established legitimately and without deceit. What matters is that it was misused in manner that amounted to “fraud, dishonesty or other improper conduct”. These were the principles applied by the Appellate Division.

The court citing Domanski<sup>34</sup> makes reference to the balancing approach in that a balance must be adopted between the preservation of the separate legal persona of the corporation on the one hand against the policies and principles that favour the piercing of the veil on the other. However, when adopting such an approach the court should look to the substance rather than the form of the business operation under dispute and the entity as a whole.

In the case of *Hülse-Reutter and Others v Gödde*<sup>35</sup> the Supreme Court of Appeal reiterated the fact that the separate legal personality of a corporation must be upheld and that the court does not possess a general discretion to simply disregard its separate existence when it deems it just to do so. A stricter approach was adopted in this case as the view of the court was that the piercing of the veil should only be used as a tool as a last resort. The court stated that:

—The circumstances in which a court will disregard the distinction between a corporate entity and those who control it are far from settled.”<sup>36</sup>

The court pointed out further that the piercing of the corporate veil depends on the facts of the particular case and that there must be some form of misuse or abuse of the

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<sup>34</sup> A. Domanski (note 24 above) 224.

<sup>35</sup> *Hülse-Reutter and Others v Gödde* 2001 (4) SA 1336 (SCA).

<sup>36</sup> *Ibid* Para 20.



distinct corporate identity. This approach was followed in the case of *Amlin Pty Ltd v Van Kooij*<sup>37</sup>. The court referred to veil piercing as a “drastic remedy” that should only be used as a last resort<sup>38</sup>.

In the case of *Die Dros (PTY) Ltd and Another v Telefon Beverages cc and Others*<sup>39</sup> the issue in dispute involved a restraint of trade clause prohibiting a franchisee of a restaurant business from trading. The court relied on the principles of “fraud, dishonesty or other improper conduct” and made reference to the balancing approach as discussed in the case of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others*<sup>40</sup>. The company was referred to as an “alter ego” and the court explained that it was trite law that the courts would allow the separate legal identity of a close corporation to be pierced when there has been a breach of a restraint of trade provision:

“Courts permit the separate corporate personality of a close corporation or company to be disregarded where a natural person who is subject to a restraint of trade uses the corporation as a front to engage in the activity that has been prohibited by an agreement in a restraint of trade.”<sup>41</sup>

Another example where the court had to deal with the abuse of a corporate structure is the case of *Airport Cold Storage (Pty) Limited v Ebrahim and Others*<sup>42</sup>. The facts of the case are as follows:

Airport Cold Storage was a company that traded in meat products and frozen vegetables. They provided an account basis to a close corporation that traded as Global foods. This corporation was placed under provisional liquidation and owed the company a large sum of money. After the company was unable to prove their claim they sought to pierce the corporate veil and hold the parties personally liable for the debt.

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<sup>37</sup> *Amlin Pty Ltd v Van Kooij* (note 18 above).

<sup>38</sup> M Henkeman “Piercing the Corporate Veil” Schoeman Tshaka Attorneys available at <http://www.polity.org.za/article/piercing-the-corporate-veil-2014-04-10>, accessed on 17 April 2014.

<sup>39</sup> *Die Dros (PTY) Ltd and Another v Telefon Beverages cc and Others* (3413/02) [2002] ZAWCHC .

<sup>40</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others* (note 30 above).

<sup>41</sup> *Die Dros (PTY) Ltd and Another v Telefon Beverages cc and Others* (note 39 above) Para 24.

<sup>42</sup> *Airport Cold Storage (Pty) Limited v Ebrahim and Others* (note 11 above).

Turning to the subject of piercing the corporate veil, the court held that it possesses no general discretion to simply disregard the existence of the separate corporate identity whenever it deems it just to do so. However, they acknowledged that this would be the case, –only where special circumstances exist indicating that it is a mere façade concealing the true facts.”<sup>43</sup> The court cited fraud as a special circumstance as well as not treating the entity as a separate identity.

The court held that the parties did not manage the corporation as a separate juristic entity and in fact on numerous occasions did not treat the corporation as a separate identity. They further did not comply with the statutory requirements necessary in order to operate a corporation and in fact were found to have traded recklessly. There had been gross abuse of the juristic personality of the corporation. The court found the defendants jointly and severally liable for the debt incurred by the close corporation.

According to Cassim<sup>44</sup> it is best that we do not have a categorising approach:

–The rejection of a categorising approach is commendable because categorising could lead to uncertainty in our law 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.”<sup>45</sup>

A complete codification of rules generally leads to inflexibility in the law. Courts will not be permitted to develop new categories and principles so that veil piercing doctrine will not be able to develop further. Cassim<sup>46</sup> further discusses that the overlapping of categories could easily occur given the various types of circumstances that could arise in a particular case. Furthermore, in the interest of justice a matter could urgently require the corporate identity to be pierced. However, if no correlating category exists for the piercing of the veil in that particular instance then the court will not be permitted to do so.

It is submitted that a partial codification of the categorising approach is advisable given the importance of the veil piercing doctrine. This would allow for the further

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<sup>43</sup> Ibid 25.

<sup>44</sup> FH Cassim et al. (note 14 above) 43.

<sup>45</sup> FH Cassim et al. (note 14 above) 43.

<sup>46</sup> FH Cassim et al. (note 14 above) 43.

development of the law and provide for a basis from which the courts could work from.

The courts have not followed consistent principles with its determination of whether or not to pierce the corporate veil. The result is that the common law has not reached a position whereby there is a certainty that the courts will adopt the veil piercing doctrine. It is clear from the common law approach that the veil piercing doctrine is an exceptional remedy to be used as a last resort and that compelling reasons must exist before the corporate veil will be pierced.

This was re-iterated in the case of *Amlin (SA) Pty Ltd v Van Kooij*<sup>47</sup> where the court stated that:

—piercing the veil is a drastic remedy. It therefore should be resorted to sparingly and as a measure of last resort, in circumstances where justice will not otherwise be done between two litigants.<sup>48</sup>

### **3.3 The Legislative Framework**

Throughout the years legislatures have attempted to provide statutory guidelines for the veil piercing doctrine in order to create a more concrete and visible rule of law. This was evident with the introduction of the 1973 Act and the CC Act.

The development of these statutory guidelines has culminated in the codification of the veil piercing doctrine for the first time in South African company law in Section 20(9) of the 2008 Act. The 2008 Act has adopted the common law doctrine of piercing the corporate veil. Statutory provisions and guidelines for the veil piercing doctrine clearly demonstrate that the separate legal personality of a juristic entity is not absolute.

#### **3.3.1 Companies Act 61 of 1973**

It is important to note that a fundamental aspect of corporate legislation is that of the transparency of the internal happenings of the company. This is evident in various

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<sup>47</sup> *Amlin (SA) Pty Ltd v Van Kooij* (note 18 above).

<sup>48</sup> *Amlin (SA) Pty Ltd v Van Kooij* (note 18 above) Para 23.

sections of the 1973 Act such as the requirement that the articles of association of the company be placed with the Registrar of Companies and the disclosure of the financial position of the company in its annual audited accounts.

Transparency is further enhanced by the legislatures providing statutory guidelines for the veil piercing doctrine in the text of the 1973 Act.

An important provision that has been repealed by the 2008 Act is Section 424 of the 1973 Act. However this section may still find application if it falls within the transitional provisions provided for in Schedule 5 of the 2008 Act. Section 424 is titled “~~Liability of directors and others for fraudulent conduct of business~~”. This provision is drafted in extremely wide terms.

Section 424(1) reads as follows:

~~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 all or any of the debts or other liabilities of the company as the Court may direct.”~~

This section was available to the unpaid creditors of a company against any person that conducted ~~reckless trading~~” or acted in a manner with ~~intent to defraud its creditors~~”. The principle elements were ~~reckless trading~~” or ~~intent to defraud~~”.

A causal link had to be proved between the element of the action of the reckless conduct and the loss suffered by the creditors. Further to this, the person that acted in this manner had to ~~knowingly be a party~~” to the action. This entailed an element of intent required on the part of this person.

In the case of *Philotex (Pty) Ltd and others v Snyman and others*<sup>49</sup> the court had no problem with finding the directors of the company personally responsible for the repayment of the company’s debts. The court ruled that:

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<sup>49</sup> *Philotex (Pty) Ltd and others v Snyman and others* [1998] (2) SA 138 (SCA).

—a director who trades "recklessly" is one who permits the company to continue to trade where there is no reasonable prospect of payment of creditors' debts."<sup>50</sup>

This case created the precedent that a director who allows a company to trade whilst knowing that the company will not be able to pay its creditors may be held personally liable for all the debts of the company.

In the case of *Fourie NO and others v Newton*<sup>51</sup> the appellants were liquidators of a company and they sought to hold the respondent personally liable for the debts of the company under Section 424 of the 2008 Act. It was discussed how the test for recklessness has both a subjective and objective element. It was held that:

—Acting "recklessly" consists in a failure to give consideration to the consequences of one's actions, or in an attitude of reckless disregard of such consequences."<sup>52</sup>

The court was unable to find the respondent personally liable according to the statutory test. This case demonstrates the difficulty in convincing a court to apply Section 424(1).

### **3.3.2 Close Corporation Act 69 of 1984**

The legislatures attempted to provide further codified guidelines for piercing the corporate veil in the CC Act. A few important provisions are set out hereunder:

Section 26 of the CC Act has been substituted by section 224(2) of the 2008 Act. This section applied to the deregistration of a close corporation. Section 26(5) read as follows:

—If a corporation is deregistered while having outstanding liabilities, the persons who are members of such corporation at the time of deregistration shall be jointly and severally liable for such liabilities".

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<sup>50</sup> Ibid.

<sup>51</sup> *Fourie NO and others v Newton* [2011] 2 All SA 265 (SCA).

<sup>52</sup> Ibid Para 29.

This section provided for the liability of the members of the close corporation for any outstanding debt that the close corporation may have following its deregistration. Although this provision was not directly a veil piercing provision as the close corporation would no longer exist due to its de-registration, it nevertheless allowed for the liability of the members for any outstanding debt.

Section 43 is titled “Liability of members for negligence”, paragraph 1 states as follows:

“A member of a corporation shall be liable to the corporation for loss caused by his or her failure in the carrying on of the business of the corporation to act with the degree of care and skill that may reasonably be expected from a person of his or her knowledge and experience.”

According to this section if a member acted negligently and due to this negligence the close corporation suffered a loss, the member could be held personally liable by the close corporation for any damages that the close corporation had suffered because of such negligence. The member would be deemed to have acted negligently if he or she did not act with the degree of care and skill that may be reasonably expected from a person with his or her knowledge and experience.

Section 63 is titled “Joint liability for debts of corporation” provides for circumstances as per paragraph (a) – (h) whereby if the members of the corporation have abused their position they will be held jointly and severally liable for the debts of the corporation.

Section 64 has been substituted by section 224(2) of the 2008 Act. This section was titled “Liability for reckless or fraudulent carrying-on of business of Corporation” Section 64(1) read as follows: -

“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.”

In the case *Ebrahim v Airports Cold Storage (Pty) Limited*<sup>53</sup> the application of Section 64 was dealt with. Cameron JA explained the principle of “recklessly” as follows:

“Acting ‘recklessly’ 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’. In applying the recklessness test to the running of a close corporation, the Court should have 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>54</sup>.

The labour court case of *Zeman v Quickelberge and Another*<sup>55</sup> provides further illustration of the application of section 64. In this case the issue under review was that the respondent had made a disposition without value. The court had to determine if the sale was concluded with a fraudulent purpose which amounted to an abuse of the corporate personality. The court gave an insightful definition of lifting the corporate veil:

“Lifting the corporate veil means disregarding the dichotomy between a company and a natural person behind it and attributing liability to that person where he has misused or abused the principle of corporate personality.”<sup>56</sup>

The court discussed further that as a general rule there needs to be an element of fraud or other improper conduct. Reference was made to the case of *Botha v Van Niekerk*<sup>57</sup> which required the element of “unconscionable injustice”. This test was regarded as being far too rigid when determining the application of piercing of the corporate veil. The causal link was established and the application of section 64 was confirmed.

Section 65 titled “Powers of Court in case of abuse of separate juristic personality of Corporation”, permits a court to deem a close corporation not to be a juristic person.

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<sup>53</sup> *Ebrahim v Airports Cold Storage (Pty) Limited* (note 11 above).

<sup>54</sup> *Ebrahim v Airports Cold Storage (Pty) Limited* (note 11 above) Para 14.

<sup>55</sup> *Zeman v Quickelberge and Another* (C45/2010) [2010] ZALC 122; 2011) 32 ILJ 453 (LC).

<sup>56</sup> *Ibid* Para 41.

<sup>57</sup> *Botha v Van Niekerk en ‘n Ander* (note 28 above).

It reads as follows:

–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 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.”

This section therefore provides that if an act by a close corporation constitutes a gross abuse of its juristic personality, an interested person can approach the court to invoke Section 65. The court can declare that the corporation is deemed not to be a juristic person and can issue a further order to give effect to that declaration, such as that its members are personally liable for its debts.

There are numerous cases illustrating the application of Section 65. In the case of *Haygro Catering BK v Van der Merwe*<sup>58</sup> the name of the close corporation had not been displayed on the close corporation’s business premises, correspondence and other applicable documents. This was in contravention of Section 23 of the CC Act. The court found that this failure amounted to a gross abuse of the separate juristic personality of the corporation as contained in Section 65.

In the case of *TJ Jonck BJ h/a Bothaville Vleismark v Du plessis*<sup>59</sup> a member of a close corporation made loans to the corporation having full knowledge that the business was in fact insolvent. As security for his loans he authorised the registering of a notarial bond over the movable property of the close corporation. He then proceeded to obtain an order entitling him to take possession of the movable property.

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<sup>58</sup> *Haygro Catering BK v Van der Merwe* 1996 (4) SA 1063 (c).

<sup>59</sup> *TJ Jonck BJ h/a Bothaville Vleismark v Du plessis* NO 1998 (1) SA 971 (O).



His motive was to acquire ownership of the business assets in his name thereby preventing the business creditors from proving any claim. He continued to conduct business as usual under a new name, from the same premises and using the same equipment and stock that previously belonged to the corporation. The court found that the member was personally liable for the debts in terms of Section 64 of the CC Act, which deemed the member to have carried on business “recklessly, with gross negligence or for any fraudulent purposes”.

The court went further and held that the plaintiff could also succeed in terms of Section 65 of the CC Act as the member’s actions had constituted a gross abuse of the juristic personality of the close corporation.

The most recently reported judgement on piercing the corporate veil is the High Court case of *Basfour 121 CC v M & R Interior Concepts*<sup>60</sup>. In this case the close corporation, who operated as a building company, had agreed to carry out alterations and renovations to the plaintiff’s property. The plaintiff had already paid the close corporation R3 million for the repair work. The corporation failed to do the repair work as agreed and eventually abandoned the building site.

The plaintiff instituted a claim for damages of R2 million due to the breach of contract. However, by this time the close corporation had become insolvent. The plaintiff therefore applied to the court to have the individual members of the close corporation deemed to be personally liable for the damages sustained<sup>61</sup>.

The court found in favour of the plaintiff and declared that in terms of section 65 of the CC Act that the close corporation was deemed not to be a juristic person thereby holding the defendants jointly and severally liable for the damages incurred.

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<sup>60</sup> *Basfour 121 CC v M & R Interior Concepts* [2015] ZAWCHC 44.

<sup>61</sup> Unknown “The art of law – piercing the corporate veil now depends on a value judgment by the court” Roodt Inc Attorneys available at <http://www.roodtinc.com/newsletter174.asp>, accessed on 10 May 2015.

### 3.3.3 *Companies Act 71 of 2008*

The commencement of the 2008 Act saw the introduction of a statutory provision for the first time in South African corporate law that permits the piercing of the corporate veil of a juristic entity.

Section 20(9) of the 2008 Act reads as follows:

~~If~~, 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
- (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).”

This section gives a court the general statutory discretion to disregard the separate legal personality of a company and to pierce the corporate veil on application by an ~~interested person~~” in instances where there has been an ~~unconscionable abuse~~” of the juristic personality of the company as a separate entity. However, the 2008 Act has failed to define the terms ~~interested person~~” and ~~unconscionable abuse~~” and have not provided any guidance as to what circumstances and facts will constitute ~~unconscionable abuse~~”. It appears as though it has been left to the discretion of the courts to provide clarity and direction on the meaning and scope of these wide terms.

It was submitted in an article by Cassim<sup>62</sup> that Section 20(9) of the 2008 Act contained uncertainties regarding its interpretation and scope. The following uncertainties were highlighted in this article:- the meaning of the term unconscionable abuse; whether Section 20(9) overrides the common law instances

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<sup>62</sup> R. Cassim, ~~Piercing the Corporate Veil: Unconscionable abuse under the Companies Act 71 of 2008~~” *De Rebus* (2012) 2.

of piercing the corporate veil; whether piercing of the veil is still to be regarded as an exceptional remedy that may be used only as a last resort; and who an ‘interested person’ would be under Section 20(9).

No corresponding provisions exist for Section 20(9) of the 2008 Act in the 1973 Act. However, when compared to the CC Act, in particular Section 65, it appears as though it has been drafted verbatim<sup>63</sup>. The difference between the provisions of the CC Act and the 2008 Act is the element of abuse required to be proved. The CC Act requires the element of “gross abuse” to be proved and the 2008 Act requires a lower standard of abuse, being “unconscionable abuse”.

The test for piercing the corporate veil as set out in section 20(9) of the 2008 Act focuses only on the abuse of the juristic personality of the company as a separate entity and on whether this abuse constitutes unconscionable abuse.

The term “interested person” in section 20(9) of the 2008 Act bears a similarity to the contents of section 65 of the CC Act. The court in the case of *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO en ‘n Ander*<sup>64</sup> examined the meaning of the phrase “any interested person” in the context of section 65 of the CC Act. The court came to the conclusion that this interest is limited to a financial interest or monetary interest such as that held by a creditor. Therefore, a creditor could be deemed as being an interested person who could bring an application in terms of Section 20(9) of the 2008 Act<sup>65</sup>.

The first case that dealt with the application of Section 20(9) of the 2008 Act is the Western Cape High Court case of *Ex parte Stephen Malcolm Gore NO and 37 others NO*<sup>66</sup>.

This case dealt with the interpretation and scope of Section 20(9) and its application to the facts of the case. The court had to decide if it should pierce the corporate veil of a group of companies that consisted of one holding company and various subsidiary

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<sup>63</sup> FH Cassim et al. (note 14 above) 57.

<sup>64</sup> *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO en ‘n Ander* (note 59 above).

<sup>65</sup> FH Cassim et al. (note 14 above) 59.

<sup>66</sup> *Ex parte Stephen Malcolm Gore NO and 37 others NO* (2013) 2 All SA 437 (WCC).

companies in circumstances where there had been a blatant disregard for the entity's individual existence.

The applicants in this matter were the liquidators of 41 companies that formed part of a group of companies called ~~the~~ "the King Group". The three King Brothers were directors and majority shareholders of the holding company known as King Financial Holdings Limited (KFH) and most of its subsidiary companies.

The order that the liquidators sought was an order where the separate personality of some of the subsidiary companies would be disregarded in order for their residual assets to be treated as the assets of the holding company which was also in liquidation. The purpose of this event would ensure that the investor's claims could be paid.

The basis for this application was that the liquidators claimed that the controllers of the various companies had treated the group of companies in such a manner that they could not establish which corporate entities the investors and creditors could prove their claims from. The group's business operations were conducted with a complete disregard for the distinguishing identities of the different business entities.

The liquidators made an application to the court under the common law alternatively in terms of section 20(9) to pierce the corporate veil of the subsidiary companies.

The liquidators were deemed to be ~~interested~~ "interested persons" as they had a direct and valid interest in the matter and the relief that they sought. It is submitted that Section 65 of the CC Act coupled with the case of *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO en 'n Ander*<sup>67</sup> provided authority for the interpretation of ~~interested~~ "interested persons" contained in Section 20(9) of the 2008 Act.

The court in *Ex parte Stephen Malcolm Gore NO*<sup>68</sup> had no hesitation in finding that the King Group had indeed operated their business activities as if they were trading under one holding company. A clear example was that investor's funds had been

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<sup>67</sup> *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO en 'n Ander* (note 59 above).

<sup>68</sup> *Ex parte Stephen Malcolm Gore NO* (note 66 above).

transferred by the controllers of the holding company between the various companies with no regard for the actual identity of each individual company involved. Such funds were allocated by the controllers into whichever company they deemed fit. Further to this, no proper accounting records were kept and maintained.

The court made the order in terms of Section 20(9) and declared that the subsidiary companies were deemed to not be juristic persons as there had been an ~~un~~conscionable abuse” of their separate identity.

The court referred to a variety of sources in its judgement such as case law both locally and abroad as well as articles and scholar’s such as Cassim<sup>69</sup>. It appears from this judgement that a wide interpretation of the words ~~un~~conscionable abuse” was adopted by the court. This case also set a lower standard of abuse as what is required under Section 65 of the CC Act. Section 65 of the CC Act uses the term ~~Gross Abuse~~” whilst Section 20(9) of the 2008 Act only requires ~~un~~conscionable abuse”.

The court also dealt with the question of whether Section 20(9) overrides the common law doctrine of piercing the corporate veil. It was explained that this section was supplementary not substitutive and therefore does not override the common law doctrine. The court stated further that the common law doctrine would be used as a tool for guidance when interpreting this section.

This court case is extremely important in the context of the topic of piercing the corporate veil. This notorious remedy that has been inconsistently applied throughout the years by our courts has finally received a thorough analysis. In addition the case of *Ex parte Stephen Malcolm Gore NO and 37 others NO*<sup>70</sup> has now dealt with the interpretation and application of Section 20(9) of the 2008 Act for the first time.

It appears quite clear that the legal basis upon which the courts are prepared to pierce the corporate veil under the common law have now been extended under Section 20(9) of the 2008 Act. This provision introduces a new direction to the remedy of piercing the corporate veil. Further, the common law principles of piercing the veil

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<sup>69</sup> FH Cassim et al. (note 14 above).

<sup>70</sup> *Ex parte Stephen Malcolm Gore NO and 37 others NO* (note 66 above).

have not been replaced with this section, but still serve as an important and useful guideline when interpreting prevailing legislation. Judging by the case of *Ex parte Stephen Malcolm Gore NO and 37 others NO*<sup>71</sup> this new statutory remedy could possibly see this previously vexatious topic as being more successfully dealt with in the future.

### ***3.4 The Distinction between Piercing the Veil and Lifting the Veil***

Although the courts sometimes do not differentiate between the concepts of “piercing the veil” and “lifting the veil”, a distinction does exist. When the courts pierce the corporate veil of an entity they are metaphorically removing the protective curtain between the juristic entity and its members. The corporation’s actions and or liabilities are then treated as if they were the member’s actions and or liabilities.

In contrast the phrase “lifting the corporate veil” means that the courts are looking behind the metaphorical curtain and taking into account the identity of the members of the corporation. It does not necessarily mean that they are treating the corporation’s actions and or liabilities as those of its members.

Judge Staughton in the case of *Atlas Maritime Co SA -v- Avalon Maritime Ltd (the Coral Rose)*<sup>72</sup>, discussed the distinction:-

—Like all metaphors, this phrase (Piercing the corporate veil) can sometimes obscure reasoning rather than elucidate it. There are, I think, two senses in which it is used, which need to be distinguished. 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. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose”.<sup>73</sup>

Similarly in the case of *Pioneer Concrete Services Ltd v Yelnah Pty Ltd*<sup>74</sup> the court commented on its ability to sometimes “look behind the legal personality to the real controllers.”<sup>75</sup>

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<sup>71</sup> *Ex parte Stephen Malcolm Gore NO and 37 others NO* (note 66 above).

<sup>72</sup> *Atlas Maritime Co SA -v- Avalon Maritime Ltd (the Coral Rose)* (No 1); CA 1991.

<sup>73</sup> *Ibid* 779.

<sup>74</sup> *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (1986) 5 NSWLR.

<sup>75</sup> *Ibid* 264.

In the labour court of South Africa in the case of *Zeman v Quickelberge and Another*<sup>76</sup>, acting Judge 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>77</sup>

There is a distinction between the topics of “Piercing the corporate veil” and “Lifting the corporate veil” although it is not always emphasised as such.

## CONCLUSION

Having seen the nature and extent of the doctrine of lifting or piercing the corporate veil in South African law, it may be concluded that there is no reason why, under the appropriate circumstances, SARS cannot employ this doctrine to, for example, hold the members of a close corporation liable for the tax debts of that corporation. However, the particular circumstances necessary for the operation of the doctrine, at either common law or in terms of statute, as outlined above, would have to be present before the doctrine operated. This might serve to limit the circumstances in which SARS may be successful. It is thus necessary to broaden the enquiry, to examine how tax legislation deals with this issue, and it is this discussion to which we now turn.

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<sup>76</sup> *Zeman v Quickelberge and Another* (C45/2010) [2010] ZALC 122; 2011) 32 ILJ 453 (LC).

<sup>77</sup> *Ibid* Para 54.

## **CHAPTER 4**

### **4. TAXATION**

Before one can embark on an examination of the specific provisions in tax law that permit SARS to ‘lift or pierce the corporate veil’ it is necessary to examine the background to the taxation system in South Africa. This chapter shall contain a brief overview of how CC’s are taxed and the legislative framework governing tax administration in South Africa.

#### ***4.1 Taxation in South Africa***

In 1789 Benjamin Franklin wrote, “In this world nothing can be said to be certain, except death and taxes.”<sup>78</sup> Finance for public expenditure is largely reliant on taxation. Taxes are a compulsory transfer of finance from individuals or business entities to a country’s government. If individuals or business entities receive revenue in a particular country they have to pay taxes to that country’s government. It is compulsory and legally enforceable to pay taxes.

Tax systems evolve through time and new taxes are introduced and others are amended. A good tax system is primarily based on the premise that it must generate sufficient revenue to finance the government’s budget expenditure. A good tax system must also comply with the concepts of equity, economic efficiency, administrative efficiency and flexibility<sup>79</sup>.

South Africa has a well-developed and regulated taxation regime with laws that are constantly being revised and amended to keep them relevant. The tax regime is set by the National Treasury and enforced by the South African Revenue Service (hereinafter referred to as SARS). SARS is headed by the Commissioner for the South African Revenue Service (hereinafter referred to as the Commissioner). SARS is created by the South African Revenue Service Act 34 of 1997 and is an autonomous organ of the state operating outside of the public service, but within the public administration. Therefore, South Africa’s tax regime is set by the National Treasury and is managed by SARS. SARS is also responsible for the collection of

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<sup>78</sup> JM Cohen *The Penguin Dictionary of Quotations* (1960).

<sup>79</sup> Black, Calitz & Steenekamp *Public Economics* 6 ed (2015) 215.



taxes. The Minister of Finance presents a Budget annually which outlines the total government expenditure for the following financial year and the manner in which this expenditure will be financed<sup>80</sup>.

South Africa has a progressive income taxation system which is based on the system that the wealthy should contribute a greater portion than those of lower income groups. This means that the more a person earns the higher percentage tax they ultimately end up paying<sup>81</sup>. The tax equity principle was explained best by the United Nations author Mr Adam Smith in *–The Wealth of Nations*<sup>82</sup>. He stated that:

*–The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.*<sup>83</sup>

Taxes can be classified in many ways. South Africa uses the classification that conforms to the International Monetary Fund’s Government Finance Statistics Manual which was published in 2001. Tax revenue within South Africa is divided into six main categories: Taxes on income and profits; Taxes on payroll and workforce; Taxes on property; Domestic taxes on goods and services; Taxes on international trade and transactions; and Stamp duties and fees<sup>84</sup>. The six categories are further sub-divided into various types of taxes.

South Africa’s taxation system is determined by laws that are administered by the Commissioner. Important tax legislation in South Africa are but not limited to: the Income Tax Act 58 of 1962 (hereinafter referred to as the *–Income Tax Act*’); the Value Added Tax Act 89 of 1991 (hereinafter referred to as the *–Vat Act*’); the Customs and Excise Act 91 of 1964 (hereinafter referred to as the *–Customs Excise*

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<sup>80</sup> SARS *–SA’s Tax System*’ available at <http://www.sars.gov.za/About/SATaxSystem/Pages/default.aspx>, accessed on 12 July 2013.

<sup>81</sup> SARS *–SA’s Tax System*’ available at <http://www.sars.gov.za/About/SATaxSystem/Pages/default.aspx>, accessed on 12 July 2013.

<sup>82</sup> A Smith *The Wealth of Nations* (1776).

<sup>83</sup> A Smith (note 82 above) Ch 2.

<sup>84</sup> Black, Calitz & Steenekamp ( note 61 above) 211.

Act”); the Estate Duty Act 45 of 1955 (hereinafter referred to as the ~~Estate Duty Act~~); and the Tax Admin Act.

To determine what amount is taxable from a natural or juristic person’s gross income in South Africa the amount must be calculated using the gross income formulae. The definition of gross income can be found in Section 1 of the Income Tax Act.

Section 1 states that:

~~gross income~~”, in relation to any year or period of assessment, means—(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature.”

The terms contained in section 1 of the Income Tax Act are not defined. This has given rise to interpretive difficulties. There have been a variety of cases that have assisted with the interpretation of this section. *Lace Proprietary Mines Ltd v CIR*<sup>85</sup>, *Lategan v CIR*<sup>86</sup>, *CIR V Geldenhuys*<sup>87</sup> and *MP Finance Group V CSARS*<sup>88</sup> are examples of such landmark cases.

Case law plays an integral role in interpreting tax legislation in South Africa. Many provisions in the various tax acts are not defined or are simply unclear or ambiguous. Therefore, South Africa has an abundance of tax case law that forms an integral role within the field of tax law.

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<sup>85</sup> *Lace Proprietary Mines Ltd v CIR* 1983 ad 269.

<sup>86</sup> *Lategan v CIR* (1926) , CPD 203, 2 SATC 16.

<sup>87</sup> *CIR V Geldenhuys* 1947(3) SA256(C)14SATC 419.

<sup>88</sup> *MP Finance Group V CSARS* 2007 SCA 69 SATC 141.

## ***4.2 Taxation of Corporations***

The 2008 Act does not permit the registration of new close corporations. However, existing close corporations that have already been incorporated remain valid and still operate. Therefore, close corporations are subject to taxation as determined by the prevailing legislation.

A close corporation is a separate legal entity and must register for Income Tax and can register for Value Added tax. It must lodge tax returns timeously otherwise it will be deregistered by the CIPC<sup>89</sup>.

Close corporations in operation create revenue and are therefore subject to the Income Tax Act. A close corporation is defined in the Income Tax Act, Paragraph 1(f), as a company. Section 38 of the Income Tax Act is titled “Classification of companies”. Section 38(2)(b) of the Income Tax Act provides that a close corporation is regarded as being a private company for the purposes of taxation. The revenue derived from a close corporation is taxed at the same rate as a company which is 28%<sup>90</sup>.

Employees tax is payable for amounts paid to the directors of private companies. According to Section 1 of the Income Tax Act every person who is involved in the management of the close corporation is regarded as being a director for tax purposes. A close corporation is also a provisional tax payer as per the Fourth Schedule Paragraph 1(b) of the Income Tax Act.

The distribution of profits made by a corporation to its members is called dividends. Dividends are subject to dividends tax and exempt from normal tax as provided in Section 10(1)(k)(i). However, the close corporation is responsible for the withholding tax on the dividends.

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<sup>89</sup> N Prinsloo “Close corporations: An introduction” available at [https://www.findanaccountant.co.za/content\\_close-corporation](https://www.findanaccountant.co.za/content_close-corporation), accessed on 12 July 2013.

<sup>90</sup> M Stiglingh et al. *Silke: South African Income Tax* (2013) 492.

### ***4.3 The Tax Administration Act 28 of 2011***

The term “Tax Administration” refers to the process taken by an individual or entity to register for tax. This is then followed by the submission of tax returns, assessment of tax and consequential payment of the tax liability due<sup>91</sup>.

The Tax Administration of South Africa is regulated by legislation. Previously the provisions for tax administration were contained in various tax acts.

October 2012 saw the commencement of the highly anticipated Tax Admin Act. The purpose of the Act is to consolidate all tax legislation relating to the administration and enforcement of the various tax Acts into one single Act. The stated objectives of the Tax Admin Act are to achieve a balance between the powers and duties of SARS on the one hand and the rights and obligations of the taxpayer on the other hand. The Tax Admin Act calls for a transparent relationship between the SARS authorities and the taxpayer. The Tax Admin Act applies to everyone who is liable to pay tax whether personally or on behalf of another person. The introduction of the Tax Admin Act resulted in several provisions of the Income Tax Act being repealed and replaced by corresponding provisions in the Tax Admin Act. The Act aims to align the administration of the various tax Acts where practically possible<sup>92</sup>.

The Tax Admin Act contains a number of provisions already familiar to the taxpayer due to previous fiscal statutes. However, a number of provisions have also been modified and entirely new provisions have been introduced into the Act. These new provision include but are not limited to: criminal investigations, searches conducted without a warrant, SARS audit and feedback procedures, grounds of assessment, voluntary disclosure and the procedure for obtaining tax clearance certificates. It has been stated that when drafting the Tax Admin Act the Commissioner took into account the rights of the taxpayer and the 1996 Constitution.

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<sup>91</sup> M Stiglingh et al. (note 90 above) 1109.

<sup>92</sup> M Stiglingh et al. (note 90 above) 1109.

#### ***4.4 Dispute Resolution and the Legal framework for Taxation***

A taxpayer that feels unjustly aggrieved by a decision or assessment of SARS has various options of recourse at his or her disposal.

Should a taxpayer wish to dispute an assessment raised by SARS he or she can firstly request reasons for the assessment as contained in Rule 3 of the Rules of the Tax Court. Should the taxpayer accept the reasons furnished by SARS, then no further steps shall be taken. However, should the taxpayer not accept the reasons provided by SARS then he or she can lodge an objection in terms of Section 104 to 106 of the Tax Admin Act and as provided in Rule 4 of the Rules of the Tax Court. Should SARS allow the objection, then the assessment will be altered accordingly. However, should the objection be disallowed, then the taxpayer can appeal against the assessment in terms of Section 107 of the Tax Admin Act and as provided in Rule 6 of the Rules of the Tax Court<sup>93</sup>.

SARS and the taxpayer can mutually agree to attempt to resolve the dispute by means of Alternative Dispute Resolution as provided in Section 107(5) and (6) and also set out in Rule 7 of the Rules of the Tax Court. Alternatively, the taxpayer can approach the office of the Tax Ombudsman as provided for in Section 15 to 21 of the Tax Admin Act. The Tax Ombudsman is tasked with reviewing complaints by taxpayers in a fair and cost effective manner. SARS has indicated that the office of the Ombudsman will follow the same model as applied by the United Kingdom<sup>94</sup>.

Should either party wish to proceed to litigation they can either approach the Tax Board or the Tax Court as the court of the first instance. The Tax Board is provided for in Section 108 to 115 of the Tax Admin Act and Rule 8 of the Rules of the Tax Court. The Tax Board is regarded as an administrative tribunal and can only hear a dispute if the amount in dispute does not exceed R500 000.00. This amount is determined by the Minister by Public Notice under section 109(1)(a) of the Tax Admin Act.

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<sup>93</sup> M Stiglingh et al. (note 90 above) 1138.

<sup>94</sup> B Croome –“The Tax Administration Act and Taxpayers' Rights” available at <http://www.bericcroome.com/2013/02/the-tax-administration-act-and.html>, accessed on 12 October 2015.

Should the amount in dispute exceed R500 000.00 or should the taxpayer or SARS not be satisfied with the Tax Boards findings, they can have the matter heard in the Tax Court as provided in Section 116 to 132 of the Tax Admin Act. A decision by the Tax Court will be final and binding subject to the decision of either party to appeal to the Provincial Division of the High Court. Should an appeal be lodged against the decision of the High Court then the final appeal shall lie with the Supreme Court of Appeal<sup>95</sup>.

### CONCLUSION

With knowledge of the South African taxation system and how tax administration is regulated, an analysis and consideration of SARS ability to attach the tax liability of a CC to its members shall be undertaken. The specific provisions in tax law which may empower SARS to “lift or pierce the corporate veil” shall be discussed in the following chapter.

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<sup>95</sup> M Stiglingh et al. (note 90 above) 1142.

## **CHAPTER 5**

### **5. SOUTH AFRICAN REVENUE SERVICE-PIERCING THE CORPORATE VEIL**

This chapter will evaluate the efficacy of the lifting of the corporate veil doctrine in order for SARS to hold taxpayers standing behind the CC responsible for the tax debt of the CC. A discussion of the common law, corporate legislation and in particular the prevailing tax legislation will be undertaken. The purpose of which is to identify the various tools which SARS may employ in order to “pierce the corporate veil”.

#### ***5.1 SARS use of the Common Law to Pierce the Corporate Veil***

In terms of the common law there are numerous tax cases illustrating how a company is liable for its own tax debts. In the cases of *ITC 1611*<sup>96</sup>, *Hughes v Ridley*<sup>97</sup> and *Ochberg v Commissioner for Inland Revenue*<sup>98</sup> it was confirmed that the profits, losses, assets and liabilities of a company belong to the company<sup>99</sup>.

In *ITC 1611*<sup>100</sup> the court stated 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>101</sup>

In the case of *Ochberg v Commissioner of Inland Revenue*<sup>102</sup>, certain items had been included by the Commissioner in Ochberg’s taxable income for the year of assessment. These amounts represented the value of shares allotted to him by a company, profit accrued from the sale of certain lots and profit accrued from the sale of certain portions of property. The appellant contended that the decision was erroneous in law as none of the items under dispute constituted income as defined in the Income Tax Act.

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<sup>96</sup> *ITC 1611* 59 SATC 126.

<sup>97</sup> *Hughes v Ridley* 2010 (1) SA 381 KZP.

<sup>98</sup> *Ochberg v Commissioner for Inland Revenue* 1931 AD 215.

<sup>99</sup> Derek Brits “The Long Arm of the Tax Man” available at <https://www.legalex.co.za/articles/long-arm-tax-man>, accessed on 18 March 2014.

<sup>100</sup> *ITC 1611* (note 96 above).

<sup>101</sup> *ITC 1611* (note 96 above).

<sup>102</sup> *Ochberg v Commissioner of Inland Revenue* (note 98 above).

This case dealt with various legal principles, but for the purposes of this research we will focus only on the principles relating to the piercing of the corporate veil. In his judgement De Villiers CJ was of the view that the court should look to the substance of a transaction. He further 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."<sup>103</sup>

Traditionally, the common law notion of piercing the corporate veil is applied when the interests of creditors are balanced against the manner in which the directors, shareholders or members have conducted themselves in the running of the business entity. An important and surprisingly unreported tax case is the Gauteng Tax Court case of *CSARS v Metlika Trading Limited*<sup>104</sup>. The judgment did not lay down any new principles, however what is important is that the court based its ruling on general common-law principles<sup>105</sup>.

The case itself involved an interlocking of a web of companies and trusts established by a well-known entrepreneur, Mr David King. The taxability of profits made from the sale of shares in one of the companies, Specialised Outsourcing Ltd, was the subject of the dispute. Specialised Outsourcing Ltd was a subsidiary company of Ben Nevis Ltd which held 71% of its shares. Ben Nevis Ltd authorised Mr David King to sell all the Specialised Outsourcing Ltd shares that it held. Some of the proceeds from this sale were transferred directly to Mr David King's personal bank account which was used by him to purchase various assets<sup>106</sup>.

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<sup>103</sup> *Ochberg v Commissioner of Inland Revenue* (note 98 above) 99.

<sup>104</sup> *CSARS v Metlika Trading Limited* [2010] ZAGPPHC 17.

<sup>105</sup> Unknown –Piercing the Corporate Veil” PWC available at [https://www.saica.co.za/integritax/2013/2165. \\_\\_Piercing\\_the\\_corporate\\_veil.htm](https://www.saica.co.za/integritax/2013/2165. __Piercing_the_corporate_veil.htm), accessed on 12 March 2015.

<sup>106</sup> Unknown –Piercing the Corporate Veil” PWC available at [https://www.saica.co.za/integritax/2013/2165. \\_\\_Piercing\\_the\\_corporate\\_veil.htm](https://www.saica.co.za/integritax/2013/2165. __Piercing_the_corporate_veil.htm), accessed on 12 March 2015,



The taxability of the profits from the sale of the shares was assessed by SARS and various inquiries were made to Mr David King in this regard. This was preceded by SARS launching an investigation and an inquiry in terms of Section 74 C of the Income Tax Act into the affairs of Mr David King.

From the investigation it was concluded that Bermuda Trust which was in control of Ben Nevis Ltd had created a shelf company, called Metlika Trading Ltd, in the British Virgin Islands which would hold the proceeds of the Ben Nevis subsidiary companies. The result was that when SARS sought to tax the profits of the sale of the shares of Specialised Outsourcing Ltd, the “upboard was bare” as there were no funds to derive the tax from.

On the basis of its findings SARS issued assessments against Ben Nevis Ltd and sought an order to pierce the corporate veil or alternatively to rely on the common law principle, the *actio pauliana*. The *actio pauliana* is a Roman law remedy available when a debtor has disposed of his assets with the intent to defraud the creditor. The court made mention of this principle, but did not provide an in depth discussion.

The court applied the principles as laid down in the case of *Cape Pacific Ltd v Lubner Controlling Investments (Pty)Ltd*<sup>107</sup> whereby the court is empowered to pierce the corporate veil where there has been evidence of “fraud, dishonesty or other improper conduct”.

In his judgment, Ledwaba J held that:

“The transfer of assets of Ben Nevis to Metlika, on King’s instruction, on an urgent basis was in my view, to create a ‘blind alley’.”<sup>108</sup>

He held further that the documents:

“clearly show that the transfer of assets was to stop SARS from tracing and attaching assets of Ben Nevis for tax purposes.”<sup>109</sup>

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<sup>107</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty)Ltd* (note 30 above).

<sup>108</sup> *CSARS v Metlika Trading Limited* (note 104 above) Par 51.

The court concluded that:

—Metlika was based on a façade to hide the tax liability of Ben Nevis Ltd from SARS.”<sup>110</sup>

The court, using the common law principles held that the corporate veil of the company Metlika Trading Ltd should be pierced in order to enable SARS to attach its assets to satisfy the tax liability of another company, Ben Nevis Holdings Ltd<sup>111</sup>.

This judgment can be regarded as a considerable victory for SARS as it establishes not only a precedent going forward but also provides a clear indication of how the tax courts are approaching the topic of piercing the corporate veil using common law principles.

## ***5.2 SARS use of Statute to Pierce the Corporate Veil***

Courts are usually reluctant to lift the corporate veil of an entity and ignore its separate existence. However, in tax matters it appears as if this rule is flexible especially if there is a possibility that a tax evasion scheme has been implemented. Tax evasion can take a variety of forms. The reason for tax evasion schemes is that they entitle the taxpayer to either a reduction in their tax liability or alternatively result in no tax liability.

### ***5.2.1 Realisation Companies***

There are numerous tax cases dealing with the issue of the taxability of the transactions of realisation companies.

The concept of the realisation company was described best in the case of *Berea West Estates (Pty) Ltd v SIR*<sup>112</sup>. The court stated that:

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<sup>109</sup> *CSARS v Metlika Trading Limited* (note 104 above) Par 53.

<sup>110</sup> *CSARS v Metlika Trading Limited* (note 104 above) Par 61.

<sup>111</sup> Unknown “Piercing the Corporate Veil” PWC available at [https://www.saica.co.za/integritax/2013/2165.\\_Piercing\\_the\\_corporate\\_veil.htm](https://www.saica.co.za/integritax/2013/2165._Piercing_the_corporate_veil.htm), accessed on 12 March 2015.

<sup>112</sup> *Berea West Estates (Pty) Ltd v SIR* [1976] 38 SATC 43.

–A realisation company is formed for the purpose of facilitating a specific realisation of property and acts as a mechanism for carrying out the realisation function required by its shareholders.”<sup>113</sup>

The issue under dispute with realisation companies has been whether the proceeds derived from the sale of the particular asset under review constitutes gross income and thus taxable by SARS or whether the proceeds are not subject to tax as they constitute receipts or accruals of a capital nature. The definition of Gross income is contained in Section 1 of the Income Tax Act.

The intention of the taxpayer is the key factor in determining if a receipt or accrual is income or capital in nature. The taxpayer’s intention can therefore be regarded as either speculative or investment. A number of factors relating to intention can be considered when determining the nature of the proceeds.

In the case of *Elandsheuwel Farming (edms) Bpk v Sekretaris van Binnelandse Inkomste*<sup>114</sup> the test to determine intention was applied subjectively. In this case the concept of the realisation company was applied in conjunction with the lifting of the corporate veil principle. The taxpayer, a realisation company, owned farm land which it leased out to farmers. There was a change in the shareholding of the company and a decision was made to sell the land to the municipality. A profit was derived from the sale which led to the question of whether these proceeds were income or capital in the hands of the taxpayer. It was held that the intentions of the new shareholders must be attributed to the taxpayer. The court lifted the corporate veil of the realisation company and examined the new shareholders intentions to establish if there had been a change in the intention and subsequent “crossing of the rubicon”. The proceeds derived from the sale were deemed to be income in the hands of the taxpayer and thus taxable by SARS.

In the case of *ITC1406*<sup>115</sup> the court found that the lifting of the veil was not necessary as the change in shareholding had only amounted to 50% change in shareholding.

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<sup>113</sup> Ibid 59.

<sup>114</sup> *Elandsheuwel Farming (edms) Bpk v Sekretaris van Binnelandse inkomste* 39 SATC 163 (a) – 1978.

<sup>115</sup> *ITC1406* 48 SATC 12.

In both cases emphasis was placed on the intention of the shareholders of the company. This is a clear illustration of the application of the doctrine of lifting or piercing the corporate veil by SARS and the tax courts.

### ***5.2.2 Simulated Transactions***

Although not promoted by South African tax law, every person is entitled to arrange his or her affairs in a manner that reduces their tax burden. However, a thin line exists between the concepts of “tax planning and subsequent tax avoidance” and “tax evasion”. In the United Kingdom case of *IRC v Duke of Westminster*<sup>116</sup>, Lord Tomlin summarised the concept of tax planning as follows:

“every man is entitled, if he can, to order his affairs so that the tax attaching is less than it otherwise would be”.<sup>117</sup>

One of the most common forms of tax evasion schemes occurs when the parties that have entered into a contract attempt to disguise the true nature of their dealings in order to claim a tax benefit. Tax planning structures generally involve an interconnection of natural persons and legal entities. The question is when can SARS re-characterise contractual arrangements for taxation purposes?<sup>118</sup>

Tax evasion was dealt with previously in terms of section 103 of the Income Tax Act. Sections 80A to 80L titled “impermissible avoidance arrangement” have since been introduced into the Income Tax Act to act as a further safety net for SARS. These provisions enable the court to look to the substance of the transaction rather than its form. In particular, Section 80B(1)(a) to (e) allows the Commissioner to, for example disregard or combine any steps in the arrangement or deem different parties as one and the same person.

There are a variety of cases where the separate corporate personality of a company have been used to mask the true intentions of the parties to a sham or a simulated

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<sup>116</sup> *IRC v Duke of Westminster* (IRC 51 TLR 467).

<sup>117</sup> Ibid.

<sup>118</sup> Unknown “Anti Avoidance Disguised or Simulated Transactions” PWC, available at [https://www.saica.co.za/integritax/2009/1743\\_Disguised\\_or\\_simulated\\_transaction.ht](https://www.saica.co.za/integritax/2009/1743_Disguised_or_simulated_transaction.ht), accessed on 8 June 2014.

transaction in order to take advantage of tax laws in order to acquire tax benefits. The tax courts have shown little hesitation in lifting or piercing the corporate veil in these matters to determine the true intention of the parties to the transaction.

The grounds for the refusal of SARS to allow a tax benefit are based on the fact that the transaction in question has been disguised. Disguising a transaction reveals an element of dishonesty. The true transaction, once uncovered, does not allow for the tax benefit claimed, hence there has been an impermissible tax avoidance arrangement. In the case of *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd*<sup>119</sup> a “disguised transaction” was explained as follows:

—In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, inter parties, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax.”<sup>120</sup>

The tax case of *ERF 3183/1 Ladysmith (Pty) and Another v CIR*<sup>121</sup> is regarded as the leading case on the principles relating to simulated transactions. The parties were involved in disguised transactions and made use of a dormant subsidiary company and a holding company. In applying the Income Tax Act, in particular the anti-avoidance provision contained in section 103 of the Income Tax Act, the court lifted the corporate veil of the entities and looked at the true intention of the parties. It was held that the substance of an agreement reflected the true intention of the parties.

The decision in another tax case *Relier (Pty) Ltd v CIR*<sup>122</sup>, was based on the outcome of the same factual and legal issues that were considered in the case of *ERF 3183/1 Ladysmith (Pty) and Another v CIR*<sup>123</sup>. In both the case of *ERF 3183/1 Ladysmith*

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<sup>119</sup> *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* (1941) AD 369.

<sup>120</sup> *Ibid.*

<sup>121</sup> *ERF 3183/1 Ladysmith (Pty) and Another v CIR*, 58 SATC 229.

<sup>122</sup> *Relier (Pty) Ltd v CIR*, 60 SATC 1.

<sup>123</sup> *ERF 3183/1 Ladysmith (Pty) and Another v CIR* (note 121 above).

*(Pty) and Another v CIR*<sup>124</sup> and the case of *Relier (Pty) Ltd v CIR*<sup>125</sup> the question arose whether the separate corporate personality of that entity had been abused due to the entity claiming the tax benefit. Both courts did not hesitate to lift the corporate veil of the entity.

### **5.2.3 Appointment as an Agent of the Taxpayer**

Sections 95-101 of the Income Tax Act was titled ~~“Representative taxpayer”~~. Section 99 of the Income Tax Act gave the Commissioner a discretionary power to declare any person an agent of the taxpayer. This section therefore empowered the Commissioner to appoint any person such as employers, banks, members, shareholders, directors or retirement funds as being liable for the taxpayer’s tax debt<sup>126</sup>. The declaration as an agent of the taxpayer is termed the representative taxpayer. This section bares a striking resemblance to the veil piercing doctrine as should a juristic entity not be able to pay its tax liability; the Commissioner could appoint the member or shareholder as the agent of the taxpayer hence rendering them personally liable for the entities tax debt.

Section 99 states that:

~~“The Commissioner may, if he thinks necessary, declare any person to be the agent of any other person, and the person so declared an agent shall be the agent for the purposes of this Act and may be required to make payment of any tax, interest or penalty due from any moneys, including pensions, salary, wages or any other remuneration, which may be held by him for or due by him to the person whose agent he has been declared to be”.~~

The case of *Pestana v Nedbank Limited*<sup>127</sup> provides a practical example of the application of this section. In this case the bank of Mr Pestana was appointed as an agent by SARS as they were in possession of funds belonging to Mr Pestana.

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<sup>124</sup> *ERF 3183/1 Ladysmith (Pty) and Another v CIR* (note 121 above)

<sup>125</sup> *Relier (Pty) Ltd v CIR* (note 122 above).

<sup>126</sup> EN Sonnenbergs — “Appointment as Payment Agents” available at [https://www.saica.co.za/integritax/2011/2010.\\_Appointment\\_as\\_payment\\_agent.htm](https://www.saica.co.za/integritax/2011/2010._Appointment_as_payment_agent.htm), accessed on 5 July 2015.

<sup>127</sup> *Pestana v Nedbank Limited* 2008 (3) SA466 (W).

### ***5.2.4 Corporate Legislation***

As discussed previously, the veil piercing provisions contained in section 65 of the CC Act and Section 20(9) of the 2008 Act are also mechanisms that may be used effectively by SARS as supportive means to pierce the corporate veil of an entity to satisfy a tax debt.

### ***5.3 SARS use of the Tax Administration Act 28 of 2011 to Pierce the Corporate Veil***

As previously mentioned, tax administration in South Africa is primarily regulated by the Tax Admin Act. The Act has provided SARS with even further-reaching powers to enforce the collection of a corporation's tax debts by proceeding against its directors, members or shareholders.

The definition of a taxpayer is contained in Section 151 of the Tax Admin Act:

–a person chargeable to tax; a representative taxpayer; a withholding agent; a responsible third party and a person who is the subject of a request to provide information under an international agreement”.

#### ***5.3.1 Representative Taxpayer***

The definition of a taxpayer in section 151 of the Tax Admin Act contains the term –representative taxpayer”. The concept of the representative taxpayer first appeared in the Income Tax Act and the VAT Act. The Tax Admin Act has retained this concept and extended its application even further.

The representative taxpayer is contained in Chapter 10 Section 153 of the Tax Admin Act. Section 153 titled –Tax Liability and Payment” defines a Representative taxpayer as:

- (1) In this Act, a representative taxpayer means a person who is responsible for paying the tax liability of another person as an agent, other than as a withholding agent, and includes a person who-
- (a) is a representative taxpayer in terms of the Fourth Schedule to the Income Tax Act; or
  - (b) is a representative employer in terms of the Fourth Schedule to the Income Tax Act; or

(c) is a representative vendor in terms of section 46 of the Value-Added Tax Act”.

This provision provides that a representative taxpayer is:

~~a~~ person who is responsible for paying the tax liability of another person as an agent, other than a withholding agent”.

Every juristic person has to appoint a representative taxpayer, who can be liable for the tax liability of the taxpayer that he represents in his representative capacity as well as in his personal capacity. This concept bears a striking resemblance to the provision of personal security by one party for the debt of another in the form of a suretyship. Should the tax liability remain unpaid then the representative taxpayer becomes personally liable for the tax debt.

Chapter 10 of the Tax Admin Act is titled ~~tax liability and payment~~”. Section 154(1) sets out the tax liability of the representative taxpayer:

- ~~(a)~~ the income to which the representative taxpayer is entitled;
- (b) moneys to which the representative taxpayer is entitled or has the management or control;
- (c) transactions concluded by the representative taxpayer; and
- (d) anything else done by the representative taxpayer,

in such capacity as a representative taxpayer, such person is:

- (i) subject to the duties, responsibilities and liabilities of the taxpayer represented; entitled to any abatement, deduction, exemption, right to set off a loss, and other items that could be claimed by the person represented; and
- (ii) liable for the amount of tax specified by a tax Act.”

Section 155(1) governs the ~~personal liability of a representative taxpayer~~” and states that: -a representative taxpayer will be 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."

The corporation as the principle taxpayer is not relieved from its tax liability when SARS has determined that the representative taxpayer must pay any outstanding tax debt. Further to this, the representative taxpayer has the right to indemnity after paying the relevant tax debt<sup>128</sup>. A representative taxpayer may, however, be held personally liable for tax payable in a representative capacity if, while the tax debt remains unpaid:

~~a~~ representative taxpayer: alienates, charges, or disposes of amounts in respect of which the tax is chargeable; or disposes of or parts with funds or monies, which are or came into the possession of the representative taxpayer after the tax is payable, if the tax could legally have been paid from those funds or monies."

The Tax Admin Act makes it quite clear that every company must have an appointed representative taxpayer. The representative taxpayer of a company is known as the ~~public officer~~" of the company. Section 246 (1) of the Tax Admin Act titled ~~Public officers of companies~~" provides as follows:-

~~Every~~ company carrying on business or having an office in the Republic must at all times be represented by an individual residing in the Republic".

The Act further requires in Subsection 2(a) that the public officer must be: ~~a~~ senior official of the company that is approved by SARS".

Chapter 11 titled ~~Recovery of Tax~~" provides in Section 169 (2)(a) that:

~~a~~ tax debt due to SARS is recoverable by SARS under this Chapter, and Is recoverable from-

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<sup>128</sup> CD Hofmeyr ~~Persons liable for tax~~" SAICA available at [https://www.saica.co.za/integritax/2012/2106.\\_Persons\\_liable\\_for\\_tax.htm](https://www.saica.co.za/integritax/2012/2106._Persons_liable_for_tax.htm), accessed on 4 August 2015.

(a) in the case of a representative taxpayer who is not personally liable under section 155, any assets belonging to the person represented which are in the representative taxpayer's possession or under his or her management or control"

Prior to the introduction of the Tax Admin Act, if a juristic entity had an outstanding tax liability, SARS would issue letters of demand to the legal entities members, shareholders or directors. These letters would request the members, shareholders or directors to provide SARS with a reasonable explanation as to why they or another third party should not be held personally responsible for the entities tax debt. SARS would further state that if the requested explanation does not reach their offices within 21 business days, they would have no alternative but to come to the conclusion that they or the particular third party is personally liable for the outstanding tax debt. Furthermore, there would be no access to further legal remedies<sup>129</sup>.

Since the inception of the Tax Admin Act, SARS now issue letters of demand to the members, shareholders or directors of the juristic entity titled "Notice of Personal Liability of Representative Taxpayer". These letters allege the particular member, shareholder or director is the appointed representative taxpayer of the juristic entity as provided for in terms of section 153(1)(a), 153(1)(b) and 153(1)(c) of the Tax Admin Act<sup>130</sup>.

Consequently as the representative taxpayer the member, shareholder or director is subject to the duties, responsibilities and liabilities of the taxpayer whom they represent. They are also liable for any amount of tax that has not been paid by the legal entity. This onerous letter issued by SARS maintains that SARS can actually hold an individual such as the member, shareholder or director of the juristic entity personally liable for the entities tax debts.

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<sup>129</sup> D Brits –The Long Arm of the Tax Man” available at <https://www.legalex.co.za/articles/long-arm-tax-man>, accessed on 18 March 2014.

<sup>130</sup> CD Hofmeyr –Personal liability for tax debts” SAICA available at [https://www.saica.co.za/integritax/2012/2080.\\_Personal\\_liability\\_for\\_tax\\_debts.htm](https://www.saica.co.za/integritax/2012/2080._Personal_liability_for_tax_debts.htm), accessed on 2 July 2014.

### 5.3.2 *Responsible Third Parties*

The definition of a taxpayer contained in Section 151 of the Tax Admin Act, includes the phrase “A responsible third party”. The term “responsible third party” is defined in Section 158 as follows:

“responsible third party means a person who becomes otherwise liable for the tax liability of another person, other than as a representative taxpayer or as a withholding agent, whether in a personal or representative capacity”.

Such person can be a third party appointed by SARS to satisfy tax debts, a person involved in the financial management of a taxpayer, a shareholder of a company, a member of a close corporation, or a transferee or a person who assisted with the dissipation of assets.

The collection of the tax debt from the third party is contained in Sections 179 to 184 of the Tax Admin Act. These provisions empower SARS to collect and recover a taxpayer’s tax liability from third parties.

Without a doubt, the most far reaching provision contained in the Tax Admin Act that provides SARS with a surmountable amount of power to collect corporation’s tax debts is undoubtedly the provisions of Section 180 of the Tax Admin Act<sup>131</sup>. This Section provides 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”

When exactly a person is deemed to be “in control or is regularly involved in the management of the overall financial affairs” of the entity is a question of fact and one

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<sup>131</sup> CD Hofmeyr Available at [https://www.saica.co.za/integritax/2012/2080.\\_Personal\\_liability\\_for\\_tax\\_debts.htm](https://www.saica.co.za/integritax/2012/2080._Personal_liability_for_tax_debts.htm), accessed on 5 August 2015.

which will depend on the facts of the case under review<sup>132</sup>. The term control is defined in the International Financial Reporting Standards. These standards describe the term as “having the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities”. Control is presumed when for example a holding company obtains more than half of the voting rights of the corporation. The holding company in this position may be held liable for outstanding tax<sup>133</sup>.

It would seem that section 180 of the Tax Admin Act contemplates the establishment of a causal link between the person and the affairs of the company. In the absence of such a link, the person would not be liable under this section. The trigger for such personal liability will be the elements of negligence or fraud on the part of that person. This provision provides SARS with the exact same powers of recovery against the third party as it has against the taxpayer himself.

Shareholders of a company may also incur personal liability for a company's tax debts as contained in Section 181 of the Tax Admin Act. This provision titled, “liability of shareholders for tax debts” provides that:

“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 withholding agent, or a representative taxpayer, employer or vendor”.

Subsection (2) provides further that:

“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...”

It is submitted that it appears as though the Tax Admin Act has paved the way even further for SARS to target the directors, members or shareholders in their personal

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<sup>132</sup> CD Hofmeyr Available at [https://www.saica.co.za/integritax/2012/2080.\\_Personal\\_liability\\_for\\_tax\\_debts.htm](https://www.saica.co.za/integritax/2012/2080._Personal_liability_for_tax_debts.htm), accessed on 5 August 2015.

<sup>133</sup> Derek Brits “The Long Arm of the Tax Man” available at <https://www.legalex.co.za/articles/long-arm-tax-man>, accessed on 18 March 2014.

capacity for the tax debts of the juristic entity. It can be concluded from these provisions that the Tax Admin Act contemplates and seems to facilitate the piercing of the corporate veil in certain circumstances without explicitly saying so.

### CONCLUSION

The courts findings in *CSARS v Metlika Trading Limited*<sup>134</sup> confirm that SARS was able to pierce the corporate veil of a company in order to satisfy the payment of tax debts in terms of the common law principles. The introduction of the Tax Admin Act and the 2008 Act have provided SARS with even further reaching powers to attach the tax liability of a corporation to its members. It appears as though SARS is now able to elect which method to employ in order to pierce the corporate veil of a CC. In view of the findings and in order to broaden the enquiry a comparative analysis of other jurisdictions shall follow.

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<sup>134</sup> *CSARS v Metlika Trading Limited* (note 104 above) Par 61.

## **CHAPTER 6**

### **6. A COMPARATIVE ANALYSIS**

The approach of tax authorities in other jurisdictions with regards to the veil piercing doctrine shall be considered. This chapter will consider the approach followed in a variety of countries in order to establish whether the South African tax authorities are aligning with international practices.

#### ***6.1 A Comparative Analysis of South Africa, United Kingdom and the United States of America with Piercing the Corporate Veil in Tax matters***

The doctrine of piercing the corporate veil and in particular veil piercing in tax matters have been increasingly applied by the courts and revenue authorities globally.

The taxation authority in the United Kingdom is the HM Revenue and Customs (hereinafter referred to as the HMRC). The HMRC reports to Parliament through the Treasury minister who oversees the finances within the country. A policy partnership exists between the HMRC and the treasury whereby the treasury controls strategic tax policy and policy development, and the HMRC controls policy maintenance and implementation<sup>135</sup>.

Statutory exceptions enacted by Parliament with regards to the separate legal personality of a juristic entity that have been codified in the United Kingdom include but is not limited to: Failure to obtain a trading license as contained in Section 767(3) of the Companies Act 2006; Failure to use the company's name as contained in Section 349(4) of the CA 1985; Disqualified directors as contained under Section 15 of the Company Directors Disqualification Act 1986; Just and equitable winding under Section 122(1)(g) of the Insolvency Act 1986 and Fraudulent trading under Section 213 of the Insolvency Act of 1986.

In the 2010 Supreme Court case of *Holland v The Commissioners for Her Majesty's Revenue and Customs and another*<sup>136</sup>, the issue under review was whether a director

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<sup>135</sup> Unknown — Government UK HMRC” <https://www.gov.uk/government/organisations/hm-revenue-customs/about>, accessed on 24 May 2014.

<sup>136</sup> *Holland v The Commissioners for Her Majesty's Revenue and Customs and another* [2010] UKSC 51.

could be deemed a *de facto* director of a company that had made unlawful dividend payments.

In this case Mr and Mrs Holland ran a business administering the business and tax affairs of contractors. The Holland's set up various trading companies for each business in a manner whereby they would be subject to lower tax rates. They further incorporated two other companies to act as the sole director and secretary of each trading company. The Holland's were the directors of these two companies and also owned each trading company via another company. The trading companies became insolvent and HMRC pursued Mr Holland as a *de facto* director.

The Supreme Court rejected the appeal lodged by HMRC. In giving his judgment Lord Hope found that Mr Holland could not be declared a *de facto* director as Mr Holland and the companies were in law separate personalities. Mr Holland was found to have acted within his role as the director of a sole corporate director. It was submitted that if a director acted within the ambit of his duties and responsibilities then he cannot be held personally liable for the entities debts. Parliament has not enacted a provision which provides for such personal liability. The court did not pierce the corporate veil in this instance.

In the United Kingdom the veil piercing doctrine is recognised. However, it is submitted that it is strictly applied in practice. Judicial precedents in the United Kingdom clearly show that this principle will not be implemented for the sole reason that justice permits it to do so. The courts require the element of fraud as a legitimate ground for applying the doctrine. The court looks to the form of a transaction and not the substance, unless there is conclusive evidence of fraud in which case the court will look to the substance of a transaction.

It would appear that the tax courts in South Africa will more readily pierce the corporate veil of an entity in comparison to the courts in the United Kingdom. The element of fraud appears to be the deciding factor for the United Kingdom courts to pursue the matter further and to look at the substance of a transaction rather than its form. The South African courts do not have to rely on any principle to lift the corporate veil of an entity to look at its substance rather than its form. Furthermore,

the common law doctrine has not been applied consistently by the South African courts resulting in the application of a variety of elements and principles. Corporate Statutes in South Africa have codified the elements of “Gross abuse” and “Unconscionable abuse” as principles that may allow for the piercing of the corporate veil.

In the United States of America taxation is imposed on both a federal level and a state level. Federal taxes and state taxes are completely separate and they even have a separate authority to charge taxes. In the United State of America each state has its own taxation system and within each state there are several jurisdictions that charge taxes. The United State of America’s taxation authority is the Internal Revenue Service (IRS). The Internal Revenue Code is the domestic portion of federal statutory tax law in the United States.

The veil piercing doctrine originated in the United States of America and therefore has common law roots. It is not uncommon in the United States of America for federal legislation to have provisions that will attach liability to the members of corporations for the acts of that company. This would normally be in instances where there would be a grave injustice should the company be regarded as a separate form. Each state within the United States of America develops its own set of elements that should be taken into account when determining if an entity should not be regarded as a separate persona. In the United States of America, the doctrine of piercing the corporate veil is called the “Corporate Personhood”.

A company’s separate legal identity independent from its members was established in the case of *Bank of Augusta v. Earle*<sup>137</sup>. Some authors have tried to codify the requirements for piercing of the veil and term it “the totality of circumstances rule”. Ultimately, it is the judge’s decision as each case is judged on its merits. The scope of abuse by the members of a company appears to be a deciding factor<sup>138</sup>.

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<sup>137</sup> *Bank of Augusta v. Earle* 38 U.S. 519 (1839).

<sup>138</sup> A Farat —“Lifting the Corporate Veil:” available at <http://www.commonlawreview.cz/lifting-the-corporate-veil-limited-liability-of-the-company-decision-makers-undermined-analysis-of-english-german-czech-and-polish-approach>, accessed on 15 August 2014.



Federal tax court decisions dealing with the piercing of the corporate veil have shown that the state must first look to property law concerning the alter ego, or as we know it the piercing of the veil, before it can establish if the liability is attached to the alter egos property<sup>139</sup>.

In the case of *G.M Leasing Corp v United States*<sup>140</sup> it was held that: “if an entity is a taxpayers alter ego then it is appropriate to regard all of the entity’s assets as that of the taxpayers property for tax collection purposes”. In *Towe Antizue Ford Found v Commissioner*<sup>141</sup> the court stated that:

“The alter ego doctrine often involves “piercing the corporate veil” to hold an individual or shareholder liable for the debts of a business entity, although “reverse piercing” may also be used to recover a taxpayer’s delinquent tax liability from his alter ego business entity. The alter ego doctrine therefore involves the imposition of liability on an entity by treating that entity as the taxpayer for tax collection purposes.”<sup>142</sup>

The United States of America derives its veil piercing powers from the federal common law. The courts also place a great emphasis on property law when dealing with the veil piercing doctrine. It is submitted that the courts in the United States of America are less hesitant to pierce the corporate veil of a juristic person than the courts in the United Kingdom. South Africa’s English law influence can be seen in corporate law in that extenuating circumstances must exist before the courts will permit the encroachment of the separate personality of a juristic entity. This however does not seem to be the position in tax cases.

Tax authorities in South Africa have aligned themselves to the same position that the United States of America follows. South Africa has well drafted tax statutes which provide that SARS may appoint other persons to be held liable for an entities tax debt. The tax courts have also clearly shown their flexibility with the veil piercing doctrine when the need calls for it.

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<sup>139</sup> New Jersey Law Journal “Tax Law” available at <http://www.scarincihollenbeck.com/wp-content/uploads/2012/01/Brunetti-IRS-Peircing-Corp-Veil2-6-121.pdf>, accessed on 6 October 2014.

<sup>140</sup> *G.M Leasing Corp v United States* 429 US 338351 (1977).

<sup>141</sup> *Towe Antizue Ford Found v Commissioner*, 999 F.2d 1387.

<sup>142</sup> Ibid.

## ***6.2 Case law on Piercing the Corporate Veil in Tax matters in the Philippines, India, Canada and China***

It is submitted that a common feature in most countries is that when there are elements of fraud or tax evasion, the courts do not hesitate in lifting or piercing the corporate veil in order to determine the true substance of the transaction or entity that is the object of the dispute. In particular, the tax authorities of countries generally show no hesitation in piercing the corporate veil of an entity in order to recover a tax debt and to attach the entities tax liability to its shareholders, members or directors.

In the republic of the Philippines the Supreme Court in the case of *Commissioner of Internal Revenue v. Menguito*<sup>143</sup> showed no hesitation in piercing the corporate veil. In this case a Sole Proprietor and corporation were treated as one taxable entity due to the manner in which the entities were managed. The court stated that:

—In a number of cases, the Court has shredded the veil of corporate identity and ruled that where a corporation is merely an adjunct, business conduit or alter ego of another corporation or when they practice fraud on our internal revenue laws, the fiction of their separate and distinct corporate identities shall be disregarded, and both entities treated as one taxable person, subject to assessment for the same taxable transaction.”<sup>144</sup>

The Supreme Court explained further that the doctrine of piercing the veil of entities would apply when the separate juristic personality of a corporation is used in a manner to perpetuate fraud on the countries internal-revenue laws. It was further submitted in this case that no hard and fast rules apply to veil piercing and that each case is judged on its merits.

Another important application of the principle of piercing the corporate veil in the Phillipines applies in instances of tax avoidance. The Supreme court has in a number of cases pierced the entities veil where corporate entities have been used as “~~dummy~~” to serve as shields for tax evasion<sup>145</sup>.

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<sup>143</sup> *Commissioner of Internal Revenue v. Menguito* (G.R. No. 167560, September 17, 2008).

<sup>144</sup> *Ibid* Par 28.

<sup>145</sup> SAD Tizon –Piercing the Corporate Veil for Tax Purposes” available at [www.bdbl.com.ph/index.php?option=com\\_dms&task=doc](http://www.bdbl.com.ph/index.php?option=com_dms&task=doc), accessed on 09 January 2014.

In India, the law is heavily influenced by English Law. The result is that the law in India bears a striking resemblance to the law in the United Kingdom. The Income Tax Act 1961 is the primary Act that regulates taxation in India. The government in India has recently introduced a draft statute called the Direct Tax Codes which is intended to replace the Income Tax Act 1961. The courts in India apply the doctrine of piercing the corporate veil. This is evident in a number of cases: *Sunil Siddharthbhai v CIT, Ahmedabad*<sup>146</sup>; *CIT v Sri Meenakshi Mills Ltd & ors*<sup>147</sup>; and *Life Insurance Corporation of India v Escorts Ltd*<sup>148</sup>.

The court in the tax case *Pravinbhai M Kheni v ACIT*<sup>149</sup> had commenced tax recovery procedures of a company. The tax authorities were unable to recover funds from the company. They therefore applied Section 179 of the Income Tax Act 1961 which enabled them to recover the tax debt from the director of the company. The court turned to the concept of piercing the corporate veil which it termed “cracking the corporate shell” and discussed how the courts would apply this principle in two instances. Firstly, when statute permits the encroachment and secondly:

—when due to glaring facts on record it is found that a complex web has been created only with a view to defraud the revenue interest of the State. If it is found that incorporation of an entity is only to create a smoke screen to defraud the revenue and shield the individuals who behind the corporate veil are the real operators of the company and beneficiaries of the fraud, the Courts have not hesitated in ignoring the corporate status and striking at the real beneficiaries of such complex design.”<sup>150</sup>

The court discussed the application of Section 179 of the Income Tax Act 1961 and deemed it to be “a statutory creation of piercing of the corporate veil”. The issue in dispute was discussed regarding the varying applications of this provision to private and public companies. The Honourable Gujarat High Court reiterated the fact that the corporate veil can be pierced by the tax authorities, particularly in cases where companies are used as tools to escape tax liabilities. The High Court in this case even placed the liability to pay taxes upon the directors of public limited companies<sup>151</sup>.

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<sup>146</sup> *Sunil Siddharthbhai v CIT, Ahmedabad* [1985].

<sup>147</sup> *CIT v Sri Meenakshi Mills Ltd & ors* [1967].

<sup>148</sup> *Life Insurance Corporation of India v Escorts Ltd* [1986].

<sup>149</sup> *Pravinbhai M Kheni v ACIT* [2012].

<sup>150</sup> *Ibid* Para 16.

<sup>151</sup> A Mangaldas —Recovery of Tax by Lifting the Corporate Veil” available at <http://www.inhouselawyer.co.uk/index.php/india/10077-recovery-of-tax-by-lifting-the-corporate-veil>, accessed on 2 July 2015.

In Canada, the basic rule is that veil piercing for taxation purposes is to be applied in exceptional circumstances only. Such an exception can be found in the landmark case of *Toronto (City) v Famous Players Canadian Corp*<sup>152</sup> and *Aluminum Co of Canada v Toronto (City)*<sup>152</sup>. This case involved the use of a subsidiary company and a holding company, which resulted in the income of the subsidiary company being included in the income of the holding company for taxation purposes. The court stated that: —in a way the subsidiary was a puppet in the hands of the parent company as it had no independent functioning of its own”. In the Canadian tax courts to justify the infringement on the legal personality of the corporation, there must be proof of fraud.

In China, as reported in the *China Tax News*<sup>153</sup>, the PRC tax authorities will pierce the corporate veil when recovering a tax liability. In this case, there was a transfer of shares from one company to another without informing the Chinese tax authorities of the substantial capital gain. Years later, the transaction was discovered by the Qinhuangda tax authorities, but at this point the company had already been de-registered in Hong Kong. The tax authorities approached Mr Yu for payment of the capital gains tax as he was a legal representative and shareholder of the de-registered company. Initially, Mr Yu refused to pay the tax liability as he was not the only shareholder of the company under review, but eventually paid the outstanding tax<sup>154</sup>.

## CONCLUSION

It is submitted that it is evident that tax authorities globally will pierce the corporate veil in order to satisfy a tax debt. The courts in various countries show no hesitation in piercing the corporate veil where for example there have been instances of tax evasion, elements of fraud or abuse of the separate legal identity of a juristic person. South Africa follows the tax global approach when it comes to the need to lift the corporate veil.

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<sup>152</sup> *Toronto (City) v Famous Players Canadian Corp* 10 and *Aluminum Co of Canada v Toronto (City)* [1944] 3 DLR 609 (SC).

<sup>153</sup> J Liu & J Eichelberger —China Tax Scene” Intertax (2013) available at <https://www.kluwerlawonline.com/abstract.php?id=TAXI2013044>, accessed on 4 August 2015.

<sup>154</sup> Unknown —China Tax Scene” available at <https://www.deepdyve.com/lp/kluwer-law-international/china-tax-scene-9EnJogSjYB>, accessed on 2 April 2015.

## **CHAPTER 7**

### **7. CONCLUSION**

#### ***7.1 Overview***

The aim of this research was to discuss the ability of SARS to attach the tax liability of a juristic entity to a corporation's members, shareholders or directors. This would mean that SARS may pierce the corporate veil of the corporation in order to attach the tax debt to the key players of the entity.

The doctrine of piercing the corporate veil is a well-established principle in foreign jurisdictions. In comparison to other jurisdictions, the South African tax courts have not as readily applied the principle of piercing the corporate veil for tax liability. However, it appears as though the South African tax courts could soon be following suit with the introduction of the Tax Admin Act and the 2008 Act.

There are a variety of options at SARS disposal that could assist them in their quest to recover a tax debt. It appears as though the common law principles of the doctrine of veil piercing have already been successfully applied by SARS as is evident in the case of *CSARS v Metlika Trading Limited*<sup>155</sup>.

As an alternative to the common law, an application to court to pierce the corporate veil may be brought in terms of Section 20(9) of the 2008 Act or Section 65 of the CC Act when dealing with juristic persons. Both the 2008 Act and the CC Act do not list the circumstances in which the veil may be pierced, but instead use broad all-encompassing terms like “unconscionable abuse” and “gross abuse”. The failure of the company or close corporation to pay taxes may amount to an “unconscionable abuse” or “gross abuse” in which case section 20(9) or 65 may apply. While every decision depends on the facts of each case, it is submitted that it is imperative that members, shareholders and directors tread lightly in this area. Of particular importance is to ensure that any movement of funds or loan accounts within companies be managed carefully showing a clear division between the companies and the members, shareholders and directors.

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<sup>155</sup> *CSARS v Metlika Trading Limited* (note 104 above).

The Tax Admin Act has provided SARS with even further reaching powers to enforce the collection of a corporation's tax debts against its members, shareholders or directors. The provisions contained in the Tax Admin Act, in particular Section 180, seem to facilitate and contemplate the piercing of the corporate veil in certain instances. The concept of the representative taxpayer as contained in Section 153 of the Tax Admin Act appears to be a form of personal security by one party for the debt of another in the form of a surety. Should the corporation be unable to satisfy a tax debt owed to SARS, then SARS could seek satisfaction for payment of the tax liability from the representative taxpayer.

Section 158 of the Tax Admin Act introduces the concept of a responsible third party. According to this provision, SARS has the exact same powers of recovery against the person they deem to be the responsible third party as it has against the taxpayer. SARS could determine that the member of the corporation is considered to be the responsible third party and deem them personally responsible for the tax liability of the corporation. The Tax Admin Act could indeed allow SARS to go behind the corporate curtain to receive compensation for a tax debt.

The introduction of statutes within the tax and corporate law sphere, coupled with the common law and in particular the most recent judgement in the case of *Ex parte Stephen Malcolm Gore NO and 37 others NO*<sup>156</sup> could indeed aid SARS in their quest to argue that where a corporation lacks the financial resources to pay its taxes, such liability should be imposed on other parties such as the members, shareholders or directors.

It is submitted that in light of the introduction of the new corporate and tax law provisions that only time will tell in which direction the courts will proceed in matters involving the collection of taxes from corporate entities that are unable to pay their tax liability.

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<sup>156</sup> *Ex parte Stephen Malcolm Gore NO and 37 others NO* (note 66 above).

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