

The use of Corporate Structures and Tax Avoidance

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Abstract

South Africa has seen many developments in both the areas of corporate law and tax legislation. The legislation in question has developed from an apartheid or pre-democratic era to that of the current democratic South Africa, in which individuals have the freedom to become entrepreneurs, and have the opportunity to start up small to medium and larger enterprises, in order to firstly make a profit but also to ensure that they enjoy the benefits which the separate legal personality of Corporate Structures are entitled to.

The focus of the research was to carefully study Corporate Structures created by directors and other entities and to show how these personalities make use of various arrangements to reduce tax liability, both by lawful and unlawful methods. In addition to this, the research involved a close analysis a of how a Corporate Structure is formed, from the date of incorporation of the entity, to the rights, and duties of the entity, the rights and duties of the role-players such as directors and shareholders, who control the entity and make the necessary decisions relating to the entity.

The thesis focuses on the tests used by the courts to examine the true commercial substance of Corporate Structures and the arrangements put in place by these entities or individuals mentioned above. The above approach was applied by analysing the principle of Piercing the Corporate Veil both at common law and statutory level, the principles of Substance over Form, General Anti-Avoidance provisions and the Tax Administration Act 28 of 2011 provisions, in light of the Anti-Avoidance provisions. It is trite law that taxpayers are allowed to arrange their affairs or commercial activities in a manner in which they may gain a tax advantage provided they do so, within the ambit of the law. The effect of the taxpayer having such freedoms is that many of the contracting parties or taxpayers abuse the legislative provisions and enter into transactions and commercial activities which circumvent the legal provisions.

The framework of the analysis was to look at the Companies Act 71 of 2008, Income Tax 58 of 1962 and the Tax Administration Act 28 of 2011 Acts respectively.

The result of the research has shown that the tests put forward by the courts assist in ensuring that the principle of separate legal personality is upheld, taxpayers such as entities are free to arrange their affairs in a manner that allows a certain tax advantage provided it is within the ambit of the law. The study has shown that the doctrine of separate legal personality is upheld within our current legal system. There are many tax and legal benefits to natural persons establishing an entity; however these benefits should not lead to abuse by entities.

Lastly, the courts will carefully scrutinise the commercial substance of a transaction and test whether the parties to the transaction have acted in accordance with the true principles of the transactions, the conclusion herein is therefore that the law should not interpret the modern commercial world with a closed minded approach and legislate strictly, without considering all the circumstances of a matter in light of the necessary law and policy considerations and in so doing, rather adopt a modern commercial minded approach.

As a growing South African economy, entities should be permitted to arrange their commercial transactions and affairs in the best possible way to obtain a legal tax benefit and make profits which will ultimately ensure that we have a sustainable economy and strong Corporate Structures in place, in order to be placed in a stronger position in terms of an African perspective and compete more competitively at an International level.

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1 Introduction

Company Law and Tax legislation plays a significant role in the economy and in commercial activities within South Africa. The 2008 Companies Act,¹ as well as the previous Companies Act, has recognised the company as being a separate legal person from those who operate and control the company, that is the directors and shareholders of companies. Section 19 of the Companies Act,² provides, on date of incorporation of a company it is a juristic person and confirms that it has all the powers of an individual, save for when there is a restriction in the companies Memorandum of Incorporation.³

South Africa has seen many developments over the years, politically, historically and more importantly within the areas of Company law and Tax law. South Africa has seen a total of three Companies Acts, the first was passed in 1926, the next was passed in 1973 and the current Act, the most recent being the Companies Act of 2008. It may be considered that the new companies act was unnecessary; however there are many reasons for the creation or enactment of the new Companies Act.⁴ Amongst these reasons is the fact that the 1973 Companies Act became outdated and technical, was in many ways, un-user friendly and in many instances contradictory to policy and the South African Company law system in general.⁵ Change was therefore welcomed, based on the socio-economic and political upheavals and there was a definite gap for company law to become more relevant and modern as the previous company law acts did not take into account international developments and trends.

¹ Act No 71 of 2008.

² Ibid.

³ Section 19 of the Companies Act 71 of 2008.

⁴ Act No 71 of 2008

⁵ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2nd ed para 23 page 26

Notably, the most significant reason in my view for change is the need for the recognition of higher standards of corporate governance and the requirement that entities should have a greater standard of transparency and mindfulness towards the public and the communities in which they operate. This standard of care would not only take into account investors but also stakeholders which the Companies Act 61 of 1973 failed to identify.⁶

In addition, the new Companies Act 2008 has amplified the duties of directors and confirms that directors should act in a manner that benefits the company, exercise all their powers in a good manner, for a proper purpose and to act meticulously with the necessary skill required from directors.⁷ In line with this point, is that throughout the years entities have attempted to circumvent the legislative provisions in order to avoid paying taxes or paying lesser amounts of tax, seemingly in a manner that would be beneficial to the company. An example of one of these duties is that a director must act in a manner which is in the best interest of the stakeholders and make certain that the business turns a profit and yields favourable dividends.

The acknowledgment of a company with separate legal personality⁸ plays an important role in the way in which taxpayers arrange their affairs, as companies and the other parties involved in a company, such as the directors and shareholders, can conceal or disguise the true nature of transactions and abuse the corporate legal personality to obtain a fiscal advantage or tax benefit. In order to deal with corporate abuse, one of the methods employed by the courts is to disregard the form of the transaction and rather look at the substance or genuine intention of the transacting parties.

⁶ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2ed at para 1.1 at page 3

⁷ N Schoeman 'Piercing the Corporate Veil' (2012) *De Rebus* at page 26-28

⁸ *Solomon v Solomon* 1987 AC.

The concept of substance over form and the significance of 'Sham Transactions' will be discussed in this paper, with reference to the common law rules applicable herein and the relevant tax case law. In addition the research will cover an analysis of the various schemes and arrangements used by taxpayers. In addition to looking at the substance over form, the legislature has also enacted various provisions in the 2008 Companies Act,⁹ the Income Tax Act¹⁰ and the Tax Administration Act¹¹ to deal with the abuse of the corporate form.

In many instances a company will be registered in order for natural persons to avoid paying normal tax. Normal tax is enforced on all persons, whether they are individuals, or entities such as companies, trusts or close corporations.¹² For persons other than a company, ordinary tax is imposed. This will therefore increase the taxable income of a company and if a company is classified as a small business, this company will pay tax in accordance with the rates specified for small businesses.¹³

In order for businesses to trade it must comply with various legislative requirements. Further, when an entity is in the process of establishment, those who are in control of the entity must bear in mind principles of capital maintenance, funding, the company's strategic objectives and tax requirements. When a business makes a profit, such profits must be taxed.¹⁴

⁹ Companies Act 71 of 2008.

¹⁰ Income Tax Act 58 of 1962.

¹¹ Tax Administration Act 28 of 2011.

¹² AP de Kocher , RC Williams , *Silke South African Income Tax* (2015), at para 1.2 at page 5

¹³ *Ibid*

¹⁴ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2ed at para 23 at page 26

The Income Tax Act¹⁵, does not permit the avoidance of tax, the Act¹⁶ can only tax that which falls within its ambit. If a taxpayer organises his commercial transactions or matters in such a way that it will not be within the directive of the act, then the tax avoidance is permissible. I will therefore examine instances in which the taxpayer as a corporate structure has made use of arrangements which fall outside of the ambit of the act in which the avoidance is permissible, that is when legal methods are used by a taxpayer to pay a lesser amount for taxable income.

1.1 Aim of the research paper

Based on the fact that there have been numerous enactments in the area of company law as well a tax law, there are important questions to be examined relating to both the aforementioned areas.

1.1.1 Commercial or corporate law aspects of the research paper

The commercial or corporate law aspects of the research paper is: (a) whether the Companies Act 71 of 2008 overrides or reinforces the age old principle of piercing the corporate veil, in addition, (b) it must be considered whether the new Companies Act provision of Piercing the Corporate veil is a stride in the right direction for commercial law, and (c) can the statutory provision afford more protection in cases where taxpayers attempt to avoid tax and more so in light of simulated transactions.

1.1.2 Tax Implications related to research paper

This section is aimed at setting out the questions which must be answered in relation to the relevant tax provisions, the questions which will be addressed in the paper is: (a) whether the law permits tax avoidance arrangements by entities, (b) is this a criminal offence in terms of our current corporate and commercial rubrics in South Africa, (c) does the law permit Tax Avoidance

¹⁵ Income Tax Act 58 of 1962.

¹⁶ Income Tax Act 58 of 1962.

as opposed to Tax Evasion, (d) have entities made use of various legislative ambiguities and nuances to avoid paying taxes and (e) what are the South African courts view of Corporate Structures and Tax Avoidance and has this been challenged by the Commissioner of South African Revenue Services with success.

1.2 Chapter Two

Chapter two provides a background into corporate structures and the issues related to thereto. The salient points which will be identified in this chapter is: (a) what is the process of the formation of a company, (b) the principles applicable to separate legal personality and (c) what is the abuse of the concept of separate legal personality.

1.3 Chapter Three

Chapter three provides an integral analysis of the use and application of the term, piercing the corporate veil. I will investigate how the courts pierce through the corporate veil of an entity to see the true nature of the company's affairs. I will further draw a distinction between the common law as well as the statutory provision of piercing the corporate veil, based on the aforementioned, conclusions will be reached on this point..

1.4 Chapter Four

Chapter four will address what is meant by sham transactions and the substance over form concept and identify the factors which the court has used over the years to identify whether a transaction is in fact a simulated transaction, based on the aforementioned, conclusions will be reached on this point.

1.5 Chapter Five

Chapter five will examine the concepts of Tax Evasion and Tax Avoidance will be addressed and the Tax Administration Act ¹⁷ provisions related to tax avoidance and conclusions will be drawn regarding, notwithstanding the fact that there is more than one way in which a company may avoid liability to pay income tax; the courts have throughout the years developed various tests. These tests are designed to look through a corporate structure in a manner which will give effect to the genuine nature or a transaction.

1.6 Chapter 6 and Conclusion

Finally, section six will answer the questions raised in chapter one and provide a conclusion to the research question raised. A summary of the salient conclusion points are as follows:

- (a) The Commissioner of South African Revenue may either pierce through the corporate veil of an entity or apply the principles as set out in the *Commissioner for South African Revenue Services v NWK Ltd* ¹⁸ and further case law, to establish what the true state of affairs of a corporate structure is, he may also make use of section 20 (9) of the Companies Act 71 of 2008 which is beneficial to modern company law as s20(9) Companies Act 71 of 2008 does not overrule the principle of piercing the corporate veil, as set out in the common law, but reinforces this remedy and confirms that the court will still only give effect to this remedy in exceptional circumstances.

- (b) Section 20(9) of the Companies Act ¹⁹ deals with the validity of a company's transactions, however it may be argued that this provision should be seen as an anti-avoidance provision in relation to the Companies Act 71 of 2008. The statutory provision also affords more

¹⁷ Ibid

¹⁸ 2011 (2) SA 67 (SCA)

¹⁹ Companies Act 71 of 2008.

support to the courts, as it allows the party who wishes to set the contract aside, the use of section 20(9) Companies Act²⁰ when taxpayers attempt to evade tax as opposed to the common law provisions.

²⁰ Ibid

2 Separate Legal Personality of Entities

2.1 Introduction

The focus of this chapter will be on what is meant by the term 'Separate Legal personality, which will hereafter be referred to as in relation to the Companies Act, Company law as a whole and how this principle is misused.

A company is a person, completely separate from those who manage, work for it or interact with it i.e. directors, shareholders, employees and third parties. In addition to understanding the aspect of separate legal personality, it is crucial to examine the corporate principle, which provides an understanding of who the various personalities are within a company, who have to manage, control and operate the company.

Section 1 of the Companies Act 71 of 2008 confirms that at the point of incorporation, a company will be seen as a legal person.

Section 1 of the Companies Act 2008 defines a company as:

A juristic person incorporated in terms of the Act, a domesticated company or a juristic person that, immediately before the effective date was registered in terms of the Companies Act 1973, other than as an external company as defined in the Act or the Closed Corporation Act, was in existence and recognised as an 'existing company' in terms of the Companies Act 1973 and was de-registered under the Companies Act 1973 and re-registered under the Companies Act 2008.²¹

In terms of section 14(4) of Companies Act 71 of 2008, upon the company obtaining a registration certificate, the company will be seen as having been incorporated.

²¹ Section 1 of the Companies Act 71 of 2008

It is from section 19 of the Companies Act 71 of 2008 that the company as a legal entity is created, with its own rights and obligations. The single most important consequence of separate personality is that a company acquires its separate legal personality.²²

The principle of separate personality is in line with the concept of limited liability. In addition to this, section 19(1) of the Companies Act²³ confirms that when the registration certificate is obtained, the company is a legal person and will remain a legal person until the company's name is removed from the register of companies. Section 19(1) of the Companies Act²⁴ therefore empowers companies with their own powers and capabilities except where the company's Memorandum of Incorporation states otherwise.²⁵

The Bill of Rights of the Constitution of the Republic of South Africa provides the constitutional entitlement for entities, as it states that entities are entitled to all the rights as set out in the Bill of Rights.²⁶

In King Code I of 1994, describes corporate governance as the system which governs and directs companies.²⁷ Within a company, there are various role players, inter alia, the directors and the shareholders, each having a unique role within the company. There are instances where a person who does not carry the title of director, but is in fact de facto acting as a director. This principle is evident in practice and a court may question whether a person who is not in fact a director is acting as such.

²² Section 19 of the Companies Act 71 of 2008.

²³ Ibid

²⁴ Section 19 of the Companies Act 71 of 2008.

²⁵ Ibid

²⁶ Section 8, Chapter 2 of the Constitution of the Republic of South Africa.

²⁷ M King SC, King Report on *Corporate Governance for South Africa* I (1994)

2.2 *Who is a director and what are their roles*

The term director usually denotes a role of importance, or is a person who manages the daily activities of a company. Section 1 of the Companies Act 71 of 2008 provides clarity on the meaning of a director and confirms that a director is a member of a board of a company or may be an alternate director.²⁸

The King report²⁹ distinguishes between executive and non- executive directors,³⁰ which indicates that a director is in charge of the daily running of the company, a salaried employee whereas the non-executive director is not. The King report further distinguishes between a chairman of a company who provides leadership to a company, a chief executive officer who is a director and is the managing director and general directors.³¹

2.2.1 *Board of Directors*

All directors make up the body known as the board of directors, the directors of the board are selected by the shareholders at the annual general meeting and the board of directors are accountable to the shareholders.

King II provides that the function of the board of a company is to manage and control the company. All companies should have executive and non-executive directors.³² The purpose of having executive directors is to allow these members to provide specific business knowledge to the entity and the non-executive directors to provide a broader based knowledge and skills which will assist the entity.³³

²⁸ Section 66 of the Companies Act 71 of 2008

²⁹ M King SC King Report on Corporate Governance for South Africa, II (2002) at chapter 1

³⁰ T Wixley and G Everingham (2010) 3ed

³¹ M King SC , Institute of Directors King Reports on Corporate Governance, II (2002) at chapter 1

³² Cliffe Dekker on King Report on Corporate Governance (2002)

³³ M King SC *King Report on Corporate Governance for South Africa II* (2002) principle 2.1

The board of directors are empowered to manage the commercial activities of a company and fulfil any of the functions the company may have, provided the company's Memorandum of Incorporation does not state otherwise.³⁴ Directors also manage the business risks of the company and exercise commercial judgment on behalf of the company, and where executive and non-executive directors interact this may be seen as an exchange of business experience and knowledge.³⁵ The 2008 Companies Act further provides that the board has a mutual responsibility to ensure that there is good corporate governance that involves the management of the company.³⁶

2.3 *The role of Shareholders*

A shareholder of a company acquires a right to hold a share, which is issued to it. The shareholder will only become a shareholder once its name is entered into the certified or uncertified securities register.³⁷

2.4 The Separate Legal personality of a company

Based on the fact that the law recognises an entity as a separate legal person, the current South African climate demands that companies take greater responsibility for the communities which are affected by their activities.

The *Salomon v Salomon & Co Ltd 1897* has been accepted by South African courts as acceptable principles of law, notwithstanding the fact that the case is an English decision. This case was the first case to establish the

³⁴ Section 66 of Companies Act 71 of 2008.

³⁵ M King SC, Institute of Directors King Reports on Corporate Governance II (2002) at chapter 1

³⁶ Ibid

³⁷ Section 1 of the Companies Act 71 of 2008.

principle which explained the relationship between directors and shareholders.³⁸

Lord Macnaghten expressed the legal principle in the *Solomon*³⁹ case, as the company being a different person in law to the directors of the company, even though the directors of a company may subscribe to the companies memorandum of incorporation, after the incorporation of the company, the business will be the same as it was before and the profits will be that of the company as the company is not the agent of the directors.⁴⁰ This principle which was established in *Solomon* has various important legal implications for the principle of separate legal personality and moreover for Company law in general.

One of the central elements of South African law is the separation between directors and shareholders of company. However, this principle has an exception, as the court may, in exceptional instances pierce through the corporate veil of an entity to ensure that the directors of a company are held personally liable.⁴¹ In many instances the abuse of the principle will lead to cases where the separate legal existence of an entity will be discarded by a court and the court will pierce through the metaphorical corporate veil.

2.5 Consequences of separate legal personality

There are consequences which flow from this principle, an entity has limited liability and may continue to exist even when the membership of the company changes, the company retains its legal identity and continues to survive. A company also owns its own property, and is allowed to make use of its assets, by way of cession, disposing of the asset or selling it as it

³⁸ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2ed at para 2.2 pg 23

³⁹ *Solomon v Solomon* (1987) AC

⁴⁰ *Ibid*

⁴¹ PM Meskin, P Delport, Q Vorster *Henochsberg on the Companies Act 71 of (2008)*, section 19(1) of the companies act commentary accessed on May 2015 available at <http://www.mylexisnexis.co.za/Index.aspx>

deems necessary. The profits which the company generates or the debts which a company incurs are that of the company.

Therefore, in the event of a company being sued or entering into any form of litigation the company may litigate and be litigated against in its own name. Further, if a company cannot afford to meet its financial obligations and is liquidated, the company itself will be held responsible for the failure to fulfil its obligations and not the shareholders or directors of the company.

In the case of *Dadoo Ltd v Krugersdorp Municipal Council*, it was confirmed that:

A company cannot have body parts or passions but may have separate legal rights and duties and such rights do not attach to the members of the company but to the company itself. It was confirmed that a registered company is a legal person distinct from the members who compose it. It cannot be disputed or it is in no doubt true that a company is a juristic conception distinct from its members, and that its rights and duties are not the same as those of its members.⁴²

It is one of the chief principles of company law that a registered company is an entirely different entity to that of its shareholders.⁴³ It is confirmed that property owned by the entity will not be seen as being owned by the members.⁴⁴

In *Macaura v Northern Assurance Co Ltd*⁴⁵ it was confirmed that property owned by a company is not owned by its shareholders or creditors and not even a controlling shareholder or creditor has a legal right to insure the company's property in his or her own name.⁴⁶

⁴² *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD

⁴³ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, Li Coetzee, D Burdette, *Companies and other business structures in South Africa* 2nd ed (2011) para 2.2 pg 23

⁴⁴ *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD at page 550

⁴⁵ *Macaura v Northern Assurance Co Ltd* 1925 AC 619

⁴⁶ T Wixley and G Everingham 3ed (2010)

A company may enter into an agreement with its shareholders. When a company issues shares, the rights and duties attached to the sale of these shares must be documented in a Shareholders Agreement. The shareholder will pay a monetary amount or a consideration for the shares and will receive an equal amount of shares for the value which he has purchased.⁴⁷ Shareholders of a company have limited liability in respect of the shares which they have purchased in the company. Shareholders of a company are not responsible for the debt of the entity.⁴⁸

The 2008 Companies Act encourages a business activity approach by providing an environment which is based on regulations, in which office bearers of the company are accountable to the stakeholders of a company.⁴⁹

The starting point of this discussion was to illustrate that at the incorporation of the company, it is not part of the directors but is separate. Upon the establishment of a company, a representational veil is drawn between the shareholders, directors and the company.

The role of a director may be split into the common law duties and the statutory duties. The fundamental principle is that a director stands in a position of trust or a fiduciary position in relation to the company. This fiduciary duty requires a director to conduct himself in a manner that places the needs of the company as paramount to his own interests and to act with honesty and integrity when dealing with the company's affairs.

At common law, a director may not allow their personal interests to clash with the interests of the entity and must keep an unfaltering principled

⁴⁷ Section 40 Companies Act 71 of 2008

⁴⁸ *Airport Cold Storage (Pty) Ltd v Ebrahim & others* (2007) JOL (1990) (C)

⁴⁹ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* 2nd ed 2011 at page 3-4

approach to the entity and act with care and skill.⁵⁰ In addition to the common law responsibilities, directors have a number of duties which are set out by the Companies Act.⁵¹

Section 76 of the Companies Act 71 of 2008 attempted to codify the common law duties of directors. Section 76 (3) of the Companies Act 71 of 2008 sets out the manner in which a director must perform his functions.

A director must perform his functions in good faith for a proper purpose, in the best interests of the company and with the degree of skill and diligence that may reasonably be expected of a person (a) carrying out the same functions in relation to the company as those by a director and (b) having the general knowledge skill and experience of that director.⁵²

Directors will be held personally liable should they fail to perform the necessary required tasks under the common law and statutory law. Section 77(3) (b) of the Companies Act 71 of 2008, confirms that directors will be held liable in their personal capacities, if found to have act in a manner that arises, as a result of the director knowingly carrying on business in a reckless manner and as a result of him acting grossly negligent and intentionally defrauding an individual or being involved in fraudulent activities.⁵³

Section 214 of the companies act provides for criminal liability if an act of fraud is perpetrated under the Combating of Corrupt Activities act 12 of 2004 (“POCA”) and confirms that any person who holds a position or leadership or who reasonably is aware that a person committed fraud exceeding R100 000 or more, is required under the aforementioned act to

⁵⁰ Companies Act 61 of 1973.

⁵¹ Act 71 of 2008.

⁵² T Wixley and G Everingham Corporate Governance 3rd (2010) at 54

⁵³ Section 77(3) (b) of the Companies Act 71 of 2008.

report suspicious transactions and if this is not adhered to a criminal charge will be brought against the individual in question.⁵⁴

In terms of S424 of the Companies act 61 of 1973, if a court finds that a company had entered into any transaction or carried on business recklessly and intended to defraud its creditors the court could base on an application by the Master, liquidator, judicial manager or any other creditor, declare that the person is knowingly party of the fraudulent activity as set out above and will be held personally liable.⁵⁵

The 2008 Companies Act sets out that personal liability will be imposed on a director if as a result of his misconduct the company suffered losses.⁵⁶ Any person who commits fraud in relation to the company, employees or creditors, will in terms of Section 214 of the Companies act 71 of 2008 be held criminal liable.⁵⁷

It should be noted the reason for the principle of separate legal personality is to protect those who control and make the necessary daily decisions of the company to ensure that the company makes a profit and is ultimately meeting the requirements of solvency and liquidity in order to operate. Without these principles, individuals would not wish to form a company or a closed corporation as they would then be held personally liable.

There are however instances when the court will not look at the separate person but will look at directors or shareholders, which is when the court will pierce the corporate veil. The separate personality may also be used in a transaction in order for a party to avoid tax liability; in these

⁵⁴ Combating of Corrupt Activities Act 12 of 2004.

⁵⁵ Section 424 of the Companies act 61 of 1973.

⁵⁶ Section 77 Companies Act 71 of 2008.

⁵⁷ Werksmans Attorneys '*Duties and Liabilities of Directors*';

http://www.werksmans.com/wpcontent/uploads/2013/04/Directors-liability_1 Accessed on 18 August 2015.

instances you could possibly have sham transactions. The distinction will be addressed by way of an analysis of the Piercing the Corporate Veil doctrine, the Sham Transactions principle and the term Substance over Form following the chapters to follow.

3 Piercing the Corporate Veil

3.1 Introduction

The Companies Act provides that a company and a closed corporation are seen as separate legal entities with their own rights, duties and obligations. Where a company is found guilty of wrongdoing, liability can only be incurred by directors and shareholders of a company, where the veil is pierced by way of the common law or the Companies Act⁵⁸ and the Tax Administration Act⁵⁹ can be called upon to put the directors or shareholders of the company personally liable in respect of tax issues.⁶⁰

The separate legal personality is fundamental, as was set out earlier and as a result, this principal has given rise to the principle of the corporate veil.⁶¹

In the case of *Amlin (SA) Pty Ltd v Van Kooij*⁶² the court stated that this principle of piercing the corporate veil requires that the court open the corporate veil and determine the true state of the affairs. The courts have however made it clear that even though an entity is seen as a different legal entity, the principle of separate legal personality may not be abused. In exceptional instances, the courts will strip away the veil to bring to light the true state of affairs and give effect to the principle of piercing the corporate veil.⁶³

⁵⁸ Act No 71 of 2008.

⁵⁹ Act No 58 of 1962.

⁶⁰ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2ed at page 24

⁶¹ *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 2.4 p41

⁶² *Amlin (SA) Pty Ltd v Van Kooij* (2008) (2) SA 558 (C) at para 12

⁶³ Cilliers and Bernade *Corporate Law* 3rd ed (2009) para 1.24 p 13

3.2 *Difference between the concepts piercing the Corporate Veil and Lifting the Corporate Veil*

It is of importance to note the difference concerning the concepts of piercing the corporate veil and lifting the corporate veil.⁶⁴ There is a view within the courts to make use of these phrases interchangeably, for example the courts would refer to lifting of the veil when the effect is that of piercing the veil.⁶⁵

In *Atlas Maritime CO SA v Avalon Maritime Ltd*⁶⁶, the court provided a certain degree of clarity on the difference between piercing the corporate veil and lifting the corporate veil.

Like all metaphors, the phrase 'piercing the corporate veil' can sometimes obscure the reasoning rather than explain it. There are two senses in which it is used which need to be distinguished. To pierce the veil is a term which is used to treat the rights and liabilities of the company as those of the shareholders. To lift the veil is to look behind it and to have regard to the shareholding in the company for a certain legal purpose.⁶⁷

3.3 *The two legs of Piercing of the Corporate Veil*

As can be seen in the *Atlas Maritime CO SA v Avalon Maritime Ltd*⁶⁸ case above, the principal of piercing the corporate veil may be seen as having two legs, namely the common law leg and the statutory leg, which is section 20(9) of the Companies Act.⁶⁹

Where the veil is pierced, the protection which the shareholders, directors and the creditors enjoy will be removed and the court will then

⁶⁴ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2ed at para (2011) at page 26

⁶⁵ *Ibid*

⁶⁶ (1991) 4 ALL ER

⁶⁷ *Atlas Maritime CO SA v Avalon Maritime Ltd* (1991) 4 ALL ER

⁶⁸ *Ibid*

⁶⁹ 71 of 2008

have sight of what the true state of affairs are, and not that of the arrangement which was put forward by the company. As a result of this, personal liability will be credited to the person who has attempted, to hide behind the entity.

According to LAWSA⁷⁰ the piercing of the veil takes at least two forms. The first is described as looking behind the veil or veil transparency and this occurs where some fact about the person who controls the company comes to light, which is made evident by a legal rule.⁷¹ The second instance is where the term piercing the veil is used to refer to those instances where the legislature holds the directors responsible for the liabilities of the entity.⁷²

In the case of *Die Dros (Pty) Ltd v Telefon Beverages CC*,⁷³ the court found that if the existence of fraud or dishonesty is found the court must ensure that it preserves the principle of separate corporate personality of an entity. This principle should also be weighed against the necessary policy concerns which favour the piercing of the corporate veil.⁷⁴

In *Airport Cold Storage (Pty) Ltd v Ebrahim*⁷⁵, decision the court dealt with the issue of the abuse of corporate liability and noted that a court may ignore this principle of separate liability and hold directors or members personally liable. A closer analysis of this principle will be discussed with reference to the facts of the aforementioned case.

⁷⁰ Lawsa 4(1) 2^{ed} Edition at para 85

⁷¹ Ibid

⁷² Lawsa 4(1) 1st Re-issue (1995) at para 42

⁷³ *Die Dros (Pty) Ltd v Telefon Beverages CC* (2003) at para 23

⁷⁴ Ibid

⁷⁵ 2008 (2) SA 303 (C)

Airport Cold Storage (Pty) Ltd was the plaintiff in the matter and had entered into an agreement with Sunset Beach Trading 232 CC.⁷⁶ During the period of March to June 2005, Airport Cold Storage (Pty) Ltd retailed and distributed certain food products to the entity.⁷⁷ In August 2005, the corporation was unable to pay its debts and was liquidated.⁷⁸ The provisional liquidation order was made final and Airport Cold Storage (Pty) Ltd had proven their claim in respect of the outstanding amounts in terms of the agreement entered into. Even though Airport Cold Storage was able to prove the claims it would not be able to receive these amounts as the corporation did not have property which could possibly be liquidated and turned into cash. It was alleged by Airport Cold Storage that the members of the entity should be held liable in their personal capacities for the debts owed by the corporation, which is the question that the court had to decide upon.⁷⁹

The court confirmed that an entity and its members are seen individually and enjoys separate legal rights.⁸⁰ It was confirmed that it does not matter which form piercing of the veil may take, veil piercing is only to be used as an extraordinary principle or as an exception. The court does not have a general discretion to ignore an entities separate corporate identity.⁸¹

The starting point of the enquiry to determine whether the veil piercing may occur is based on whether exceptional circumstances exist. In light of the above it is clear that the court could not simply ignore an entities separate legal personality, the court will only do so, when it deems it necessary and the court will make use of a balancing test to ensure that the issues relating to policy, favour the piercing of the corporate veil.

⁷⁶ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 at para 12 -14

⁷⁷ *Ibid*

⁷⁸ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) at para 12 -14

⁷⁹ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) at para 14

⁸⁰ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 at para 17

⁸¹ *Hülse-Reutter & Others v Gödde* 2001 (4) SA 1336 (SCA) at para 20

An example of this principle is the case of *Robinson v Randfontein Estates Gold mining Co Ltd* 1921. Robinson group consisted of a number of associated companies which owned Randfontein and Waterval.

The Robinson group was the plaintiff in the matter and the parent company. The defendant was a director of one of the entities in the Robinson group. The defendant purchased land and thereafter entered into an agreement with the Waterval Trust Company and agreed to sell the purchased land to the Waterval Trust Company. It is a well-known principle that a director is in a position of authority and confidence towards the company and its shareholders. A director may not enter into transactions which place himself in a favourable position such as in the Robinson case which but results in the entity being placed into a questionable position. A director cannot enter into a transaction and make an undisclosed profit.⁸²

The *Robinson v Randfontein Estates Gold mining decision* confirmed separate legal personality was used to overcome contractual duty. The court noted that if the elements of fraud or misconduct were made use of or present in the companies transactions the court may also consider whether the transactions criticised was part of a device, stratagem, and cloak or sham.⁸³

3.4 The Common Law piercing the Corporate Veil and the Statutory Piercing the Corporate Veil

From this point of the discussion, I will firstly discuss the common law principles and thereafter the statutory principles related to the principle of piercing the corporate veil.

⁸² *Robinson v Randfontein Estate Gold Mining Co Ltd* (1921) at para 177

⁸³ *Ibid*

3.5 Piercing the Corporate Veil - Common law

Academics and commentators of the law have attempted to create categories when the veil will be pierced, however as stated above the courts have not been clear as to the categories in which separate legal personality would be abandoned.

The writers Chris Ewing and Yaniv Kleitman are of the view that the courts are unclear about the instances when the veil will be pierced, as the courts will pierce the veil on the interpretation of each case and on the facts of the particular matter in question.⁸⁴ The reason for this is based on the fact that by creating a closed list, the court could bring about a certain level of uncertainty.

This principle was confirmed by the *Cape Pacific v Lubner*⁸⁵ case, where the court commented on this point and confirmed that we do not have a categorising approach to piercing the corporate veil.

In *Cape Pacific v Lubner*⁸⁶ the appellate Division held:

The law is far from settled with regard to the circumstances in which it would be permissible to pierce the corporate veil. Each case involves a process of enquiring into the facts which, once determined, may be of decisive importance. In determining whether or not it is legally appropriate in the given circumstances to disregard corporate personality, one must bear in mind the fundamental doctrine that the law regards the substance rather than the form of things, this is a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur*.⁸⁷

⁸⁴ Chris Ewing and Yaniv Kleitman, Without Prejudice 'Piercing the Corporate Veil' Issue 11, 2011

⁸⁵ 1995 (4) SA 790

⁸⁶ 1995 (4) SA

⁸⁷ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and others* 1995 (4) SA at para 28

In the above matter the court confirmed that an analysis of each case must be done. If the court has to ignore an entities separate personality this will require a determination of whether it is appropriate to do so, the court will further also give effect to the principle of substance over form. The court did not provide its view on whether an unfair advantage should exist.

In the *Hulse-Rutter v Godde*⁸⁸ case the court departed from the rule in *Cape Pacific* and stated that there needs to be an existence of an unfair advantage, in terms of establishing whether the veil may be pierced.⁸⁹

There can be no doubt that the separate legal personality of a company is to be recognised and upheld except in the most unusual circumstances. A court has no general discretion simply to disregard the existence of a separate corporate identity whenever it considers it just or convenient to do so. The circumstances in which a court will disregard the distinction between a corporate entity and those who control it are far from settled, as this will depend on a close analysis of the facts of each case, considerations of policy and judicial judgment. Nonetheless, what is clear is that as a matter of principle in a case such as the present there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it which results in an unfair advantage being afforded to the latter.⁹⁰

The fundamental principle to bear in mind is that which was expressed in *Botha v Van Niekerk*,⁹¹ the court did not want to lift the corporate veil because there was a valid substitute remedy and in this instance the act of veil piercing was a mere act of convenience and rather than obtaining legal relief. The decision to allow veil piercing would be destructive to the separate legal survival of the entity. Many authors such as Andrew Domanski, are of the opinion that in the *Botha*

⁸⁸ 2002 (2) ALL SA 211 A

⁸⁹ *Hülse-Reutter & Others v Götde* 2001 (4) SA 1336 (SCA) at para 20

⁹⁰ *Ibid*

⁹¹ *Botha v Van Niekerk en Andere* 1983 (4) All SA 157

*v Van Niekerk and others*⁹² case, they attempted to justify the refusal by the court to pierce the corporate veil and the arguments were based on suitability rather than principles of law. The courts should rather take both these aspects and balance it, this balancing exercise will allow the balancing of the corporate existence against policies justifying the piercing.⁹³

Throughout the years there have been numerous decisions in which entities have attempted to abuse the principle of separate legal personality of a company or where the principle of separate legal personality was used as a means by a director to evade his fiduciary responsibilities and used to overcome a contractual responsibility.

Piercing of the Corporate Veil refers to an outstanding remedy for those cases or situations where the court could either (i) disregard the separate legal presence of an entity, handle the assets of the company as that of the members of the company of the assets or (ii) where the court attributes certain rights to the shareholders in the company.⁹⁴

The South African courts have been mindful not to permit the piercing of the corporate veil and would only allow same in extraordinary circumstances⁹⁵. It is clear from the *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*⁹⁶ case that the courts did not provide a closed list but merely provided guidelines for the assistance of the court when reviewing instances in which the veil may be pierced. The

⁹² 1983 (4) All SA

⁹³ Hülse-Reutter & Others v Gödde 2001 (4) SA 1336 (SCA) at para 20 and A Domanski 'Piercing the Corporate Veil , A new Direction (1986) 103 SAJL 224

⁹⁴ D Davis, F Cassim, W Geach, T Mangalo, D Butler, A Loubser, L Coetzee, D Burdette *Companies and other Business Structures in South Africa* (2011) 2nd ed para 2.3 page 26

⁹⁵ Mwachela M. Kakubo 'Justifications of Piercing the Corporate Veil' LLM Dissertation

⁹⁶ 1995 (4) SA

element of fraud is not essential; in *Shipping Corporation of India Ltd v Evidomom Corporation*⁹⁷ Corbett CJ stated that:

I do not find it necessary to consider, or attempt to define the circumstances under which the court will pierce the corporate veil. Suffice to say that they would generally have to include an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs.⁹⁸

The veil will also be pierced where the controlling shareholders fail to regard the company as separate, and make use of the company as their alter ego. The defendants did not conduct the business in line with good bookkeeping requirements which therefore required the piercing of the corporate veil.⁹⁹

The common law provisions are clear, that the remedy of piercing the corporate veil cannot be used by the court on a daily basis, but a principle that requires a court to apply its judicial mind, by looking at compelling reasons and the circumstances of the case before it will ignore an entities separate legal existence.¹⁰⁰

It may be said that the occurrences of piercing the corporate veil at Common law have been problematic because the courts have not passed equal judgment in their approach and application of this principle.¹⁰¹ It is for this reason that the authors of the Companies Act took this principle into account when drafting the new Companies Act, by creating a statutory provision which will assist the court in the application of Piercing the Corporate Veil, namely s 20 (9) of the Companies Act.¹⁰²

⁹⁷ *Shipping Corporation of India Ltd v Evidomom Corporation* 1994 (1) SA550 (A) at para 44

⁹⁸ *Ibid*

⁹⁹ *Airport Cold Storage (Pty) Ltd v Ebrahim* (2008) at para 39

¹⁰⁰ *Ibid*

¹⁰¹ *Hülse-Reutter & Others v Götde* 2001 (4) SA 1336 (SCA) at para 22-23

¹⁰² 71 of 2008

3.6 Statutory Piercing of the Corporate Veil

The corporate veil has been legislated in terms section 20(9) of the Companies.¹⁰³ In terms of this provision an application may be made to the court, by any person who is involved in the proceedings and, the court may deem such company as a juristic person, as a separate entity or where a company is involved in the proceedings, for an act by the company to be constituted as an unacceptable misuse of the juristic personality of the company. The court may declare the company not to be a juristic person with respect to the right, obligation or liability.

According to section 20 (9) of the Companies Act 71 of 2008, the veil will be pierced when:

An application is made by an interested person or in any proceedings in which a company is involved, where 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 declare that the company is 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 make any further order the court considers appropriate to give effect to a declaration.¹⁰⁴

The unconscionable abuse by a company may occur in three instances: (a) on the start of a company, (b) as an outcome of any use of the company as a legal entity and (c) as a result of any act by or whereas previously in company law there was legislative provisions that allowed a court to enforce personal liability on directors and shareholders in certain instances.¹⁰⁵

¹⁰³ Ibid

¹⁰⁴ Section 20 (9) of the Companies Act 71 of 2008.

¹⁰⁵ Rehana Cassim Piercing the corporate veil 'Unconscionable abuse' under the Companies Act 71 of 2008.

3.7 Section 20(9) of the Companies Act resembles Section 65 of the Closed Corporation Act

Section 20(9) of the Companies Act resembles section 65 of the Closed Corporation Act¹⁰⁶ in some respects. Section 65 of the Closed Corporation Act considers a company not to be a juristic person in cases of 'gross abuse' of the juristic nature of the corporation as a separate legal personality, whereas section 20 (9) of the Companies Act 71 of 2008 deems a company not to be a juristic person in cases of 'unconscionable abuse' of the juristic personality.¹⁰⁷

The language of section 20 (9) of the companies act 71 of 2008 is set out very broadly, which has the effect that this may find application in many varying circumstances.¹⁰⁸ The newly introduced provision may be seen as a remedy, which will change the fact that the court approaches piercing the corporate veil when it is justifiable on application of the act. The provision also seems to move away from the concept that the cure should be regarded as exceptional, or drastic.¹⁰⁹

3.8 The use of the word 'unconscionable abuse'

The use of the word 'unconscionable abuse' is not sufficiently explained in the act. The guidance to understanding this term may be obtained from section 65 of the Closed Corporations act which is worded similarly to section 20 (9) of the Companies Act. Therefore it may be useful to look at what the courts have regarded as the abuse of juristic of a closed corporation corporate personality.

¹⁰⁶ Section 65 of Closed Corporation Act 69 of 1984.

¹⁰⁷ Section 20 (9) of the Companies Act 71 of 2008

¹⁰⁸ Ibid

¹⁰⁹ Ex Parte: Gore NO and Others 920130 2 All SA 437 (WCC) at para 34 -35

*In the case of TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NOO*¹¹⁰ a member of the entity made large amounts of loans to the closed corporation, even though it was aware that the closed corporation was insolvent. The court held that the member was liable in their personal capacity for the amounts outstanding by the closed corporation in terms of section 64 of Closed Corporation Act,¹¹¹ where the business of the closed corporation was operated recklessly with gross negligence or for a fraudulent purpose.

Another instance of gross abuse of juristic personality is the case of *Airport Cold Storage*¹¹², which was addressed earlier in this chapter, but the manner in which the members operated the entity is relevant in order to explain the application of the principle of gross abuse of juristic personality. In this case the court listed instances of gross abuse of the juristic personality:(a) the closed corporation was part of a family business which operated the entity with little or no regard for the principle of separate legal existence of the entities, (b) the closed corporation failed to keep their accounting records in proper working order, (c) the closed corporation failed to appoint an accounting officer, (d) the closed corporation had willingly accepted liabilities owed by the family business when it was established and in addition to this, the liabilities increased throughout the operation of the business, which amounted to reckless trading.

In *Haygro Catering BK v Van der Merwe en Andere*¹¹³ the court noted that the members of the closed corporation were personally liable for the unpaid funds of the closed corporation as the names of the closed corporation was not clearly presented for the public to note on the closed corporations business grounds and this contravened section

¹¹⁰ 1998 (1) SA 971 (O)

¹¹¹ Closed Corporation Act 69 of 1984.

¹¹² 2008 (2) SA 303.

¹¹³ *Haygro Catering BK v Van der Merwe en Andere* 1980 (3)

23 of the Closed Corporation Act¹¹⁴ and was a gross abuse of the juristic personality.¹¹⁵

The law is not settled on whether there is a difference between the gross abuse and unconscionable abuse. These issues will have to be addressed when applying the provisions of section 20(9) of the Companies Act¹¹⁶. However, section 65 of the Closed Corporation Act and common law may serve as useful guidelines to the courts when making its determination.

In terms of s 20(9) of the Companies Act, the declaration by the court may be done by way of application proceedings or by way of action proceedings. The court also has the right to decide that a company is not to a juristic person.¹¹⁷

The wording of section 20(9) of the Companies Act 71 also makes reference to an interested person, however the meaning of an interested person is not fully explained in the act and therefore this concept will have to be addressed.

3.9 The term interested person

In *Jonck BK h/a Bothaville Vleismark v Du Plessis NO*¹¹⁸ the term interested person was considered with reference to section 65 of the Closed Corporation Act¹¹⁹ to determine the meaning of an interested person. The court said that the meaning should not be looked at too narrowly nor should it be looked at too widely. In the event of the

¹¹⁴ Ibid

¹¹⁵ Rehana Cassim Piercing the corporate veil 'Unconscionable abuse' under the Companies Act 71 of 2008.

¹¹⁶ S20 (9) of the Companies Act 71 of 2008.

¹¹⁷ Ibid.

¹¹⁸ 1998 (1) SA 971.

¹¹⁹ Closed Corporation Act 69 of 1984.

interest being a financial interest, the creditor would be an interested person.¹²⁰

In order to fully understand section 20(9) of the Companies Act, the case of *Ex Parte: Gore NO and Others*¹²¹ should be examined. This case dealt with the application of section 20(9) of the Companies Act,¹²² and may be described as one of the recent cases which applied the principle of piercing the corporate veil. The facts of the *Gore and Others (2013) 2 All SA 437 (WCC)*, hereafter referred to as the ('Gore decision') were as set out below.

The applicants in this case were liquidators of one or more companies which was included in a group of companies. The holding company was ('KFH') King Financial Holdings Limited. The KFH's shares were owned by three groups of shareholders, who were also known as the trustees of the Adrian King Beleggings Trust, the Paul King Beleggings Trust and the Stephen King Beleggings Trust.¹²³

The King Brothers were directors of KFH and most of its subsidiaries, and on this basis were in control of the KFH group. The King Brothers used the companies in the group to do business by way of financial services. The Financial Services Board ('FSB') conducted a search of the operation of the business activities, at the group's business address and the investigations revealed that the affairs of the group were conducted in such a way that there was no distinct corporate identity, between the various companies in the group. The holding company controlled the group of companies and the funds which were provided

¹²⁰ R Cassim Piercing the corporate veil 'Unconscionable abuse' under the Companies Act 71 of 2008 accessed September 2015 available at <http://www.saflii.org/za/journals/DEREBUS/2013/197.pdf> at para 16.

¹²¹ (2013) 2 All SA 437 (WCC)

¹²² Companies Act 71 of 2008

¹²³ Gore and Others (2013) 2 All SA 437 (WCC) at para 5-7

by capital investors were moved around to other companies by the controlling members. On this basis the court confirmed that the entire group was controlled by the holding company and that the controllers of the company treated all the companies as one.

There was no distinction between the Investors Funds, between KFH and the subsidiary companies. The court found that the disregard by the King Brothers of the separate corporate personalities of the companies in the King Groups amounted to a sham.¹²⁴ As a result of the deceitful and unorganised manner in which the affairs were managed by the King Brothers, the liquidators of the companies found it very difficult to recognise the corporate entities in comparison to the individual stakeholder or creditors' claims.¹²⁵

The court ruled that there was an unacceptable mishandling by the controllers of the subsidiary companies, as independent entities and that this had brought the case within the scope and application of section 20(9) of the Companies Act.¹²⁶

In the *Gore* decision the companies in question were a group of companies, even though the company may operate as one economic unit this does not entitle the court to view the company as one and ignore the separate existence of each company. Based on the aforementioned principle it was held that the holding company is a separate legal entity from its subsidiaries and the acts of the subsidiary company cannot be one and the same of the holding company.

¹²⁴ Rehana Cassim '*Hiding Behind the Veil*' De Rebus , October 2013

¹²⁵ Ibid

¹²⁶ Rehana Cassim '*Hiding Behind the Veil*' De Rebus , October 2013

The court in the *Gore* decision noted that the courts have been divided in their approach as to when to pierce the corporate veil, especially when a group of companies are involved. The courts in the past have noted that they are not entitled to discard the separate personality of a group, however this is based on a principled approach where the courts will access case law to determine whether it is just to do so.¹²⁷

Upon application of section 20(9) the court declared that the subsidiary companies with the exclusion of KFH were deemed not to be a juristic person.¹²⁸ The court noted that the King companies ignored the principle of separate legal personality. The holding company was perceived as the as the sole company. Section 20(9) Companies Act 71 of 2008 gave the court the necessary power to declare a company to not be a juristic person in line with any right, liability or obligation of the company.

The right in respect of the *Gore* decision was a right to property which was held by the subsidiary companies.¹²⁹

The applicants were ordered to handover all remaining funds in the King Companies, which consisted of the remainder of funds after the compensation of the liquidators, bondholders and claims other than investment claims group of assets.

The introduction of the statutory provision has brought about a level of uncertainty with regard to whether the statutory provision overrides the common law or whether is a supplement to the common

¹²⁷ *Gore and Others* (2013) 2 All SA 437 (WCC) at para 19

¹²⁸ *Ibid* at para 60

¹²⁹ *Ibid* at para 11

Law.¹³⁰ The court in the *Gore* decision confirmed that the legislature did not state that the subsection replaced the common law nor did it confirm that it did not.

It is my view that section 20 (9) of the Companies Act¹³¹ may only be raised where a company is used as a stratagem or as a sham, even in instances where a company is legitimately formed but later is misused, which is in line with the *Cape Pacific v Lubner*¹³² case which confirmed that the corporate personality may be disregarded even when a company was legally started but was misused in a particular instance and that it was not necessary for a company to be founded on deceit.

A company is seen as a separate legal entity, which affords the individual shareholders and directors with many benefits as was pointed out above. However, those who manage the company do not always follow the necessary provisions of the law and find the necessary ambiguities in law to either gain a financial advantage from the provisions of the act or avoid following the provisions of the Companies Act. In these instances the courts are forced to make use of the process of piercing the corporate veil.

From the above discussion, it is not clear that the application of the section 20(9) of the companies act 71 of 2008 leg may also be used, where applicable. However, the courts now have a wider discretion to apply this remedy.

It is suggested that a balancing approach should be used in terms of the application and interpretation of s 20(9) of the companies

¹³⁰ Ibid at para 31

¹³¹ Companies Act 71 of 2008.

¹³² 1995 (4)

act 71 of 2008, where the courts should balance the separate legal personality against those policy considerations in favour of piercing the corporate veil.¹³³ In the *Gore* decision, section 20(9) of the companies Act 71 of 2008 supplemented the common law provisions on piercing the corporate veil and has not overridden the common law provisions.

Today this remedy is not only afforded to the courts in terms of the Common law but where the requirements of section 20(9) 71 of 2008 of the Companies Act are met the court may rely on the statutory provision for piercing the veil.

The conclusion herein is therefore that where s20 (9) of the Companies Act 71 of 2008 of the Companies Act may not be relied on, the common law remedy should be applied by the courts. The section 20(9) 71 of 2008 statutory remedy does not override the common law provisions of piercing the corporate veil but strengthens and reinforces it.

The recognition of a company as a separate legal entity plays an important role in the way in which companies, directors and shareholders as taxpayers arrange their affairs, as many Companies often conceal or disguise the true nature of transactions and abuse the corporate legal personality to obtain a fiscal advantage or tax benefit. The court may either pierce through the company and hold the directors or shareholders liable or will look at the substance of the transaction rather than the form.

In Income Tax cases parties will attempt to gain a benefit of the complexities of income tax legislation in order to gain a decrease in their

¹³³ *Gore and Others* (2013) 2 All SA 437 (WCC) at para 34

overall liability for income tax. There are many ways in which to do this however, what is common amongst all of these is that they take ordinary commercial transactions and add additional elements to it to make it complex.¹³⁴

It may be said that the court may look through the transaction to find out what the true state of affairs are. An investigation into the manner in which the courts interpose and look through entities is prudent, as this is not the piercing of the corporate veil principle but an alternate remedy available to courts. In instances where parties attempt to disguise the true state of affairs, the court will look at the substance of the transaction and disregard the legal labels or form which parties attach to the transaction. Many taxpayers arrange their matters in such a way to avoid, reduce or delay a tax liability under tax legislation and in this way taxpayers circumvent and exploit the provisions of tax legislation.

3.10 Personal Liability for tax debts of third parties under the Tax Administration Act 28 of 2011

The South African Receiver of Revenue Services (“SARS”) can insist that an individual e.g. the director or shareholder of a company, member of a closed corporation or trustee of a trust personally liable for the legal entities tax debts.

It has been set out in chapter 2 of this paper, that an entity such as a (a)company, (b)closed corporation or (c) a trust is seen as having separate legal personalities and SARS could make use of the piercing of the corporate veil principle or certain provisions in the Tax Administration act such as section 180 Tax Administration Act 28 of 2011,¹³⁵ section 184 (1) Tax

¹³⁴ R Cassiem, De Rebus ‘Hiding behind the veil’ DR October 2013 accessed august 2015 available on <http://www.saflii.org/za/journals/DEREBUS/2013/197.pdf>

¹³⁵ Section 180 Tax Administration Act 28 of 2011.

Administration Act¹³⁶ or section 184 of the Tax Administration Act (2)¹³⁷ to hold each of the individuals who control the entity personally liable.

The starting point of the enquiry is that SARS will first have to acknowledge the liability for the tax debt of an entity rests with the legal entity, because in the normal course of events directors, shareholder, members and trustees are not held individually liable for the entity's tax liability when it is unable to pay SARS.¹³⁸

Section 180 of the Tax Administration Act¹³⁹ states that an individual might be held personally liable for any tax liability of a taxpayer; this would include a company, CC or a trust to the extent that the person's disregard or deception resulted in the non-payment of taxes. This is however based on the fulfilment of necessary requirements, (a) the person manages or is regularly included in the overall financial affairs of that entity,¹⁴⁰ and (b) a senior SARS official is content that this individual is or was neglectful or fraudulent with regards to the payment of the arrear tax.¹⁴¹

The question of when a person will be viewed as being in charge or regularly included in the management or general financial activities of an entity is an enquiry of fact and will be based on the facts of each case.

In terms of s 184(1) of the Tax Administration Act¹⁴² SARS may recover debt through the assists of an individual as it has against the

¹³⁶ Section 184 (1) Tax Administration Act 28 of 2011.

¹³⁷ Section 184(2) Tax Administration Act 28 of 2011.

¹³⁸ The South African Institute for Chartered Accountants available at www.saica.co.za/integritax/.2080. *Personal liability for tax debts*, accessed on 28 July 2015

¹³⁹ Tax Administration Act 28 of 2011.

¹⁴⁰ Section 180(a) Tax Administration Act 28 of 2011.

¹⁴¹ Section 180(b) Tax Administration Act 28 of 2011.

¹⁴² Tax Administration Act 28 of 2011.

taxpayer's own assets which would include a company, closed corporation or trust.

Section 184(2)(a) of the Tax Administration Act gives the person possibly facing individual debt a chance to make representations, before s180 of the Tax Administration act¹⁴³ liability is established, provided that this does not threaten the receiving of the tax liability,¹⁴⁴ alternatively, under subsection 184(2)(b) of the Tax Administration Act, as soon as possible, following the person being held accountable for the tax debt of the taxpayer.¹⁴⁵

It is clear that SARS may make use of the Tax Administration Act to affect personal liability on directors; however it is clear that before SARS can do so, it is imperative that the legal principles are applied as set out in the Tax Administration Act as well as the application of the facts of each case

¹⁴³ Section184(2)(b) Tax Administration Act 28 of 2011

¹⁴⁴ Ibid

¹⁴⁵ Section184(2)(b) Tax Administration Act 28 of 2011

4 Sham Transactions and the term Substance over Form

4.1 Introduction

Corporate structures have attempted to pay reduced income tax by making use of tax legislation to avoid paying large amounts of money. There have been a number of cases dealing with the difference between tax avoidance and tax evasion and sham transactions.

An avoidance arrangement concerns a legitimate transaction which can only be attacked if it falls within the ambit of the general anti avoidance provisions, whereas tax Evasion speaks to the usage of illegal and deceitful means to elude tax, for which penalties are given under the Act and constitutes a criminal offence.

The foundation of simulated transactions was established in the case of *Zandberg v Van Zyl*¹⁴⁶ in which the court stated that a party to a transaction may attempt to hide the true character, call a transaction by a different name and have as its intention not to express but to hide the true nature. The law however, permits people to organise their matters in a manner which will permit them to obtain a benefit, if they had arranged their affairs in a simplistic manner they would not have been able to obtain a benefit from the transaction.¹⁴⁷

When parties enter into a transaction, they enter into it knowing that they would like to obtain the best possible financial advantage. In South African Law an individual or entity may arrange their commercial affairs in a manner which will lessen their tax liability, provided they remain in the confines of the law. This also includes the fact that all persons are entitled to set out his financial matters in a way that would

¹⁴⁶ (1910) AD

¹⁴⁷ *Zandberg v Van Zyl* (1910) AD 309 at 302

attach less tax liability. In the event that an individual or entity arranges his affairs in such a manner that gives him the greatest advantage, the Commissioner cannot request him an increased tax amount without proving that the taxpayer should have done so.¹⁴⁸

It is a renowned principle of Tax law that a taxpayer may structure a transaction any manner possible in order to minimize taxes, but he cannot make a transaction appear to be what it is not. The taxpayer has the legal right to reduce the amount of his taxes, where the law permits.

4.2 Doctrine of Substance over form – common law

The common law states, the doctrine of substance over form may be said to rest on two principles, namely the label principles and the simulation principle set out as follows:

1. In the first instance the parties attach a wrong label to the principle, but act in moral grounds and even though it seems not to be the case, the parties will give effect to the transaction;¹⁴⁹ and
2. In the second instance, the parties enter into a sham transaction or a *fraudis legis* i.e. a transaction which is in fraud of law.¹⁵⁰

4.3 What is the meaning of a Sham transaction

There are many decisions in the South African courts, as well as foreign courts which have tried to give a meaning to the term 'sham'. A sham transaction may be said to be one in which the parties do not give effect

¹⁴⁸ IRC v Duke of Westminster (1936) AC 1 at 19

¹⁴⁹ A Hutchison and D Hutchison *Simulated Transactions and the Fraudus Legis Doctrine*, at page 69

¹⁵⁰ Ibid

to the ostensible terms of the arrangement, or may be said to be a cloak to conceal the parties real intent.¹⁵¹

South African and foreign courts in the environment of tax and otherwise, have defined specific dealings as being a "sham".

In the *English decision of Bridge v Campbell Discount Co Ltd*¹⁵², Lord Devlin said:

When a court of law finds that the words which the parties have used in a written agreement are not genuine, and are not designed to express the real nature of the transaction but for some ulterior purpose to disguise it, the court will go behind the sham front and get to the reality.¹⁵³

In the Australian decision of *Sharment (Pty) Ltd v Official Trustee in Bankruptcy*¹⁵⁴ ruled:

A sham is, for the purposes of Australian law, something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not.¹⁵⁵

4.4 The development of the principle of Substance over form

In order to fully understand the doctrine, the development of the doctrine throughout case law should be discussed.

¹⁵¹ Ibid

¹⁵² *Bridge v Campbell Discount Co Ltd* (1962) AC 600

¹⁵³ Price Waterhouse Coopers Anti-avoidance Sham transactions April 2010 re-issue 128 accessed on 23 July 2014 available at [https://www.saica.co.za/integritax/2010/1834 Sham transactions.htm](https://www.saica.co.za/integritax/2010/1834%20Sham%20transactions.htm)

¹⁵⁴ *Sharment (Pty) Ltd v Official Trustee in Bankruptcy* 1988.

¹⁵⁵ Ibid

The court looked at the subject of simulated transactions with reference to *the Zandberg v Van Zyl*:¹⁵⁶

Whenever all involved in a transaction try their best to hide the true effect of the transaction, by shape or intent, and when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is, not what in form it purports to be, but the words of the rule indicate its limitations. The Court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances, that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.¹⁵⁷

More than thirty years later the court looked at this principle in terms of *Customs and Excise v Randles, Brothers & Hudson Ltd*¹⁵⁸ where the court pointed out that the intention of the parties must be examined.¹⁵⁹

A business deal is not classified as a masked deal if it is intended to evade the prohibition or avoid tax payments. If a transaction is completed with good intention, the only question that rises is whether it falls inside or out of the scope of the prohibition. A masked business deal in the way shown above is, set out is somewhat different. A masked business deal's purpose will be to hide what is the truth from the necessary stakeholders. Parties involved in a transaction try to conceal the transaction from everyone involved, in order for them to hide that the real agreement falls within the scope of the prohibition. A business deal of this manner is known as *Fraudem Legis* and is seen in conjunction by the court with what is real after investigation.¹⁶⁰

¹⁵⁶ 1910 AD 302 at 309.

¹⁵⁷ *Zandberg v Van Zyl* 1910 AD 302 at 309

¹⁵⁸ 1941 AD 369

¹⁵⁹ *Ibid*

¹⁶⁰ *Emslie and Davis Income Tax and case materials 3ed* (2011), *The Taxpayer*, Cape Town. at page at page 94

In 1996, *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 1996*¹⁶¹ was seen as the leading case on the doctrine:

The facts of the case were briefly as follows, in 1983 the Directors of a company called Pioneer Seed Company (Pty) Ltd and its subsidiary Pioneer Seed Holdings (Pty) Ltd established a furniture factory which would be operated by Pioneer Seed Company (Pty) Ltd. The taxpayers who were wholly owned subsidiaries also acquired pieces of land. In 1984 eight separate but inter-related written agreements were simultaneously concluded. The agreements set up that an independent pension fund who hired the land from the taxpayers from 1984 to 1991 and the lessee at his own expense was allowed to build structures and other enhancements on this property and the buildings would become the possessions of the lessor. A building contract was entered into between the pension fund and the building contractor. The commissioner assessed the Landlord for tax based on the construction of the factory, which brought forward an accrual of income in terms of subsection (h) of the definition of gross income.¹⁶²

The court proceedings brought out two reputable principles, the first principle was expressed in the case of Duke of Westminster, which was adopted in the case of *CIR v Estate Kohler and others*¹⁶³, which in effect is the general principle expressed in the case of *Dadoo v Krugersdorp Municipal council 1920 AD 530* and in *Van Heerden v Pienaar 1987 SA* which confirmed that parties are entitled to organise their affairs so as to stay out of the confines of the act, however in each case the court will determine whether the intended consequences were

¹⁶¹ 1996(3) SA 942 A

¹⁶² *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 1996 (3) SA* at para 2-7

¹⁶³ 1953(2) SA 584

realised and will depend on the facts of the case and the law will be applied according to these facts.¹⁶⁴

What the court looked at was based on the principle expressed in *Kilburn v Estate Kilburn*,¹⁶⁵ which is that the courts will investigate the form of the transactions and link it to its real intent for substance.¹⁶⁶

The South African position has for many years been according to that which was set out in the *Dadoo*¹⁶⁷ case in which judge Innes CJ said, *frudem legis* arises when the true identity of a transaction is hidden intentionally to evade the tax provisions.

In *Commissioner of South African Revenue Services v Cape Consumers (Pty) Ltd*¹⁶⁸ the court stated that it could not ignore contracts because the parties in fact and in law began the process to allow for the agreement in question to have effect, the doctrine is not a solution for parties to use ignore what the agreements were in fact and in law intended to be.¹⁶⁹

The current climate in the South Africa courts is an environment which is not conducive to tax avoidance schemes as the courts do not easily ignore the substance of a transaction, however in the past when a court enquired into the tax liability of parties, the court would look at the actual transaction and not the true essence of the contract.¹⁷⁰

¹⁶⁴ Ibid

¹⁶⁵ *Kilburn v Estate Kilburn* 1931 AD

¹⁶⁶ Ibid

¹⁶⁷ *Dadoo Ltd and Others Appellants v Krugersdorp Municipal Council* 1920

¹⁶⁸ 1999 (4) SA

¹⁶⁹ T Legwaila, *Modernizing the Substance over Form Doctrine*, Commissioner for the South African revenue Service v NWK Ltd (2012)

¹⁷⁰ Ibid

This therefore leads to the controversial decision of *NWK*¹⁷¹ which expands the traditional understanding and application of the doctrine. It looks at the substance and the form in a different manner compared to the aforementioned decisions. The *NWK* decision also deals with the implications of tax structures and the commissioner's choice of action against persons who try to evade tax.¹⁷²

4.5 An evaluation into the case of Commissioner of South African Revenue Services v NWK 2010

*4.5.1 The factual background of Commissioner of South African Revenue Services v NWK*¹⁷³

In the *Commissioner of South Africa v NWK, Slab Trading Company (Pty) Ltd, hereafter referred to as ('Slab')*, a subsidiary of First National Bank was a company which had as one of its business activities transactions relating to financial instruments. *Slab* gave *NWK* a loan of R96 415 776 which was supposed to be repaid in a period of five years. The initial loan amount should have been paid by *NWK*, by handing over 109 315 tons of maize to *Slab* after the agreed period. There was a fixed interest rate of 15.41% that was due at the end of every 6 month period. *NWK* gave ten promissory notes to FNB for an amount less than the face value. *Slab* gave up its right to the maize to First derivatives for the sum of R45 815 776. This allowed FNB to be in a liquid position to settle the debt with *NWK*.¹⁷⁴

During the five years *NWK* claimed interest expenses on a loan it had from *Slab* which lowered its tax liability. The commissioner allowed the deductions however he raised an assessment in which he refused the deductions and the portions of interest.

¹⁷¹ 2011 (2) SA 67 (SCA)

¹⁷² *Ibid*

¹⁷³ *NWK* 2011 (2) SA 67 (SCA)

¹⁷⁴ *Ibid* at para 1

The commissioner appealed in contrast to the directive of the tax court based on the fact that the transactions were simulated. The court had to view the transactions in light of the many other arrangements between NWK and FNB. The basis of the claim was that the transactions were arranged in a way which would increase the loan amount in order to have greater deductions of interest. NWK insisted that their deductions were true and there were no dishonest intentions.¹⁷⁵

4.5.2 The transactions in NWK

The transactions in question were set up as follows:

(a) Slab had loaned R96 415 776 to NWK, (b) the capital amount would be repaid by NWK sending 109 315 tons of maize to Slab, (c) interest was based on the initial amount at a fixed interest rate of 15.41% annually, which was payable every six months and NWK would provide 10 promissory notes in return, valued at R74 686 861, (d) to pay for the debt, Slab then reduced the price of the notes to sell to FNB. FNB would be paid by NWK on the due date, (e) Slab agreed to give ownership of the maize to First Derivatives a division of FNB at the end of the agreement, to settle the whole outstanding debt amount owing to NWK to the amount of R45 815 776. This would allow FNB to settle the debt to NWK, (f) First derivatives sold the ownership of delivery of the maize to NWK for R46 415 776 which was paid on the date of the completion of the agreement, and delivery would happen after 5 years and (g) Slab would cede its rights to a trust company.¹⁷⁶

NWK argued on appeal that the contracts were in line with its terms and NWK was not involved in the collusion of Slab and FNB and the agreement of the loan showed intent of NWK.

¹⁷⁵ Ibid at para 3

¹⁷⁶ Ibid at para 11

4.5.3 The decision in Commissioner of South African Revenue Services v NWK

The court said that it is not enough to look at the intention of the parties, it is important to look at the way in which participants put together a business deal to gain an object instead of the intention of the terms of the contract. The test to evaluate simulation was to look at the commercial sense of the transaction, in other words the real substance and purpose. If the existence is only to gain evasion of tax, the object would then be seen as pretended. The fact that the involved persons are acting in terms of the agreement, does not make it genuine or 'not created'.

4.5.4 The significance of the Commissioner of South African Revenue Services v NWK

The *NWK* case evolved the South African law in connection to simulated transactions. The position remains that the court will examine the whole transaction in light of the circumstances of each case.¹⁷⁷

The principle of substance over form therefore confirms that the real nature of the commercial transaction will be taken into account by the court, this only applies where the individuals and business entities do not set out to ensure that the contract includes the true effect of what is conveyed to the world. In essence this principle may be said to have its limitations.¹⁷⁸

The *NWK* decision is an example of how corporate structures make use of ingenious methods of transactional financing and structuring in order to avoid paying taxes. The agreements in respect of the maize were in my view, a facade and an illusion. From the facts it is clear that the

¹⁷⁷ E Bloomberg SC *NWK* and Founders Hill 2011 at page 206

¹⁷⁸ *Ibid*

parties set up the transactions in such a manner that there was never going to be delivery of the maize in the future. The contract itself between NWK and FNB did not give effect to legitimate rights and duties which would enable the parties to gain some sort of tax benefit.

Upon examination of the facts, it is clear that there was never a loan for R95 million in fact there was only a loan for R50 million. The significance therefore of NWK is that if the transaction had as its sole purpose tax evasion or that would be enough to qualify as simulated and set aside the consequences in light of the real agreement. I agree with the Commissioner of South African Revenue Services that the transactions were simulated.

4.6 Tax Avoidance and Simulated transactions

The position put forward by the NWK decision was the position for many years until, 20 November 2012 in which *Bosch and Another v Commissioner of South African Revenue Services* was heard.¹⁷⁹

The Commissioner for South African Revenue services taxed the taxpayers with employees and past employees of the Foschini group of companies, in respect of their participation in the Foschini Share Incentive scheme. The commissioner raised additional assessments based on the variance between the price of the shares and the price on the dates when they exercised their options under the scheme and the market value of the shares on the anniversary of the second, fourth and sixth anniversaries of granting the options, which were the dates on which the shares were delivered.¹⁸⁰

¹⁷⁹ 94 of 2012

¹⁸⁰ The Taxpayer volume 11 'Income Tax- Share incentive Scheme-unconditionally of Rights acquired thereunder- Simulated transactions- NWK 2012 at page 205

Foschini understood that the employees would be at an advantage, when they exercised the options within a short period after they were granted, in order for the taxable amount in terms of S8A of the Income Tax Act could be small and any movement which was done from the time of the exercising of the date on which the shares were handed over, income tax would not be charged.¹⁸¹ The commissioner requested the court to assess the matter and look at the substance and the applicability of section 8A Income Tax Act.¹⁸²

The issue which had to be addressed in the case was whether the scheme amounted to a simulated transaction designed to disguise the conditions of the scheme. SARS attempted to challenge the interpretation of the law and wanted to subject the taxpayers to income tax. SARS was successful in the court below but when the taxpayers appealed to the Western Cape High Court, the taxpayers were successful.¹⁸³

There were two separate judgments in the case. Both the judgements in the Bosch case rejected the views put forward by SARS. Davis J (with Baartman J concurring) stated that NWK should not be seen to have changed the law regarding simulated transactions but is coherent and in line with the law before the NWK decision. Davis J stated that all that was needed was an assessment into the Davis J found that the SCA merely required, as part of the inquiry into the 'real commercial sense of the transaction.'¹⁸⁴

Waglay J, in a separate judgment, concurred with Davis J's conclusion, but for different reasons. He stated that it did depart from the long line of previous case law on simulated transactions and stated any event that's purpose is to avoid tax will be considered simulated notwithstanding that it is

¹⁸¹ Ibid

¹⁸² 58 of 1962

¹⁸³ The Taxpayer volume 11 '*Income Tax- Share incentive Scheme-unconditionally of Rights acquired thereunder- Simulated transactions*' NWK 2012 Page 208

¹⁸⁴ Bosch and Another v Commissioner of South African Revenue Services 94 of 2012

genuine. He stated that NWK cannot be authority in which transactions may be set aside as simulated based on tax evasion as this is an involuntary consequence in light of the law. He also pointed out that the confusion created in NWK in respect of the wording of “tax evasion” being replaced by “tax avoidance” goes against what is accepted law. Therefore, NWK is not a judgment which should be used as a binding precedent for lower courts.¹⁸⁵

4.7 The questionability of Commissioner of South African Revenue Services v NWK and Rochcon (Pty) Ltd v Anchor Auto Body Builders CC

In many areas NWK was seen as a weapon to be used when a tax arrangement was seen as questionable and certain writers questioned whether General Anti-Avoidance Rules (“GAAR”) was necessary. This was where NWK created a certain level of uncertainty, which in my view was unintentional and the Rochcon decision placed the concept of substance over form back into place.

It is important at this stage to deal with the question raised in the *Rochcon*¹⁸⁶ decision which was, who the True Owner of five Nissan trucks were and whether the floor plan agreements should constitute simulated transactions or disguised transactions.¹⁸⁷

Rochcon was granted a contract in September 2008 to purchase five trucks which were to be fitted with cranes to modify the trucks. Rochcon ordered the five trucks from Toit’s and Toits then ordered the trucks from Nissan Diesel. The transaction was financed by Wesbank. Nissan Diesel supplied the vehicles under a supplier agreement it concluded with Wesbank. Wesbank purchased and paid for the vehicles that authorised Nissan Dealers. The trucks were delivered to Anchor on

¹⁸⁵ Ibid

¹⁸⁶ *Rochcon (Pty) Ltd v Anchor Auto Body Builders CC* (2014).

¹⁸⁷ *Rochcon (Pty) Ltd v Anchor Auto Body Builders CC* (2014), para 10 at page 7

Toit's instruction to have the modifications undertaken to the sub-frames and load certain features onto the truck. In 19 November 2008 Rochcon took delivery of the two trucks. On 21 November 2008 Rochcon took delivery of the remaining trucks, signed the handover sheet but did not take possession. On 28 November 2008 the documentation constituting proof of delivery was handed over to Rochcon and Rochcon paid Toit for the five trucks. Anchor was not prepared to hand over the remaining three trucks as Toit had not paid for the modifications. Rochcon then paid for the modifications but at that point Anchor had gone into liquidation and Anchor did not want to release the trucks on the instructions of Wesbank who claimed ownership of the trucks because Toit did not pay for it yet.

Rochcon contended that the supplier agreement and the floor plan agreement were disguised or simulated. Rochcon contended that the floorplan agreement was a loan against the security of the trucks without Wesbank taking possession of it. Wesbank contended that the onus rested on Rochcon to prove simulation.

The Court addressed this point by referring to the dictum in the *Zanberg v Van Zyl decision 1910 AD 302* in which it set out the test which had to be applied when considering whether an agreement may be seen as a simulated transaction. The court stated that one must look at the facts which gave rise to the contract and look for an unusual provision set out in the transaction.

The *NWK* decision departed from existing case law on simulated transactions and set a new rule where any event that is directed in tax avoidance will be considered as a simulated event notwithstanding that it is a genuine transaction, however *NWK* cannot be raised where evasion is not in question. Tax evasion is an unlawful occurrence and will be punishable with a criminal offence. *NWK* cannot be seen as a

mechanism for setting aside simulated transactions by motive of being a means for “tax evasion”. If the words evasion were to be exchanged with avoidance then this is in contradiction of what is allowed in terms of Income Tax law, which is the acceptance of transactions in which tax avoidance arises.

4.8 Conclusion

The conclusion to be reached is therefore as was set out in the Rochcon decision. That in order for a transaction to be seen as simulated, it must be established that there was no genuine purpose to the transaction or in other words, the transaction did not reflect the parties true intention. In order to evaluate whether the transaction is genuine, a court must assess the elements of the transaction and determine whether this adds any value to the transaction or may serve as no commercial sense then the aforementioned factors could lead SARS as a court of initial occurrence to and the court in the next occurrence to settle that the transactions were not honest and was imitation.¹⁸⁸

The crucial aspect to bear in mind is that this could not be seen as a closed list or as standalone deciding factors, as to whether a transaction is simulated or can be labelled as a sham. The court must have regard for the long line of case law in order to come to a conclusion.

¹⁸⁸ E Mazansky, ‘The Supreme Court of Appeal clarifies NWK’ (2014)

5 Anti-avoidance rule, Tax Administration Act and the relation to Avoidance Arrangements

5.1 Introduction

This chapter examines the rules relating to the general anti-avoidance provisions set out in the Income Tax Act 58 of 1962.

Tax Evasion refers to the unlawful means of avoiding tax which will include amongst other things fraud and simulated transactions. The evasion of tax is illegal and will have the effect of criminal prosecution.

Impermissible tax avoidance occurs where more than one of the tainted elements contained in the anti-avoidance provisions are present. This is made up of aspects such as the abnormality in terms of rights or duties created, what the solitary or core existence is to gain a tax advantage and possibly whether a transaction lacked commercial substance. The consequence of an impermissible tax avoidance arrangement will give rise to the nullification of the tax benefit and the taxpayer may in certain instances have to pay interest on unpaid tax.¹⁸⁹

There are various requirements in the Income Tax Act, Act no 58 of 1962 that are designed to prevent schemes or arrangements which may be aimed at the avoidance of tax, these sections include: (1) section 1 (c) of the Income Tax Act,¹⁹⁰ the meaning of gross income which deals with receipts or accruals by a person of amounts for offering service or to be rendered by another individual, (2) section 7(2) Income Tax Act¹⁹¹ up to and including section 10 of the income Tax Act

¹⁸⁹ AP de Koker , RC Williams , Silke on South African Income Tax (2015), para 25.2 page 774

¹⁹⁰ Income Tax Act 58 of 1962

¹⁹¹ Ibid

deals with income resultant from a person in consequence of certain donations by another person, (3) section 8(e) Income Tax Act 58 of 1962 deems certain dividends to be interest, (3) section 8(f) of the Income Tax Act 58 of 1962 deals with interest paid by s9D Income Tax Act which deals with income from foreign sources, section 22(8) Income Tax Act 58 of 1962 deals with donation or private consumption or trading stock and section 54 Income Tax Act 58 of 1962 up to and including section 64 Income Tax Act 58 of 1962 deal with donations tax.

The most important provision for purposes of my research is section 80A-80L of the Income Tax Act 58 of 1962 which will be discussed below.

Section 103 of the Income Tax act 58 of 1962 used to set out the General Anti-Avoidance rule for many years, until s80A to s80L was inserted into the Income Tax act. Before explaining the operation of s80, we must first examine s103 of the Income Tax act 58 of 1962.

In order for section 103(1) Income Tax act 58 of 1962 to find application all the requirements of the section must be met. There must have been a business event, operation or scheme entered into or conducted, the consequence of the transaction, scheme must have been to lessen or delay tax liability created by the Act, the commercial transaction must have been abnormal in terms of: (a) the way it was done, (b) what was created by the transaction as in rights and obligations or done only to gaining the tax benefit. This will not specifically be addressed in this paper.

Before the application of GAAR is discussed, there are certain definitions which must be highlighted in respect of s 80L of the Income Tax Act Income Tax act 58 of 1962.

The term tax refers to any tax, duty or levy set out by the Act or another Act administered by the Commissioner.¹⁹²

An arrangement includes any business dealings, events, scheme, contract or understanding, even if it is enforceable or not and also includes any steps including the aforementioned involving the alienation of property.¹⁹³

Impermissible avoidance arrangement is any avoidance arrangement described in section 80A.¹⁹⁴ A tax benefit is defined in section 1 of the Income Tax Act,¹⁹⁵ and refers to any avoidance, delay or postponement or reduction of tax liability.

5.2 When does Section 80A find application

Section 80A¹⁹⁶ can only be applied when an avoidance arrangement is not allowed in court.¹⁹⁷ Section 80A¹⁹⁸ sets out the provisions on impermissible arrangements and when this may be applied.

¹⁹² AP de Koker , RC Williams , Silke on South African Income Tax (2015), para 1.1 2015

¹⁹³ Income Tax Act 58 of 1962

¹⁹⁴ Income Tax Act 58 of 1962

¹⁹⁵ Section 1 Income Tax Act 58 of 1962

¹⁹⁶ S80A Income Tax Act 58 of 1962

¹⁹⁷ Taxation simplified and demystified ' General Anti-avoidance Rule'

<https://sataxguide.wordpress.com/general-anti-avoidance-rule-gaar> accessed on 23 March 2015

¹⁹⁸ Income Tax Act 58 of 1962

An avoidance arrangement is an arrangement which is not allowed, if its only or main purpose is to gain a tax advantage and as set out in (a), (b) or (c) as set out below:

(a) in the context of business: (i) it was concluded by means or in a manner that would not normally be used for bona fide business purposes, other than gaining a tax advantage; or (ii) it is short of or lacks commercial substance, in line with the provisions of section 80C, (b) in an environment other than business, it was entered into or conducted in a manner which would not be employed for a bona fide purpose, other than gaining a tax advantage; or (c) in any context (i) it created rights or obligations which would not normally be created by parties dealing at arm's length; (ii) it will result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).¹⁹⁹

The section 80A²⁰⁰ requires that distinct principles must be met. Set out as follows (i) an avoidance arrangement, (ii) the impermissible avoidance arrangement should have been entered into on or after the 2nd of November 2006, (iii) the only or core purpose of the arrangement should have been to acquire a tax advantage and the arrangement must have been abnormal in terms of (a) business context, (b) context other than business or (c) any context and (d) it must have resulted in an abuse or misuse of the Act.²⁰¹

5.3 When does an impermissible arrangement arise

An impermissible arrangement comes into being if the only or core purpose of the avoidance was to gain a tax advantage and that a tainted element exists. section 80A of the Income Tax Act²⁰² contains three tainted elements which are set out as follows the abnormality, the

¹⁹⁹ Section 80 Income Tax Act 58 of 1962.

²⁰⁰ Section 80A Income Tax Act 58 of 1962.

²⁰¹ Ibid

²⁰² 58 of 1962.

non-existence of commercial substance; and the misappropriation or mistreatment of the provisions of the income tax act.²⁰³

Section 80C of the Income Tax Act²⁰⁴ sets out the general rules applicable, and confirms when a transaction will have an absence of commercial substance for the purposes of section 80A. Section 80C states that an arrangement will fall short of commercial substance if, it results in a substantial tax advantage for a party, but does not have a noteworthy result on the business risks or the net cash flow of that party.²⁰⁵

The examples of instances of where arrangements may lack commercial sense is situations where a substance of a transaction differs from the form, round trip financing as provided for in s 80D the Income Tax Act²⁰⁶, accommodating of tax indifferent parties as set out in s 80E²⁰⁷ or instances where elements exist which by nature can change or extinguish one another the items will be brought to light on transaction gains a large tax advantage and the other only neutralises the effect of the first.²⁰⁸

The general anti avoidance provisions requires an objective analysis. Section 80A provides that you must look at the purpose or the arrangement is against the purpose for which the taxpayer entered into the arrangement.

²⁰³ Section 80A Income Tax Act 58 of 1962.

²⁰⁴ Taxation simplified and demystified ' General Anti-avoidance Rule'
<https://sataxguide.wordpress.com/general-anti-avoidance-rule-gaar> accessed on 23 March

²⁰⁵ Section 80C Income Tax Act 58 of 1962

²⁰⁶ Income Tax Act 58 of 1962

²⁰⁷ Income Tax Act 58 of 1962

²⁰⁸ Taxation simplified and demystified ' General Anti-avoidance Rule'
<https://sataxguide.wordpress.com/general-anti-avoidance-rule-gaar> accessed on 23 March

Once an arrangement has been determined to be within the realms of an impermissible avoidance arrangement, section 80B Income Tax Act 58 of 1962 will find application and the Commissioners may (a) disregard, combine, or re-characterise any section arrangement,²⁰⁹ (b) deemed individuals who are in associated, or to be the same person for dealing with tax treatment,²¹⁰ (c) reallocate any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties,²¹¹ (d) re-characterise any gross income, receiving or accrual of a capital nature or expenditure or (e) treat the disallowed avoidance arrangement as if it had not been carried out, or in a manner that the Commissioner decides fitting for the prevention of the relevant tax benefit.²¹²

The above serves as confirmation that the legislature is serious about tax compliance and does not take lightly to any tax avoidance schemes. A significant reform of the new GAAR is that it replaces the subjective purpose inquiry with an objective one, the distinction between purpose and effect as contained in Section 103(1) has thus fallen away.²¹³

GAAR does assist with the inherent weaknesses in respect of the old anti-avoidance provisions however there are a few shortcomings as it has very wide application and it may be potentially difficult to administer.

²⁰⁹ Section 80B Income Tax Act 58 of 1962

²¹⁰ Ibid

²¹¹ Section 80B Income Tax Act 58 of 1962

²¹² Section 80B Income Tax Act 58 of 1962

²¹³ Section 103(1) Income Tax Act 58 of 1962

5.4 Tax Administration Act and the relation to Avoidance Arrangements

The Tax Administration Act 28 of 2011, was enacted as a result of inefficiencies in tax legislation. The Act was developed as a single document to deal with the administration of taxes in South Africa.

Tax Administration refers to the process a person follows for a specific tax. This includes registering, submitting returns, assessments and making payment. This process is also known as the tax cycle. This act applies to all tax acts and their administration of taxes. For the purpose of our discussion we will look at its application in the Income Tax Act and how it provides for a mechanism to criminally charge offenders through administration.

5.5 Section 3(2) Tax Administration Act 28 of 2011

Section 3(2) Tax Administration Act sets out the meaning of 'Administration of a tax Act'. It explains terms such as how information is gained, how to establish whether returns have been filed, the establishment of identities, ascertaining the liability for tax, collection of tax and refunds, investigation of offences and how international agreements are given effect.²¹⁴

Section 3(1) Tax Administration Act marks "SARS" as a unit that is in control for the administration, and states that SARS as being "under the control or direction of the Commissioner, whereas in preceding law, the administration duty laid explicitly with the Commissioner as a person."²¹⁵

²¹⁴ Section 3(2) Tax Administration Act 28 of 2011

²¹⁵ Tax Law Review November 2012

The South African Revenue Service plays a key role in the implementation and governance of the Tax Administration Act. This includes ascertaining whether a person has submitted the correct returns, assessing the liability of a person for tax, investigating whether an offence has been committed, enforce their procedures under the Tax Acts and perform their duties in accordance to the Acts. Tax returns and submission dates are to be complies with from both SARS with regards to notification of submission dates and Tax payers by submitting returns on time. Lastly, signing of returns by a tax payer confirms that the tax payer understands the content of the return and will be held accountable if a case of tax evasion is discovered under.²¹⁶

When a taxpayer commits an act of fraud, attempts to evade tax it may be seen as fraud, this will bring about the elements of fraud in terms of Common law.

5.6 Definition of Fraud Common Law

In terms of Common Law fraud is defined as making an intentional an unlawful misrepresentation that could cause another person to act in a manner which could be detrimental. When a person commits a tax fraud it will be deemed as fraud. However, the Tax Administration Act provides for specific acts of fraud such as acts which will be deemed to be a statutory offence. When faced with a question of fraud, in terms of the Tax Administration Act it is important to investigate the provisions of section 235 of the Tax Administration act which deals with undue refunds and tax evasion.

²¹⁶ AP de Kocher, RC Williams, Silke South African Income Tax (2015) Lexis Nexis, South Africa

5.7 Section 235 Tax Administration Act requirements of the contravention

Section 235 of the Tax Administration Act²¹⁷ sets out requirements of the contravention in respect of this section and includes instances which will amount to an offence under tax legislation. The person must have the intention to evade tax legislation or must have assisted another person to evade tax or the person must have obtained an undue refund under a Tax Act and the penalty in respect of the above listed crimes is imprisonment of up to five years.

It is important to note that this section sets out a 'reverse onus', the reverse onus provides that the person who is accused of any of the provisions set out in section 235 of the Tax Administration Act 28 of 2011 will be regarded as guilty unless the person in question is able to prove that reasonable possibilities exist that they were ignorant of the falseness of the statement and that they were not negligent.²¹⁸

5.8 S235 and Criminal Offense

Section 235 of the Tax Administration Act²¹⁹ allows for the discovery of tax avoidance to be viewed as a criminal offence if the correct procedures and necessary proof is provided. The procedure will start with a normal tax audit conducted by a South African Revenue Services official. If during the audit, the official notices discrepancies in a tax return, this could be the result of a severe tax transgression, the official has to then report these findings to a Senior Tax Official.

At this stage the audit must continue as normal and the investigation by the senior tax official must commence. If after the investigation the senior official believes that a serious tax offence was committed, the

²¹⁷ Tax Administration Act 28 of 2011

²¹⁸ H Louw 'Personal tax- New criminal offences for taxpayers, guilty until proven innocent' 15 October 2012

²¹⁹ S232 Tax Administration Act 28 of 2011

senior official must report this offence to the South African Police Services (SAPS) or to the National Prosecuting Authority (NPA). In these circumstances the accused could face a prison sentence of up to 5 years. It is under this section that Tax evasion is allowed to become a criminal matter and persons could be sentenced to a jail period.

There are numerous types of offences which are classified as serious offences, including failure to lodge income tax returns, failure to attend a section 264 notice examination, false or misleading statements to taxation officer, signing a document that has not truthfully be filled out and submitted and preparing or authorising false books of an entity.

5.9 Anti-avoidance rule, Tax Administration Act and the relation to Avoidance Arrangements - Conclusion

The Tax Administration Act²²⁰ should be read with the GAAR principles as set out in the Income Tax Act²²¹, as it sets out the consequences of Tax avoidance.

The Tax Administration Act²²² has empowered the legislature and the Commissioner with the necessary provisions to hold taxpayers who fail to comply with the Income Tax act and act outside of the scope of tax regulations, accountable. This is a mechanism which may be used, by entities to circumvent tax legislation.

²²⁰ Tax Administration Act 28 of 2011

²²¹ Income Tax Act 58 of 1962

²²² Ibid

6 Conclusion

The aim of the research was to examine how a taxpayer may use structures such as individuals, make use of structures to avoid tax liability and to show how entities such as companies, closed corporations or trusts may set up structures to avoid legal liability or tax liability.

An analysis has also been done on the tests available to the South African Revenue Services, the courts, and the tests applied by these bodies such as the Piercing the Corporate Veil, Substance over Form principle, Anti-avoidance provisions and lastly to show the consequences which may arise should a taxpayer be found guilty of violating these principles.

Tax planning or permissible tax avoidance equates to an individual arranging their affairs or commercial transactions in such a manner that allows for marginal tax liability and the parties will enter into a lawful contract which will create binding rights and responsibilities.²²³

It is clear from my research that a company is viewed as holding a separate legal personality, as was expressed in the case of *Salomon v Salomon & Co Ltd*²²⁴ which recognised the principle that the company is a separate legal person, separate from its shareholders and directors and that the shareholders should not be held accountable for the liabilities of the entity.²²⁵

²²³ AP de Koker , RC Williams , Silke on South African Income Tax (2013), para 25.1 page 773

²²⁴ *Solomon v Solomon* (1987) AC 22

²²⁵ *Ibid*

An important principle to remember is that which was laid down in the case of *IRC v Duke of Westminster 1936*, in which the principle where individuals or business are allowed to sort out the matters to stay outside of the provisions of the taxing act. On this premise, many corporate structures have made use of the separate personality and the freedom to arrange their affairs principle, to hide behind the veil of a company.

There have been a variety of instances in which parties have attempted to disguise the true nature of the transactions and contractual arrangements, which result in the parties making use of an entity as the device or facade.

The tests laid down by the courts have proven effective. The test laid down by common law identified as piercing the corporate veil, has been made use of for the real existence of a transaction to come to light and hold the individual liable for the tax.

A further test came about after the enactment of section 20(9) of the Companies Act 71 of 2008 which provides for a remedy in which the corporate veil will be pierced, however this requires specific requirements to be met including that an unconscionable abuse must be present by a company.

Today the courts are empowered to use of either the common law provisions of piercing the corporate veil or the statutory piercing of the corporate veil where the requirements of section 20 (9) of the Companies Act 71 of 2008 are met.

The conclusion herein is therefore that the statutory provision can be seen as an enhancement of the common law and both tests may be relied on. Where the section 20 (9) of the companies act 71 of 2008 provisions may not be relied on, the common law remedy will be available to the courts and further that section 20 (9) of the Companies Act 71 of 2008, statutory remedy will not supersede or be in place of the common law provisions of piercing the corporate veil, but strengthens and reinforces it.

For many years prior to the SARS v NWK²²⁶ the courts would look at the parties intention as the test. Therefore, the environment in the past was not conducive to tax avoidance schemes as the courts did not easily ignore the substance of a transaction, however in the past when a court enquired into the tax liability of parties, the court would look at the actual transaction and not the true essence of the contract.

However, in the NWK decision the test was abandoned instead Lewis J stated that the examination required a look at the commercial sense or purpose of the transaction required, this means that if the commercial purpose was to attain a goal that allows for tax evasion then the transaction would be simulated.

A further test available to the court is where the parties have entered into a Sham transactions, the courts will give effect to the principles laid down in the NWK case which is that the court may look through the transaction to find out what the true state of affairs are . An investigation into the manner in which the courts interpose and look through entities is prudent, as this is not the piercing of the corporate veil but an alternate remedy available to the courts.

²²⁶ 2011 (2) SA 67 (SCA)

The NWK decision sets the rule that all transactions that have the aim of tax avoidance will be deemed to be a simulated transaction notwithstanding that it is a genuine transaction. A court faced with the question of whether a transaction is simulated or not must look closer than just the investigation of items around business dealings and involving whether business existence, is unfitting. The point is the court will investigate the whole transaction and not exclude any of the surrounding circumstances.

The NWK judgment applied the principle that consolidated the substance over form doctrine with the general anti-avoidance provisions set out in the Income Tax Act 58 of 1962, which will allow the courts to disregard transactions in which the only or key intent is to avoid tax.

There will also be instances where Impermissible tax avoidance occurs where only one or more of the tainted elements contained in the anti-avoidance provisions are present, such as the abnormality in terms of rights or duties created, what the core nature was to acquire a tax advantage and possibly whether a transaction lacked commercial substance. The consequence of a non-allowed tax avoidance arrangement will give rise to the nullification of the tax benefit and the taxpayer may in certain instances have to pay interest on unpaid tax.

As a last resort the Commissioner is allowed to give effect to the principles of GAAR (general anti avoidance provisions) which will require an objective analysis, which will require that you must look at the purpose or actual dealings instead of the intent for which the taxpayer entered into the arrangement.

Once an arrangement has been determined to be within the realms of an impermissible avoidance arrangement, Section 80B will

find application. If the taxpayer is found to have contravened a tax act or found guilty of fraud under a tax act, Section 235 will find application, provided the requirements are met.

Taking into account the above tests as well as the consequences of circumvention, it is important to note that evasion can never be likened to avoidance. The legislature has implemented the general anti-avoidance provisions (“GAAR”) in law to allow the South African Receiver of Revenue to combat tax avoidance mechanisms and schemes which would otherwise land inside the scope and realm of the Income Tax Act.²²⁷ However, the courts should bear in mind that regulations should be, transparent, fair and understandable and should adapt, be flexible, promote adaptability which will create economic opportunities for the modern society. The regulatory scheme which is created should not create artificial preferences and distortions, it must attempt were practical to place on equal levels the challenging concerns of fiscal players and that of society.

The Law must take into account and respect a taxpayer’s right to plan his tax affairs in a manner which will minimise a taxpayers liability, should be seen as essential, as the principle of tax avoidance is not illegal. The courts will however only rely on the anti-avoidance rules, in my view, where Income tax and the Company law provisions prove to be ineffective.

This study has shown that the doctrine of separate legal personality should be upheld and is still upheld by the courts today. There are many tax and legal benefits to natural persons starting a company, however these benefits should not be misused.

²²⁷ Income Tax Act 58 of 1962

The Law will protect an entity as a taxpayer, and its right to separate legal personality, however when there is abuse, fraud or circumvention of the entities separate legal personality by directors or shareholders, the courts as well as the receiver of revenue will rely on the provisions of the common law piercing the corporate veil, section 20(9) of the Companies act 71 of 2008 or call upon the provisions of the Tax Administration Act²²⁸ to hold directors or shareholders personality liable.

Furthermore, we should not interpret the law with a closed minded approach but rather with a modern commercial minded approach. As a growing South African economy, entities should be allowed to arrange their affairs in the best possible way to obtain a legal tax benefit and directors should be able to exercise their fiduciary duty in relation to the company which is to act (a) in the greatest concern of the company, (b) includes making sure that the company makes a profit and (c) to act in good manner towards the company.

The objective of the current modern corporate law framework was clearly set out in the paper entitled “South African Company Law for the 21st Century”, Guidelines for Corporate, as it sums up the aforementioned modern approach.

Our country requires a fiscal environment that can sustain itself by meeting the requirements of our people and their enterprises. This means access to quality work and enterprise opportunities. Enterprises from various industries will have to learn how to adapt, be innovative and be internationally competitive.²²⁹ One should also be mindful that by enforcing the necessary tax provisions it ensures that the Commissioner of South African

²²⁸ Tax Administration Act 28 of 2011

²²⁹ The South African Company Law for the 21st Century”, Guidelines for Corporate Law reform notice 1183 (2004),

Revenue Services may collect the necessary tax which is imposed on entities, as it is the role of SARS to collect taxes in this manner. It is also important to note that these taxes are imposed as levies which are used for the benefit of all South Africans.

Our commercial and tax provisions should further encourage and support the growth of enterprises as well as the economy. This is evident in the tax avoidance rule as it encourages business to lessen their tax liabilities within the scope and ambit of the law. This in turn will help businesses make better profits and will encourage the establishment of new enterprises.

However, the opposite position herein is that the Commissioner and ultimately the court should be stricter in its approach to circumvention of the law. As was specifically set out in the aforementioned chapters, many corporate structures as well as those who control these structures make use of tax evasion methods to reduce their tax liability and mislead the system to gain an advantage. It is imperative that the commercial legal system is sound, so that we are able to compete with international corporate structures.

Therefore, in conclusion, it should be noted that, the legal system plays an integral part in controlling these two positions, because if it is not controlled, there will be an imbalance in the South African economy as well as the commercial industry and corporate structures as well as individuals will gain an unfair advantage. The study has proven that the principle of separate legal personality must be adhered to by entities, and that contracting parties should enter into genuine transactions to ensure that the court does not have to make use of the aforementioned tests unnecessarily and ultimately Corporate structures may flourish in South Africa.

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