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TAX ALERT

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PIERCING THE CORPORATE VEIL HAS BEEN EXTENDED

The recognition of a company as a separate juristic person, liable for its own tax (or other) debts, is an important principle relied on by taxpayers when implementing various transactions.

In *Ochberg v Commissioner of Inland Revenue 5 SATC 93* it was recognised 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."

However, when the circumstances of a particular case make it appropriate to do so, inevitably in matters in which separate juristic personality has been used improperly, in a manner inconsistent with the rationale for the creation and maintenance of the legal fiction, courts will disregard it by *'piercing the corporate veil' (see the reportable case of Ex parte application of Stephen Malcolm Gore No. O and 37 Others N.N.O* (Case No: 18127/2012), Western Cape High Court at para 4).

The recent reportable *Stephen Malcolm* case considered, among other things, the interesting issue of whether s20(9) of the Companies Act, No 71 of 2008 (Act) supplemented the common law jurisprudence on 'piercing the corporate veil' or substituted it.

In this case, the applicants were all liquidators of one or more companies that formed part of a group of companies, referred to as the King Group. The King brothers effectively managed and owned the King Group through their family trust shareholdings. The applicants alleged that the relevant businesses of the group was conducted through the holding company with little or no regard to the distinction between the company's legal personality and that of its subsidiaries. As a result, the applicants sought an order to permit certain of the assets of the subsidiaries to be dealt with as if they were the property of the holding company.

The court indicated that the investigation established that the affairs of the group were in material respects conducted in a manner that maintained no distinguishable corporate identity between the various constituent companies in the group. For instance, funds from investors were transferred by the controllers of the holding company between various companies in the group at will, with no effectual regard to the individual identity of the companies concerned, and with grossly inadequate record keeping.

The judgment discussed the various jurisprudence on the instances when the courts would be willing to 'lift the corporate veil', including the recent English Supreme Court judgment of *VTB Capital Plc v Nutritek International Corp & Ors [2013] UKSC 5*. However, the interesting aspect of the judgment is Binns-Ward J's findings on the application of s20(9) of the Act where it was said at paragraph 34 that:

- By expressly stating its [s20(9) of the Act] availability simply when the facts of the case justify it, the provision *detracts from the notion* that the remedy should be regarded as *exceptional, drastic*.
- The term 'unconscionable abuse of the juristic personality of a company' [the requirement for the application of s20(9)] postulates conduct in relation to the formation and use of companies diverse enough to cover all the descriptive terms

continued

like 'sham', 'devise', 'stratagem' and the like used in that connection in the earlier cases, and the current case illustrates *conceivably much more*.

- It seems that it would be appropriate to regard s20(9) of the Act as *supplemental to the common law, rather than substitutive*.
- The unqualified availability of the remedy in terms of the statutory provision also militates against an approach that it should be granted only in the absence of any alternative remedy (thus in agreement with *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd 1995 (4) SA 790 (A))*.

Section 20(9) of the Act, only requiring an 'unconscionable abuse of the juristic personality of a company as a separate entity', thus supplements the common law and conceivably covers much more (that applies a less stringent test than the common law position). Taxpayers should always give recognition to a company as a separate juristic person when structuring and implementing their transactions, otherwise the courts may disregard its separate existence. Taxpayers should thus be mindful that it may not be easier for the South African Revenue Service to prove the abuse of a company's corporate existence with the enactment of s20(9) of the Act.

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DRAFT INTERPRETATION NOTE ON 'GROUP OF COMPANIES' DEFINITION

On 13 March 2013, SARS released a draft Interpretation Note (IN) to provide guidance on the interaction between the definitions of 'group of companies' as it appears in s1(1) and s41(1) of the Income Tax Act, No 58 of 1962 (Act).

The definition of 'group of companies' is of particular importance in respect s45 of the Act, which provides for the transfer of assets between group companies without triggering any taxes.

The draft IN provides that the definition in s1(1) must first be applied to the relevant companies in question. Once it is established that these do constitute a group of companies as defined in s1(1) of the Act, s41(1) of the Act should be applied.

The definition of 'group of companies' in s41(1) of the Act excludes certain companies from being group companies for purposes of the special rules relating to companies. Likewise, the definition excludes certain equity shares from being taken into account when determining whether the companies in question constitute a 'group of companies' in terms of s1 of the Act. Taking s41(1) into account then, the definition in s1 of the Act should be re-applied – obviously only in respect of the remaining companies and eligible equity shares. Where the remaining companies fall within the definition of 'group of companies' in s1 of the Act, they will constitute a 'group of companies' for purposes of the special rules relating to companies.

Unfortunately the draft IN does little to ease the difficulty encountered in interpreting the awkwardly worded definition of 'group of companies' in s1 of the Act in the first place. While the definition might appear to be concisely stated, it often requires more than one read to establish its meaning in the context of applying it to a given set of companies.

The following is a breakdown of the definition of 'group of companies' in s1(1) of the Act:

- There must be two or more companies;
- One company, referred to as the controlling group company, must directly or indirectly hold shares in one or more of the other companies, referred to as the controlled group companies.
- The controlling group company, or one or more of the controlled group companies, whether together or alone, must hold at least 70% of the equity shares in each controlled group company, in order for that controlled group company to form part of the group.
- The controlling group company must directly hold at least 70% of the equity shares in one controlled group company in order for there to be a group at all.

The circular interaction between the definition in s1 of the Act and the definition in s41(1) of the Act unfortunately compounds the complexity.

It is submitted that, while the wording of the definitions and their interaction are not patently incomprehensible, it might be worthwhile to revisit the legislation for the sake of simplicity.

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