

# **ABUSE OF LEGAL PERSONALITY TO AVOID TAX**

## **PIERCING THE CORPORATE VEIL AS REMEDY IN CASE OF THE ABUSE OF LEGAL PERSONALITY FOR TAX PURPOSES**

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## DECLARATION

By submitting this dissertation electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the authorship owner thereof (unless to the extent explicitly otherwise stated) and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Date: April 2019

## ABSTRACT

Companies are legal persons and as much part of commercial traffic as the natural persons owning and controlling them. Compared to one another, companies and natural persons nevertheless have very different legal abilities and characteristics. It is therefore not unexpected that they are treated differently for purposes of the law of taxation. As a result it may often be more beneficial to have the profits generated by a business enterprise taxed in a company rather than in the hands of a natural person, especially in instances where a shareholder would be commercially indifferent to whether those profits are generated in a company or not.

By using the separate legal personality of a company shareholders may often perpetrate an abuse of that separate legal personality. Such abuse of legal personality can also take place when legal personality is employed primarily for tax reasons.

While a limited form of abuse of the corporate veil is tolerated, whether the use of separate legal personality for tax reasons amounts to an abuse thereof beyond what is permitted in South Africa can be determined in terms of three tests. These tests are the traditional “piercing of the corporate veil” judgments forming part of the common law, section 20(9) of the Companies Act 71 of 2008 and the General Anti-Avoidance Rules (“GAARs”) (and other specific provisions) in the Income Tax Act 58 of 1962. This dissertation considers when any of these various tests will dictate that the separate personality of a company be ignored (or “pierced”) for purposes of taxes levied in terms of the Income Tax Act.

Through critical analysis of both the South African rules on piercing as applied for tax purposes as well as the circumstances under which selected other jurisdictions provide for piercing for tax reasons the dissertation formulates what best practice and desired policy for piercing for tax reasons are.

Opgedra aan die koninginne Isabella en Elisabet  
en aan die Koninginnemoeder

*Contra legem facit qui id facit quod lex prohibet; in fraudem vero qui, salvis  
verbis legis, sententiam ejus circumvenit.*

***Digesta, 1.3.29***

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belastingpraktyk, sou niks hiervan moontlik gewees het nie. Ek sal jou nooit genoeg kan bedank vir hierdie geweldige reis nie.

## LIST OF ABBREVIATIONS

AD	Appellate Division
CIPC	Companies and Intellectual Property Commission
DTAs	Double Taxation Agreements
DTI	Department of Trade and Industry
GAARs	General Anti-Avoidance Rules
OECD	Organisation for Economic Co-operation and Development
SARS	South African Revenue Services
SCA	Supreme Court of Appeal
UK	United Kingdom
USA	United States of America

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## CHAPTER 1: INTRODUCTION

### 1 Background

In South African law, as in most jurisdictions, both natural persons and juristic persons take part in everyday commercial life.

Natural and legal persons share various characteristics. Both can own assets in their own name and earn income for their own account from those assets. Similarly, both natural and legal persons have the responsibility to answer for their own liabilities.<sup>1</sup> Yet natural and legal persons also have very different commercial abilities as well as different constraints imposed upon them by law because of their nature. For example, natural persons are unable to pay dividends, while juristic persons only exist in an abstract sense by virtue of law. Similarly, no one can nowadays legally own natural persons, whereas juristic persons exist typically to fulfil some legitimate purpose. So too in relation to the law of taxation very different rules apply to natural persons and legal persons respectively. This is not only true for the different tax rates at which legal and natural persons are taxed at but applies also broadly to the various tax regimes available to each.

The legal person's separate legal personality defines its existence. Since the company form is arguably the most common manifestation of legal personality today, this dissertation deals exclusively with the separate legal personality of companies. The company form may at times have access to beneficial tax regimes that natural persons do not have access to and it may therefore sometimes be more beneficial from a tax perspective for natural persons to be economically active by employing a company as vehicle to operate through indirectly.<sup>2</sup> Apart from the potentially beneficial tax rates applicable to a company, other tax advantages linked to involving a company in transactions include the

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<sup>1</sup> See the text to ch 2 part 2 3 below.

<sup>2</sup> AS Silke *Tax Avoidance and Tax Reduction* PhD dissertation, University of Cape Town (1958) 49.

often more beneficial income tax regimes in the Income Tax Act 58 of 1962 (“Income Tax Act”) that apply to them. These include being able to register as a “public benefit organisation” or a “small business corporation” and to have access to the group relief provisions contained in the Income Tax Act<sup>3</sup> (which essentially involve moving assets to and from other group companies without incurring any tax consequences). Moreover, South African companies are generally not subject to dividends tax.<sup>4</sup>

In 1984 Gower had already identified that the tax benefits associated with the company form are such that many may purposefully pursue economic interaction through a company for this reason alone:

“[I]t is a trite observation that today taxation is one of the main factors for consideration in any legal transaction and this is especially true of company law. Indeed, it is probably fair to say that in the last 60 years more companies have been formed because of the real or imagined taxation advantages than for any other single reason. Tax considerations influence the choice of business medium, the financing of companies and their capital structures and, not infrequently, their management structures.”<sup>5</sup>

This statement is even more relevant today, more than 30 years later.

One should acknowledge that different tax consequences are not always the only commercial driver when deciding whether to hold assets or run a business through a company. Considerations such as the limited liability of shareholders and the perpetual existence of a company<sup>6</sup> are some of the other influencing factors when deciding whether to conduct a business by using a company with separate legal personality. However, even where these commercial factors do not have a material bearing on a person’s decision to consider in which form to cache a business or hold assets, such person may opt to do so through the most tax beneficial structure available.

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<sup>3</sup> Ch II, part III of the Income Tax Act.

<sup>4</sup> S 64F(1)(a).

<sup>5</sup> LCB Gower *Gower’s Principles of Modern Company Law* (1984) 239.

<sup>6</sup> See the text to ch 2 part 2 3 below.

By utilising the company form primarily to achieve a tax advantage the line between prudent tax planning and impermissible tax avoidance becomes blurred. Even more so considering that the use of the company form would then extend beyond the goal that it purports to serve in commercial traffic.<sup>7</sup> While it is possible in certain instances for legal personality to be created outside of the legislative framework, statute law creates the company form specifically.<sup>8</sup> It is therefore a potentially uncomfortable contradiction where a statutory creation, the company, is used to frustrate the levying of taxes by another statutory instrument, the Income Tax Act.

## **2 Research question and scope**

### **2.1 Research question**

About three decades ago the Organisation for Economic Co-operation and Development (“OECD”) expressed concern that a person, acting through a legal entity created in a state with the sole purpose of obtaining treaty benefits, may obtain those treaty benefits which would not otherwise have been available to such person directly.<sup>9</sup>

This succinctly sets out the concern that this dissertation seeks to address, namely that companies can achieve tax benefits solely by virtue of their recognition as separate legal persons. The problem extends wider than the context of double taxation agreements (“DTAs”) to include also situations where persons can access tax relief provided for in domestic tax legislation.<sup>10</sup> To date, only specific anti-avoidance legislation could address this problem. In instances not covered by these anti-avoidance provisions, the concern could not be

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<sup>7</sup> See the text to ch 2 part 2.2 below.

<sup>8</sup> S 19 of the Companies Act 71 of 2008.

<sup>9</sup> OECD *Double taxation conventions and the use of conduit companies R(6)* (adopted by the OECD Council on 27 November 1986) (1986) para 1.

<sup>10</sup> See the examples in part 3 of this chapter below. Whereas Example 3 serves as example in the treaty shopping context and in relation to which the OECD has expressed concern, Examples 1, 2 and 4 are examples of how the same anti-avoidance problem manifests in a domestic tax context.

addressed in an adequate fashion. Examples of such inadequacies are set out below.<sup>11</sup>

The common law doctrine of piercing the corporate veil (“piercing doctrine”) has historically presented a remedy whereby it is possible for a court to ignore the separate legal personality of the company in certain instances, most notably when used to engage in “improper conduct”.<sup>12</sup>

The overarching research question that this dissertation will consider is whether it is possible to apply the piercing doctrine as a remedy in the South African income tax context where the separate legal personality of a company is used mainly for tax purposes. It will do so by considering whether the potential piercing remedies as exist in the developed common law doctrine, section 20(9) of the Companies Act 71 of 2008 (“Companies Act”) or in the General Anti-Avoidance Rules (“GAARs”) contained in the Income Tax Act apply.<sup>13</sup>

## 2.2 Scope limitation

It is necessary to limit the field of study to focus the research. Therefore this dissertation focuses on a consideration of the piercing doctrine as it pertains to “companies” as defined in section 1 of the Companies Act only, or companies formed in other countries in terms of comparable legislation that may exist in those other countries. The position of “non-profit companies” as defined in section 1 of the Companies Act is excluded.

The dissertation’s focus will further be limited to a consideration of piercing for tax purposes only. Piercing in this work is moreover only concerned with piercing as it may be applied at an income statement level. In other words, the dissertation does not consider whether existing tax debts may be recovered through the application of piercing, but rather whether piercing may be applied to affect the

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<sup>11</sup> See the text to part 3 of this chapter below.

<sup>12</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553.

<sup>13</sup> Ch III, Part IIA of the Income Tax Act.

*calculation* of a tax expense or for purposes of determining for which person the tax debt arises.<sup>14</sup>

Although the investigation's scope is limited to taxes levied in terms of the Income Tax Act, it is conceivable that a wider application of the study is possible.

The above limitations of scope do not suggest that the conclusions reached are exclusively applicable to companies as such or even to matters of taxation. Indeed, the conclusions reached may frequently be equally applicable to other corporate forms (close corporations being a case in point)<sup>15</sup> or even to piercing as applied outside the context of the law of taxation.

### **3 Examples of tax avoidance achieved by using the corporate veil**

Taxpayers attempt to avoid the incidence of tax in a variety of manners. Many of these involve complex structures and transactions which this dissertation will not attempt to investigate. In certain instances, it is also possible to mitigate tax in an uncomplicated manner. This dissertation considers four such simple examples whereby it is possible to use the separate legal personality of the company to obtain a tax advantage for those behind the company and for which specific anti-avoidance provisions in the Income Tax Act do not exist.

#### Example 1:

An individual holding a portfolio of South African listed shares would be liable for dividends tax levied at 20% on any dividends declared on those shares. In contrast, South African tax resident companies are exempt from dividends tax.<sup>16</sup>

By transferring those shares solely to avoid dividends tax to a company of which the individual holds all the shares, the individual would delay the incidence

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<sup>14</sup> Ch III, Part IIA, for example and if applicable, has specific provisions dealing with the allocation of tax consequences.

<sup>15</sup> See the text to ch 4 part 2 3 4 below for a comprehensive discussion on the position of close corporations.

<sup>16</sup> S 64F(1)(a).

of dividends tax until such time (if ever) when the dividends received by the company are declared as dividends to the individual.<sup>17</sup>

#### Example 2:

An individual operating a business is subject to income tax at a rate of up to 45%. However, a company would be subject to income tax at 28%.

An individual, earning taxable income at the maximum marginal rate, will benefit if he transfers his business operation to a company which he wholly owns due to the difference in tax rates between the individual and the company. This is the case even after one considers the effect that any subsequent dividends tax may have, should the company's profits eventually be distributed to the individual by way of a dividend.

#### Example 3:

The individual in Example 1 considers it likely that the company holding his share portfolio will in future years distribute to him all the dividend receipts which it is likely to receive. The individual understands that at that stage dividends tax will become payable. To mitigate the 20% dividends tax due at declaration of that ultimate dividend the individual designs a corporate structure with a Mauritian tax resident company interposed between the individual and the wholly owned company resident in South Africa for tax purposes.

Mauritius does not have a dividends tax regime in place. Therefore, the interposition of the Mauritian company reduces the dividends tax that the South African company pays to the Mauritian company from 20% to 5% in terms of the South Africa/Mauritius double taxation agreement (DTA).<sup>18</sup> The South African tax

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<sup>17</sup> See National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill* (2008) 38 *et seq* where the National Treasury identified taxpayer behaviour of this nature as a risk.

<sup>18</sup> At article 10(2)(a) of Article 10 (Dividends) of the agreement between the Government of the Republic of South Africa and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (effective 28 May 2015).

resident individual now receives the dividends without the imposition of any further taxes.

#### Example 4:

Three different trusts each own a valuable asset. Due to concerns relating to the imminent depreciation of the value of these assets, the trustees of each of the trusts decide to dispose of their respective assets with a view to reinvesting the proceeds in a different asset class. None of the capital beneficiaries of any of the trusts qualifies at this stage to receive any of the capital profits to be realised. However, the trustees are concerned about the high effective capital gains tax rate that would apply to such an asset disposal.

Utilising the “roll-over” provisions of section 42 of the Income Tax Act the trustees transfer the assets held to a single company in which these trusts collectively hold shares. The company now owns the assets previously held by the three trusts. These trusts now instruct the company to dispose of the assets. Consequently, the company is now able to dispose of the assets and to be taxed at a more beneficial tax rate than would have applied to the trusts.

These examples not only illustrate how the corporate veil may be used to achieve a tax advantage, but also how tax avoidance may be achieved in different contexts. I intend to measure each of the four examples above against the conclusions that are reached in this dissertation. The aim is to consider whether it is possible to apply the remedies identified in this research successfully, be it in terms of common law, the Companies Act or the Income Tax Act, to address the tax benefit otherwise achieved regardless of the context. I apply and refer to these examples throughout this work, but I also discuss each individually in chapter 6 below.

## **4 Overview**

The use and employment of assets generate income and income tax arises from income being earned. It follows that the owner of an asset will usually be the

recipient of the income generated therefrom. Income tax is therefore, most of the time, inherently linked to the ownership of assets.<sup>19</sup> It is thus possible to manipulate income tax consequences by transferring ownership of an asset to a company. A result of such a transfer would be that the tax consequences attendant on the income subsequently earned by that company will be more beneficial than would have been the case had the income not accrued to and not been taxed in the hands of the company. In this manner it is possible to avoid or delay the incidence of income tax for the ultimate commercial beneficiary, even though ownership and attribution of value from underlying assets still lie in the control of the transferor shareholder, albeit indirectly through the shareholder's legal ownership of the shares in the company.

This dissertation considers the scope of the legally permissible use of legal personality mainly for tax purposes. It does not focus on specific transactions, but rather on the doctrinal legal question namely whether the law permits the use of ownership through a company structure to achieve a tax benefit, ultimately for its shareholder. If not permissible, the appropriate remedy would be to ignore the separate legal personality of the company in those instances or to pierce the corporate veil, whether in terms of statute or the common law.

The analysis of the piercing doctrine in this dissertation strives not to be a repetition or summary of the many works published on the piercing doctrine, although it is necessary to a limited extent to revisit these briefly to lay the foundation for the remainder of the discussion. This is particularly the case with the analysis in chapter 2, which starts with an overview of the doctrine of separate juristic personality and the potential limitations thereof brought about by the piercing doctrine. That chapter further considers the reason for devising separate juristic personality as a now entrenched legal concept. The piercing doctrine serves as an exception to the doctrine of legal personality and chapter 2 seeks to define the scope of the latter doctrine. In focusing the research it further considers what piercing amounts to in practice and what it does not, by identifying the common law doctrines or remedies that differ from piercing.

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<sup>19</sup> *CIR v King* 1947 14 SATC 184 199.

In her contribution to the IFA Rome Congress in 2010<sup>20</sup> Olivier states that there are generally three measures to address impermissible tax avoidance in South Africa: (1) the application of common law principles; (2) specific fiscal legislative measures; and (3) the legislated GAARs in the Income Tax Act.

This dissertation states the law as at December 2018. It considers each of the above three measures as applied to the use of corporate personality for tax purposes specifically. I consider this a timely and relevant analysis, considering the recent developments in all three contexts identified above. In particular, the enactment of the Companies Act has brought with it a new potential remedy in section 20(9), which possibly also affects how the common law piercing doctrine will be applied in future. In recent years there have also been two significant judgments in the United Kingdom (“UK”) dealing with the piercing remedy as applied in that jurisdiction.<sup>21</sup> These statutory and common law remedies (to the extent that they may be applied) stand in contrast to the Income Tax Act’s relatively new GAARs<sup>22</sup> that no court of law has applied to date.

Chapter 3 considers whether it is possible for the South African Revenue Service (“SARS”) to apply the common law piercing doctrine as a remedy in the event of the abuse of legal personality for tax purposes. As part of this analysis the South African context is considered, as well as that of the UK, the United States of America (“USA”), Australia and Canada. I identified these jurisdictions specifically as representing those legal systems that have had a historically significant influence on the development of the South African common law system generally.<sup>23</sup> Although chapter 3 commences with an analysis of the piercing

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<sup>20</sup> International Fiscal Association *Cahiers de droit fiscal international* (2010 Rome Congress) Vol 95a: *Tax treaties and tax avoidance: application of anti-avoidance provisions* 719.

<sup>21</sup> *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 and *Prest v Petrodel Resources Ltd* 2013 UKSC 34 (discussed in the text to ch 3 part 4 1 below).

<sup>22</sup> Introduced in 2006.

<sup>23</sup> The importance of such a comparative legal study, specifically in the piercing context, is particularly relevant. See *Botha v Van Niekerk* 1983 4 All SA 157 (W) 161:

doctrine as applied generally, it ultimately focuses on the application of the analysed doctrine for tax purposes only. The traditional common law doctrine prohibits the use of juristic persons when the use of separate legal personality would amount to an abuse of legal personality in order to perpetrate fraud, dishonesty or other improper conduct, and then only if policy considerations in favour of piercing outweigh those considerations opposed thereto.<sup>24</sup> The evasion of legal obligations appears to amount to improper conduct.<sup>25</sup> Chapter 3 therefore ultimately considers whether the avoidance of tax may amount to such an evasion of a legal obligation. If it does, the corporate veil may be susceptible to piercing under South African common law as a remedy against impermissible tax avoidance, providing that piercing would also be justifiable in terms of the relevant policy considerations identified in that chapter.

The commencement of the Companies Act of 2008 on 1 May 2011 brought with it a statutory piercing provision contained in its section 20(9). In terms of this provision it is possible to disregard the separate legal personality of a company where it has been the subject of “unconscionable abuse”. It is not immediately clear what actions could amount to “unconscionable abuse”. Chapter 4 attempts to give content to the phrase that contains various striking similarities, and dissimilarities, when compared to the statutory piercing provision contained in section 65 of the Close Corporations Act 69 of 1984 (“Close Corporations Act”). It is also not immediately apparent to what extent one should consider the statutory piercing provision as a replacement of or enhancement to the common law piercing doctrine. Only once these questions have been thoroughly considered can a conclusion be drawn whether section 20(9) may potentially serve as a remedy against the use of the corporate veil for tax purposes.

If there is impermissible tax avoidance the obvious remedies should be those contained in the Income Tax Act. While this Act does contain various remedies

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*“Vir beter perspektief omtrent die mate van ontwikkeling wat hier plaasgevind het of moontlik nodig geag mag word, is 'n verwysing na oorsese regstelsel (sic) nie onvanpas nie.”*

<sup>24</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553.

<sup>25</sup> 554.

against the abuse of the corporate veil for tax purposes, such as the “controlled foreign company” or “personal service company” regimes, other forms of tax avoidance may also occur outside the scope of these specific anti-avoidance provisions. Some examples have been provided in part 3 of this chapter above. In the absence of any specific anti-avoidance provisions in the Income Tax Act, the sole remaining remedy in the Income Tax Act to potentially address abuse of the corporate veil for tax purposes is that contained in its GAARs.<sup>26</sup> Chapter 5 considers the efficacy of these rules in addressing the abuse of the corporate veil for tax purposes, particularly with a view to investigate the best practice in choosing to apply the common law doctrine, section 20(9) of the Companies Act or the GAARs in the Income Tax Act as remedy in the income tax context.

Such a comparison of the predicted effectiveness of the remedies is set out in chapter 6 and is based on the conclusions reached in the preceding chapters. The purpose of that comparison and this dissertation generally is to suggest the most effective remedy available in South Africa to address shareholders’ actions primarily aimed at achieving tax avoidance by using the corporate veil.

## **5 Methodology**

### **5.1 Holistically**

The research methodology followed in this dissertation is of a non-empirical and doctrinal nature. The research comprises primarily of case law, legislation (notably the South African Income Tax Act and Companies Act) as well as a selection of academic journal articles, theses and books. Although the dissertation considers the research question in the context of the South African legal framework, it also refers to various international reference works to inform the South African position where applicable.

### **5.2 Chapter by chapter**

Chapter 2 considers the piercing doctrine generally, particularly in the context of the common law where the doctrine originated. Chapter 3 proceeds to apply the

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<sup>26</sup> Ss 80 to 80L of the Income Tax Act.

developed common law doctrine to the income tax context specifically and as a means to address the problem statement identified in part 2 1 of this chapter above. Because these chapters focus mainly on the common law position as it exists today, both in South Africa and in other selected jurisdictions, those chapters comprise mostly of an analysis of case law.

The focus of chapter 4 is to consider the content of the piercing remedy contained in section 20(9) of the Companies Act. The research methodology followed in that chapter is one of detailed statutory interpretation.

The final potential remedy considered in this dissertation is whether SARS may apply the GAARs in the Income Tax Act as a statutory piercing remedy. Therefore this chapter also follows a statutory interpretative approach, but with significant reference to those judgments that have considered the scope and content of the GAARs as these existed in terms of previous legislative instruments.

## **6 Conclusion**

The analysis in chapters 2 and 3 portrays an academic controversy that has always surrounded the piercing doctrine, which sentiment Blackman echoes:

“It is an area of the law that has resisted clarity and coherence.”<sup>27</sup>

For the reasons advanced in chapter 4, I regard the introduction of section 20(9) of the Companies Act as bringing significant clarity to the doctrine, both when applied in terms of section 20(9) and in terms of the common law.

This research departs from the premise that separate corporate personality may have the effect of avoiding or delaying the levying of taxes in terms of the Income Tax Act. I identified examples of such instances above.<sup>28</sup> In particular this dissertation considers whether the avoidance of tax in these manners are addressed by any one of the common law piercing remedy, section 20(9) of the Companies Act or the GAARs of the Income Tax Act. To the extent that it does,

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<sup>27</sup> MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R de la Harpe *Commentary on the Companies Act* (2002) 4-133.

<sup>28</sup> See the text to part 3 of this chapter above.

this study concludes by highlighting which of these remedies is the most effective mechanism through which to address tax avoidance achieved in this manner.

## CHAPTER 2: THE ESTABLISHMENT AND DISREGARDING OF CORPORATE PERSONALITY

### 1 Introduction

In both South Africa and elsewhere a company is regarded as a distinct and separate legal person.<sup>29</sup> Metaphorically speaking, the respective separate existences of the company and the shareholder is said to be divided by the “corporate veil”.

This chapter first considers the concept of separate corporate personality, including how it arises and what the disregarding thereof entails. It further considers why and on what basis the separate existence of a company is recognised.<sup>30</sup> Thereafter the nature and consequences of the corporate veil are considered against the backdrop of the historical development of separate legal existence, as well as the commercial requirements that this separateness purportedly serves. The circumstances under which the corporate veil may be

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<sup>29</sup> See the text to part 2 of this chapter below.

<sup>30</sup> As explained by Benade in ML Benade “Selfstandigheid van die maatskappy-regspersoon” (1967) 30 *THRHR* 213, one cannot determine when the separate legal *persona* of a company should be disregarded without considering why the “separateness” itself should even be recognised:

*“Die doel wat die reël dien, bepaal die mate waarin dit aangehang moet word; in die woorde van regter Frankfurter: ‘Legal doctrines are not self-generated abstract categories ... They have a specific juridical origin and etiology. They derive meaning and content from the circumstances that gave rise to them and from the purposes they were designed to serve. To these they are bound as is a live tree to its roots.’”*  
[own emphasis]

Benade further cautions that companies serve a certain purpose in society – they are a means to an end (also see MP Larkin “Regarding judicial disregarding of the company’s separate identity” (1989) 1 *SA Merc LJ* 277 295). Therefore, he continues, one should be cautious to treat a company’s separate legal *persona* as an absolute rule; this would have the effect of making the rule (ie the means) into the end itself. Fairness considerations, according to Benade, should be the primary scale in considering the rule.

pierced in South Africa for income tax purposes are considered in later chapters.<sup>31</sup>

Only once the above matters have been discussed will it be appropriate to consider when the disregarding of that separate legal existence will be justified.

## 2 Defining the company

The definition of a company in section 1 of the Companies Act does not offer any profound revelation as to the nature, abilities, and responsibilities of a company:

“‘company’ means a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date-

- (a) was registered in terms of the-
  - (i) Companies Act, 1973 (Act 61 of 1973), other than as an external company as defined in that Act; or
  - (ii) Close Corporations Act, 1984 (Act 69 of 1984), if it has subsequently been converted in terms of Schedule 2;
- (b) was in existence and recognised as an ‘existing company’ in terms of the Companies Act, 1973 (Act 61 of 1973); or
- (c) was deregistered in terms of the Companies Act, 1973 (Act 61 of 1973), and has subsequently been re-registered in terms of this Act ...”

The definition describes a company as a juristic person incorporated either in terms of the Companies Act, or alternatively in terms of either the repealed Companies Act 61 of 1973 (“Repealed Companies Act”) or the Close Corporations Act (coupled with a conversion from a close corporation to a company). Clearly, this definition does not sufficiently address the question of what a company is.

The most significant aspect to take from this definition of a company may be that the company is stated to be a juristic person. This phrase lends the most essential criterion of a company’s existence to it, which is its separate legal

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<sup>31</sup> See chs 3 to 5 below.

personality and existence.<sup>32</sup> Although the common law itself also recognises separate legal personality, the Companies Act creates that separate legal existence for the company form specifically.<sup>33</sup>

## 2.1 The historical development and basis upon which separate corporate personality is recognised

The advent of the new and current company law era in South Africa was marked by the enactment of the Companies Act of 2008 that came into effect on 1 May 2011.<sup>34</sup> However, to what extent a different corporate law regime has been introduced as a result (particularly regarding the law involving the piercing doctrine) is still rather uncertain. Nevertheless, one can predict with relative certainty that the position prior to May 2011 will continue to form the basis of many aspects of current South African company law.<sup>35</sup>

The present Companies Act<sup>36</sup> continues to endorse one key position long entrenched in South African corporate law and previously recognised by the Repealed Companies Act.<sup>37</sup> This is that a company is a separate juristic person, capable of performing its own actions (through representatives), with perpetual succession and with members who have, generally, no liability for the obligations

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<sup>32</sup> FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev & J Yeats, *Contemporary Company Law* 2 ed (2012) 31; RC Williams “Companies: Part I” in WA Joubert (ed) *Law of South Africa IV* 2 ed (2012) para 65; Blackman et al *Commentary on the Companies Act* 4-107 – 4-111.

<sup>33</sup> See the text to n 45 below.

<sup>34</sup> Proc R32 in GG 34239 of 26-04-2011.

<sup>35</sup> Specifically at issue is whether those cases dealing with piercing under the Repealed Companies Act (although admittedly piercing was not applied in terms of that Act, but rather in terms of the common law framework influenced by that Act) are still good law under the new Companies Act. The submission is that these cases still apply and that as far as piercing is concerned, the Companies Act did not bring about any changes which render these old cases useless. This can also be inferred from a reading of *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC). See generally the text to ch 4 part 2 below on the interpretation and application of s 20(9) of the Companies Act.

<sup>36</sup> S 19(1) and (2) of the Companies Act.

<sup>37</sup> S 65(1) of the Repealed Companies Act.

of the juristic person. A company is also considered a separate person for the purposes of the Income Tax Act.<sup>38</sup>

The company's separateness recognised in law is, however, not sacrosanct.<sup>39</sup> The law also provides for the "piercing"<sup>40</sup> of the corporate veil when the separate juristic personality of the company may be disregarded, referring to those circumstances where the fiction of separate legal personality<sup>41</sup> created by law may be disregarded.<sup>42</sup> Piercing, as developed in South Africa, stems from the English common law<sup>43</sup> and is applied internationally in Commonwealth states and beyond.<sup>44</sup>

The separate legal existence of the company form for legal purposes is traditionally created *ex lege*.<sup>45</sup> This is also the case for South Africa:

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<sup>38</sup> Refer to the discussion in ch 2 part 2 3.

<sup>39</sup> Benade (1967) *THRHR* 213.

<sup>40</sup> Or "lifting" – see ch 2 part 3 2 2 below. Some would distinguish between "lifting" and "piercing" the corporate veil. See *Atlas Maritime Co SA v Avalon Maritime Ltd: The Coral Rose (No 1)* 1991 4 All ER 769 ("*Atlas Maritime Co SA*") where "lifting" is said to be applied to determine some quality of the company with reference to its shareholders (eg intent). To the extent that this distinction is accepted, this research will be limited to a discussion of "piercing" in its conventional sense only.

<sup>41</sup> Blackman et al *Commentary on the Companies Act* 4-108 and Williams "Companies: Part I" in *LAWSA* 64; cf Cassim et al *Contemporary Company Law* 31.

<sup>42</sup> Williams "Companies: Part I" in *LAWSA* 85.

<sup>43</sup> The historic English common law has made more than a significant contribution to South African Company law (Benade (1967) *THRHR* 213). The South African Company law legislation and the judgments by South African courts developing it (as recently as the example in *Ex Parte Gore*) were predominantly based on the prevailing English law for a number of decades. Refer also Williams "Companies: Part I" in *LAWSA* 3.

<sup>44</sup> See the text to n 48 and ch 3 part 4 below.

<sup>45</sup> Lord Halsbury LC in *Salomon v A Salomon & Co Ltd* 1897 AC 22 29. Also refer to the discussion below regarding the historical development of corporate legislation to this effect in South Africa. This does not detract from the fact that legal personality can also be afforded to an organisation in common law (Blackman et al *Commentary on the Companies Act* 4-112). The Companies Act is not the sole provider of legal personality in our law. The common law legal person, the *universitas personarum*, is also endowed with legal personality (cf *Ex-TRTC United Workers Front v Premier, Eastern Cape Province* 2010 2 SA 114 (ECB) 122F-123A; Blackman et al *Commentary on the*

- “(1) From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company-
- (a) is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act; [and]
  - (b) has all of the legal powers and capacity of an individual ...
- (2) A person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company ...”<sup>46</sup>

The separate existence of a company is of course no new revolutionary concept brought about by the Companies Act. Rather, the notion of companies’ independent existence can be traced as far back as Roman law.<sup>47</sup> This concept was further developed as part of Roman-Dutch law<sup>48</sup> to find application in

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*Companies Act* 4-112). For the purposes of this dissertation though, only the position of companies as distinct legal persons is analysed.

<sup>46</sup> S 19 of the Companies Act. Cf s 65(1) of the Repealed Companies Act.

<sup>47</sup> PJ Badenhorst, M Pienaar, H Mostert *Silberberg & Schoeman’s: The Law of Property* 5 ed (2006) ch 3.3.

<sup>48</sup> *Voet* 1 8 28 and the text to ch 3 part 4 1 (see also the reference and discussion thereof in *Webb & Co Ltd v Northern Rifles* 1908 TS 462). The Dutch East India Company was one of the first modern companies – see the useful discussion in this regard in *Frans v Paschke* 2010 JOL 26212 (NmH). Williams “Companies: Part I” in *LAWSA* 4 refers to the alleged first stock company, being a Russian company formed as far back as 1553. Williams “Companies: Part I” in *LAWSA* 62 also refers to *Webb & Co Ltd v Northern Rifles* 1908 TS 462, where it is concluded that the definition of a “corporation” for Roman-Dutch law purposes was (at 464-465):

“an aggregation of individuals forming a *persona* or entity, having the capacity of acquiring rights and incurring obligations to a great extent as a human being, (to be) distinguished from a mere association of individuals by the fact that it is an entity distinct from the individuals forming it, its capacity to acquire rights or incur obligations is distinct from that of its members, which are acquired or incurred for the body as a whole, and not for the individual members”.

See also Gower *Principles of Modern Company Law* 24.

modern-day South African company law whilst incorporating a strong English influence.<sup>49</sup>

This strong English influence in South African company law is to be expected, given the historical development involved and the political context when the enabling legislation came into being. In South Africa companies were first formalised under legislation by the Cape Joint Stock Companies Limited Liability Act 23 of 1861. This Act was based almost entirely on English legislation, the by then repealed Joint Stock Companies Act of 1844<sup>50</sup> as well as its successor in the form of the Limited Liability Act of 1855<sup>51</sup> which first introduced the concept of limited liability for the shareholders of a company in English law.<sup>52</sup>

Subsequent Acts in the Union of South Africa and later the Republic, all recognising the separate existence of a company, were first the South African Companies Act 46 of 1926 (“1926 Companies Act”), followed by the Companies Act 61 of 1973 the present Companies Act of 2008 and (to some extent) the Constitution of the Republic of South Africa, 1996 (“Constitution”).<sup>53</sup>

The first English judgment fully recognising the separate legal identity of a company, later followed both in South Africa and elsewhere, was *Salomon v A Salomon & Co Ltd* (“*Salomon*”):

“The company is at law a different person altogether from the subscribers to its memorandum; and though it may be that, after incorporation, the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them.”<sup>54</sup>

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<sup>49</sup> Benade (1967) *THRHR* 214.

<sup>50</sup> 7 and 8 Vict c 110.

<sup>51</sup> 18 and 19 Vict c 133.

<sup>52</sup> Williams “Companies: Part I” in *LAWSA* 4-5; JT Pretorius, PA Delpont, M Havenga & M Vermaas *Hahlo’s South African Company Law through the cases* (1999) 1-2.

<sup>53</sup> S 8(4) of the Constitution.

<sup>54</sup> 1897 AC 22 51.

Some years later the *Salomon* principle that a company constitutes a separate legal person was endorsed as forming part of South African law in *Dadoo Ltd v Krugersdorp Municipal Council* (“*Dadoo*”).<sup>55</sup>

The *Dadoo* and *Salomon* cases have been accepted as laying the foundation for the recognition of the separateness of a company’s personality in South African company law.<sup>56</sup> This was reconfirmed as recently as 2013.<sup>57</sup>

While the separate legal personality of the company therefore remains embedded in the Companies Act it is important to recognise that the company is still a statutory creature, unlike for example the trust which is merely regulated by statute as opposed to being created by it. Although legal personality has its roots in common law the legislature, in creating the company form, utilises this concept in creating its own instrument in the form of the company. The modern company is a statutory creation of the Companies Act with its very existence bound to the provisions and purpose of that Act.

## 2.2 The need for separate corporate personality

The company as legal entity, precisely because of its separate juristic existence, continues to play a vital role in the modern commercial environment. One would struggle to imagine economic activity without having the use of a vehicle like a company to separate the legal and commercial existence of an enterprise from the individuals involved therein. The early development of this concept and the survival thereof over time<sup>58</sup> provide evidence of the necessity for mercantile law to recognise the existence of such a being.

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<sup>55</sup> 1920 AD 530. Innes CJ at 551 held that “(a) registered company is a legal *persona* distinct from the members who compose it.” See also *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 (T) 345:

“In *Dadoo Ltd & Others v Krugersdorp Municipal Council* 1920 AD 530 the Appellate Division enshrined the inviolability of corporate personality.”

<sup>56</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) 160.

<sup>57</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC).

<sup>58</sup> *Gower Principles of Modern Company Law* 24.

Gower<sup>59</sup> identifies three broad functions that the modern company may fulfil, namely:

- 1 for purposes other than the profit of their members, that is so-called non-profit companies;
- 2 to enable a sole merchant or limited number of partners to carry on a business; and
- 3 to enable the investing public to share in the profits of an enterprise without having to be involved in the active management of the business carried on.

This dissertation does not consider or discuss non-profit companies. However, the second and third functions of a company formulated by Gower speak to the very essence of the development of the doctrine of separate judicial existence. This is that commercially active natural persons want to trade and invest indirectly through the use of corporate entities rather than transacting in their own capacity.

This preference is a result of the onerous realities that would otherwise arise, for example greater exposure to the risk of liability to creditors or incurring unlimited losses in spite of the full-time investment of time and skill.<sup>60</sup> The use of corporate entities comes at a cost for society, for example in the form of credit risk for potential creditors, but that is tolerated due to the benefits created through increased economic activity.<sup>61</sup> It can therefore be argued that limited liability achieved through incorporation is acceptable to society.<sup>62</sup> In a sense, it comprises a social contract between shareholders and society based on the expectation that this limited liability will generate increased benefits for society in future, society being a stakeholder in companies in general.<sup>63</sup>

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<sup>59</sup> 11.

<sup>60</sup> PL Davies *Gower and Davies' Principles of Modern Company Law* 7 ed (2003) 177 *et seq.*

<sup>61</sup> Cassim *et al Contemporary Company Law* 35; *South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004.

<sup>62</sup> S 19 of the Companies Act is a manifestation thereof.

<sup>63</sup> *South African Company Law for the 21<sup>st</sup> Century* GN 1183 in GG 26493 of 23-06-2004.

To this end the law has developed to provide a pragmatic approach to these realities and requirements: the recognition of the concept of the modern-day company. With this recognition also comes the recognition of the existence of the company distinct from its shareholders so as to allow these functions to be served, effectively allowing for the interposing of the corporate veil between the shareholders of the company and the underlying assets thereof. This allows the corporate form to engage in activities on a scale and over a period which individuals acting in their own capacity are unable to achieve.<sup>64</sup>

However, this separateness is limited and the law will refuse to recognise the legal fiction that it itself creates if the circumstances so necessitate. The circumstances under which the disregard of the separate corporate personality of a company will be allowed are discussed in chapters 3 and further. Suffice it to say at this stage that some form of abuse of corporate personality is required.<sup>65</sup>

The company embodies the commercial requirement for separateness that has underpinned the historical development of the doctrine of separate personality to serve exactly that commercial purpose: to enable and encourage natural persons to pool resources for the benefit of a joint enterprise. In other words, the act of separation of assets from natural persons' own estates and the transfer thereof into a common pool, similar in many ways to a partnership, gave rise to the recognition of this separateness. Initially, this was arguably not for protection against creditors as much as it was for protecting the various stockholders from one another. This protection prevented stockholders from taking more from the common pool than that to which they were entitled.<sup>66</sup>

Certain commercial needs and realities exist in the community which the law serves. These include the three functions listed by Gower above, but also the specific consequences of incorporation discussed in part 2 3 below, for example limitation of liabilities or fault and the ability to transact separately. These are all

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<sup>64</sup> S Deakin "The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise" (2012) 37 *Queen's Law Journal* 339 352-353.

<sup>65</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) para 20.

<sup>66</sup> Williams "Companies: Part I" in *LAWSA* 4 and 62.

legitimate reasons for incorporating a company and by implication to make use of the separate legal personality thereof. It is where corporate personality is sought for purposes other than the afore-mentioned, that the law should consider disregarding the legal existence put in place by it.

It remains to be considered whether the use of corporate personality for tax purposes should be regarded as such a legitimate commercial purpose. Chapter 3 concludes that it is not.<sup>67</sup> Not only would such a use amount to an abuse of corporate personality, being a use for which it was not intended, but indeed abuse to such an extent that the law should not recognise the corporate veil for these purposes. The corporate veil was not introduced with tax purposes in mind nor was it developed as such. There is no authority to support the notion that one of the legitimate uses of the corporate form would be the avoidance of tax.

It is not disputed that the corporate veil can bring about certain tax benefits or that some of these benefits have been purposefully introduced to allow and encourage certain commercial behaviour. This dissertation argues though that the corporate veil was not designed to achieve beneficial tax results as one of its foremost legitimate goals and that the law should not recognise the corporate veil to the extent that it is primarily so applied.

### 2.3 The consequences of separate corporate personality

The fact that a company exists as a juristic person by virtue of incorporation<sup>68</sup> means that it is endowed with various attributes, most of which flow from its legal personality. This gives rise to various abilities and consequences for the company itself as well as its shareholders.

Different legal consequences are linked to the concept of separate legal personality attributed to a company.<sup>69</sup> Crucially, these include the recognition of

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<sup>67</sup> See the text to ch 3 part 3.3.2.4 below specifically.

<sup>68</sup> S 19(1)(a) of the Companies Act.

<sup>69</sup> Cassim et al *Contemporary Company Law* 35 et seq; Blackman et al *Commentary on the Companies Act* 4-111 et seq; PM Meskin, P Delpont & Q Vorster *Henochsberg on the Companies Act 71 of 2008* (2012): Notes on "Juristic Person"; Pretorius et al *Hahlo's*

a company as a separate legal entity existing as a legal *persona* distinct from its members (that is perpetual existence), the limited liability which the shareholder(s) of a company have towards the obligations of the company, and limited ownership of the assets of the company.

These consequences are set out in section 19 of the Companies Act. From section 19(1) it follows that a company can exist perpetually and perform its own actions, with the resultant consequences, separately from its shareholders. Section 19(2) explicitly provides that shareholders are not liable for the debts of the companies in which they hold shares.<sup>70</sup>

The consequences arising from incorporation extend to more than merely perpetual existence, the ability to contract and the limited liability of shareholders to company creditors.<sup>71</sup> Of great importance, especially where the law of taxation is concerned, is that the profits, and by implication the taxable income, of a company belong only to that company. It follows that a further consequence of incorporation is that a company is also subject to taxation of its income if such a tax exists in a particular jurisdiction.<sup>72</sup> This arises primarily from the ability of a

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*South African Company Law* 11; HS Cilliers, ML Benade, JJ Henning, JJ Du Plessis, PA Delport, L de Koker & JT Pretorius *Cilliers & Benade – Corporate Law* 3 ed (2000) 10. Also see *Voet* 1 8 28 et 3 4 1 as well as Lord MacNaghten's judgment in *Salomon v A Salomon & Co Ltd* 1897 AC 22 52.

<sup>70</sup> Although admittedly the subsection is phrased in a peculiar manner (presumably to mirror the wording in the Close Corporations Act – *cf* s 2(3)), it is arguable that the provisions of subsection (2) do not add anything not already put in place by s 19(1) of the Companies Act. It is submitted that the separate juristic personality afforded to a company in terms of subsection (1) would suffice to argue that the debts of companies are in any event removed from their shareholders.

<sup>71</sup> Blackman et al *Commentary on the Companies Act* 4-114 list 21 consequences of separate juristic, or corporate, personality. Cassim et al *Contemporary Company Law* 35 et seq consider eight consequences, while Cilliers et al *Cilliers & Benade – Corporate Law* 10 identify five consequences of separateness. Williams "Companies: Part I" in *LAWSA* 65 et seq considers twenty.

<sup>72</sup> S 5(1)(d) of the Income Tax Act.

company itself to enter into contracts or to transact.<sup>73</sup> For purposes of this dissertation this capacity to transact, as well as the separate liability of the shareholders *vis-à-vis* a company, is of particular importance. As is discussed below, for income tax purposes the corporate veil allows transactions to have tax consequences separately in the company and not in the hands of the shareholders themselves. Secondly, it means that any tax debts arising as a result are that of the company alone and that they cannot be recovered from the shareholders.<sup>74</sup>

In terms of the South African Income Tax Act, and most other fiscal acts, a company is regarded as a fully-fledged separate taxpayer. According to section 1 of that Act a “taxpayer’ means any person chargeable with any tax leviable under this Act” [own emphasis].

Because a company is considered a “person” for tax purposes,<sup>75</sup> the conclusion is obvious – a company is liable for income tax and is subject to the administrative duties that accompany this.

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<sup>73</sup> Blackman et al *Commentary on the Companies Act* 4-119; cf s 33 of the Repealed Companies Act and s 19(1)(b) of the Companies Act.

<sup>74</sup> The exception in s 181 of the Tax Administration Act 28 of 2011 (“Tax Administration Act”), is discussed in ch 5 below. This will, however, no longer be the case where piercing is applied, whether on a transactional or income statement level (the so-called income statement piercing, where tax consequences arise for the shareholder and not the company) or on a creditor’s balance or balance sheet level (the so-called balance sheet piercing, where the veil is pierced to hold the shareholders of the company liable for its tax debts).

<sup>75</sup> The definition of “person” in s 1 of the Income Tax Act does not specifically mention a company as a person, although the word “includes” precedes the list of “persons” listed there. There is no doubt that a company is considered a person for purposes of the Income Tax Act. An argument similar to that raised in *CIR v Friedman and Others* NNO 1993 1 SA 353 (AD) in the context of trusts would undoubtedly fail if it were to be employed by a taxpayer where a company is involved. See *Commissioner, South African Revenue Service v Professional Contract Administration* CC 2002 1 SA 179 (T) 185:

“It is trite that a body corporate, be it a company or a close corporation, having one member, has legal personality and as such is an individual taxpayer.”

Being a taxpayer in terms of the Income Tax Act is, however, not only to the disadvantage of the company. Various beneficial tax regimes exist which companies, sometimes exclusively, are able to access.<sup>76</sup> These beneficial treatments available to companies often give rise to the formation or utilisation of companies with the purpose of reaping these tax benefits; not so much for the benefit of the company itself, but for the benefit of the shareholders behind it. Very often it will be more beneficial to have income taxed in the hands of the company as opposed to the hands of natural person shareholders. The focus of chapter 3 and further in this dissertation will be the extent to which it is acceptable for shareholders to seek out these tax benefits linked to the use of a company purposefully and primarily.

### **3 Defining piercing**

As stated above, there are circumstances in which the law will disregard the separate legal existence of a company brought about by section 19 of the Companies Act. Although these circumstances will only be discussed in chapters 3 to 5, the notion of piercing the corporate veil itself and what it entails will be discussed in greater detail here first.

#### **3 1 Introduction**

Piercing is essentially a manifestation of the “substance over form” doctrine.<sup>77</sup> This becomes particularly relevant when legal personality is easily obtained through the registration of companies: legal personality is created through the relatively simple submission of certain documents to the Companies and

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See also *ITC 1670* [1998] 62 SATC 34 38 and *ITC 1618* [1996] 59 SATC 290. The definition of “person” in section 1 of the Interpretation Act, 33 of 1957, supports the above conclusion.

<sup>76</sup> See Silke *Tax Avoidance and Tax Reduction* 49. Examples include the exemption from dividends tax levied on receipt of dividends, exemption from PAYE generally, potentially beneficial income tax rates compared to high-earning natural persons, beneficial regimes for companies qualifying as “small business corporations” (s 12E), etc.

<sup>77</sup> See the text to ch 2 part 4 2 1 below.

Intellectual Property Commission (“CIPC”). As stated above,<sup>78</sup> although there is a practical need in modern society to have such a thing as separate corporate personality, this ease of access to legal personality together with the favourable consequences associated therewith, makes the act of incorporation open to abuse.<sup>79</sup> It is interesting to note that the increased ease linked to registering a company – and creating legal personality – is a stated policy objective for which the Companies Act was drafted and introduced.<sup>80</sup>

It is certainly arguable that the greater ease of incorporating companies will lead to an increase in companies being incorporated, for both legitimate and illegitimate purposes. Therefore it is inevitable that more instances of abuse of corporate personality will occur.<sup>81</sup> It is a necessary consequence that the application and use of remedies to counter that should receive more attention. Remedies previously described as “exceptional”<sup>82</sup> should be applied in a less exceptional fashion to keep track with the changing legal framework in which they are to function.

Piercing is the legal remedy against such abuse of the benefits attached to legal personality.

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<sup>78</sup> See the text to ch 2 part 2 2 above.

<sup>79</sup> According to CIPC, a company can be registered for as little as R400 by filing three forms: Reservation of a name, Notice of Incorporation, and Memorandum of Incorporation. See CIPC “Company Registration” (2017) *CIPC* <[http://www.cipc.co.za/Companies\\_files/CompanyReg.pdf](http://www.cipc.co.za/Companies_files/CompanyReg.pdf)> (accessed 23-08-2017). Silke *Tax Avoidance and Tax Reduction* 42 identified the ease of incorporating companies in as early as 1958 already as being a concern and a clear cause for increasing incidences of the avoidance of tax.

<sup>80</sup> *South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004 3.3 (27).

<sup>81</sup> “Abuse” is not a rigid concept. What constitutes “abuse” is subject to judicial judgment and consideration which are bound to change over time. Changes in judicial opinion are for example apparent when comparing the later judgments of *Salomon* in the House of Lords and *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) to the earlier judgments of lower courts.

<sup>82</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA); *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C).

“Piercing of the corporate veil” is understood to refer to an act by either the legislature or the courts<sup>83</sup> in terms of which the separate legal personality of a company is disregarded. One frequently associates piercing with the attribution of the liabilities of a company to that company’s shareholders,<sup>84</sup> but it is certainly not limited to this.

Various definitions are available to describe piercing. Blackman et al offer the following brief effort: “In certain instances the separateness of a company from its shareholders is disregarded by the court.”<sup>85</sup>

In *Ex Parte Gore NO and Others* (“*Ex Parte Gore*”),<sup>86</sup> the most recent South African case to consider piercing in detail<sup>87</sup> and the first to do so in terms of the legislated remedy now in section 20(9) of the Companies Act, the concept was considered to entail “a facts-based determination by the courts in certain cases to disregard some or all of the characteristics of separate legal personality that statute law ordinarily attributes to a duly incorporated company ...”.<sup>88</sup>

Finally, the explanation in the widely accepted leading South African case dealing with piercing, *Cape Pacific v Lubner Controlling Investments (Pty) Ltd*

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<sup>83</sup> Although there is an *obiter dictum* in *Lategan and another NNO v Boyes* 1980 4 All SA 638 (T) 647 (“*Lategan*”) that direct statutory authority for disregarding corporate personality does not amount to a “true example of ‘piercing the veil’”, piercing by way of statute is confirmed in *Botha v Van Niekerk* 1983 4 All SA 157 (W) 164.

<sup>84</sup> See for example *Atlas Maritime Co SA v Avalon Maritime Ltd: The Coral Rose (No 1)* 1991 4 All ER 779:

“To pierce the corporate veil is ... treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders.”

<sup>85</sup> Blackman et al *Commentary on the Companies Act* 4-133. Williams “Companies: Part I” in *LAWSA* 85; Gower *Principles of Modern Company Law* 112 and Cilliers et al *Cilliers & Benade – Corporate Law* 13 also regard the primary element of piercing as one whereby the separate existence of the legal person is being disregarded. Cassim et al *Contemporary Company Law* 41 agree with this but add that it is essentially a remedy examining the substance of the company, rather than its form.

<sup>86</sup> 2013 2 All SA 437 (WCC).

<sup>87</sup> See the text to ch 4 part 1 1 below.

<sup>88</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 4.

(“*Cape Pacific*”),<sup>89</sup> states that piercing is applied where “a court would be justified in certain circumstances in disregarding a company’s separate personality in order to fix liability elsewhere for what are ostensibly acts of the company ...”.<sup>90</sup>

### 3.2 Misapplications

It is trite that the piercing doctrine is often the source of much confusion, mostly because of the inaccurate and loose application of facts and law and labelling these as examples of piercing, where in fact it is not accurate to do so.<sup>91</sup> It is therefore necessary to use the phrase sparingly.

Two examples of such wrong labelling are often encountered, one of which is included, in my view incorrectly, under the banner of “piercing”, and the other incorrectly excluded therefrom.<sup>92</sup> The first mistake involves that “piercing” can also refer to directors, as opposed to shareholders, being ascribed the liabilities of a company, predominantly because of some wrongdoing on their side. The second one involves that “lifting” the veil is something different from piercing and

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<sup>89</sup> 1995 2 All SA 543 (A) 553.

<sup>90</sup> 553.

<sup>91</sup> This is an inevitable and unhappy consequence of the use of metaphors, identified specifically concerning the corporate veil as early as in 1926 in *Berkey v Third Avenue Railway* 244 NY 84, 94, 155 NE 58, 61:

“The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an ‘alias’ or a ‘dummy’...”.

See too Blackman et al *Commentary on the Companies Act* 4-133: “It is an area of the law that has resisted clarity and coherence”; Cassim et al *Contemporary Company Law* 48 and Williams “Companies: Part I” in *LAWSA* 85; also the UK case of *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 124:

“However, such pejorative expressions are often dangerous ... and, while they may enable the court to arrive at a result which seems fair in the case in question, they can also risk causing confusion and uncertainty in the law.”

<sup>92</sup> Cf Williams “Companies: Part I” in *LAWSA* 85.

involves looking to the shareholders, directors or broader management of a company to determine certain attributes of a company, for example residence for tax purposes<sup>93</sup> or intention.

The reasons why these are considered to be mistaken are briefly discussed below.

### 3 2 1 *Piercing to ascribe liabilities to directors*

Numerous examples exist of how piercing has been considered in the past as also including the ascribing of liabilities of a company to its directors, as opposed to its shareholders.<sup>94</sup> It is submitted that this is not piercing in its true sense and that the doctrine should be limited purely to the realms of the company-shareholder relationship. The historical development of the doctrine of separate corporate personality discussed above,<sup>95</sup> as well as that of the piercing doctrine itself, dictate that this be the case. This is, however, by no means to suggest that the directors of a company can never be held accountable for the obligations of

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<sup>93</sup> *Estate Kootcher v CIR* 1941 AD 256 at 260; T Gutuza “Has recent United Kingdom case law affected the interplay between ‘place of effective management’ and ‘controlled foreign companies’?” (2012) 24 *SA Merc LJ* 424 434.

<sup>94</sup> The *Lategan* case is arguably the best illustration where piercing has been applied as such. See *Lategan and another NNO v Boyes* 1980 4 All SA 638 (T) 645 and 647, which also refers to *Orkin Bros. Ltd v Bell* 1921 TPD 92 (“*Orkin Bros*”) as representing a case of “piercing” on a similar basis (yet, not called “piercing” as such in that judgment); the FAIS case of *Siegrist v Botha – The Office of the Ombud for Financial Service Providers* case no: FAIS 00039/11 – 12/GP1. Also see the UK case of *Ad Valorem Factors Ltd v Ricketts* 2004 1 All ER 894. The difference between piercing and holding directors liable for the debts or actions of a company is well illustrated by a comparison of ss 180 and 181 of the Tax Administration Act, the latter representing true piercing, whilst the former does not. (The fact that s 180 does not amount to “piercing” as such, of course does not detract from the validity of that section.)

<sup>95</sup> See the text to ch 2 part 2 1 above.

a company, be it on a statutory,<sup>96</sup> contractual, or delictual basis.<sup>97</sup> The submission is merely that this is not piercing in the true sense.

Blackman et al argue,<sup>98</sup> in my view correctly, that directors of a company are not held liable personally by virtue of the separate corporate existence of a company being disregarded, but rather based on misrepresentation of the in-substance agency agreement which exists between company and director. In such instances, the director is held personally liable in the same manner as an agent would have been had it misrepresented its principal.<sup>99</sup> The agency relationship existing between director and company as opposed to the legal relationship existing between shareholder and company should not be confused.<sup>100</sup>

Blackman et al further argue that directors of a company being held personally liable in terms of the Companies Act does not amount to piercing since it amounts to “rules to be applied by the court”, in other words piercing by the legislature.<sup>101</sup> Although the conclusion itself is to be agreed with, one is left unsatisfied with the argument used to come to that conclusion, being that piercing is a common law instrument alone. If “statutory piercing” does not constitute “piercing” as such,

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<sup>96</sup> An example is the provisions of s 19(3) of the Companies Act (comparable to s 53(b) of the Repealed Companies Act).

<sup>97</sup> Many regard the director-company relationship as one akin to an agency agreement in terms of which the director may (as the controlling mind or *alter ego*) act as agent of the company. This may be true even though no formal agency agreement exists between the company and its director (Cassim et al *Contemporary Company Law* 52; Blackman et al *Commentary on the Companies Act* 4-110; Williams “Companies: Part I” in *LAWSA* 64).

<sup>98</sup> Blackman et al *Commentary on the Companies Act* 4-146.

<sup>99</sup> Refer also Cassim et al *Contemporary Company Law* 63; Williams “Companies: Part I” in *LAWSA* 85. For an Australian perspective, see H Anderson “Piercing the Veil on Corporate Groups in Australia: The Case of Reform” (2009) 33 *Melb UL Rev* 342.

<sup>100</sup> See the text to part 4.2.4 of this chapter below for a discussion of agency in the context of piercing.

<sup>101</sup> Blackman et al *Commentary on the Companies Act* 4-146; Cf Cassim et al *Contemporary Company Law* 63.

then neither section 65 of the Close Corporations Act nor section 20(9) of the Companies Act would amount to piercing.<sup>102</sup>

The corporate veil is set in place to create a person separate from its shareholders, not separate from the directors. Although directors and shareholders may both benefit from the existence of a company, the shareholders alone benefit from the corporate veil as such.<sup>103</sup>

The fact that directors quite often represent the face of the company easily leads to misunderstanding, but the abuse of a corporate relationship should not be confused with an abuse of the separateness which the corporate veil creates. A company requires natural persons to act on its behalf as it is itself physically unable to do so, for example to sign contracts. However, this is no different from the duty imposed on a person acting on behalf of or representing a person legally unable to act for themselves, for example minors and the mentally ill. In much the same way the director of a company performs certain actions on the company's behalf. When this duty is betrayed, it does not amount to an abuse of the corporate personality of the legal *persona*, but rather to the misuse of the association and of the position of the director with the company. To liken directors' personal liability for the liabilities of a company to piercing is to argue that a breach of duty also amounts to the misuse of the existence of the natural or legal person being misrepresented in a conventional agency context.<sup>104</sup>

It must be remembered that piercing is a legal remedy to guard against the misuse of corporate personality.<sup>105</sup> The question therefore should be: when

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<sup>102</sup> *Cf Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 4.

<sup>103</sup> *Al-Kharafi & Sons for General Trading, General Contracting and Industrial Structures Will v Pema NO & others* 2010 JOL 25851 (GSJ) 39 directs that a company-shareholder relationship is foundational to the application of the piercing doctrine.

<sup>104</sup> Directors, as the agents of companies, have a fiduciary duty towards the companies which they manage (*Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 180), the breach of which will lead to personal liability. See Part F of Ch 2 of the Companies Act generally.

<sup>105</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553. Also see *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 16 where ownership is identified as a necessary prerequisite before a court could consider piercing.

directors are held accountable for the liabilities of a company, does that attribution of liability arise as a result of the directors' misuse of the corporate personality of that company or from the misuse of their association with that company? In my view the latter: the separateness of the company *vis-à-vis* the shareholder is simply not the separateness available to the directors. Had the notion of separate corporate personality not existed, with the result that businesspeople had to conduct business in partnership, the managers or directors of the business would still have been separate from the business owners.<sup>106</sup> The separateness brought about by the corporate veil does not create a separateness for the directors that would otherwise not have existed.

That is not to say that directors never misuse or misrepresent companies and that other remedies to correct such misuse or misrepresentation do not exist. The argument is rather is that the existing remedies in such instances remain valid, but are not related to the piercing doctrine. The difference between cases where directors misuse a company as opposed to the shareholders doing so is that the company does not belong to the directors; the owners thereof (the shareholders) merely entrust its management to their care. It is therefore necessary to bear in mind that separate legal personality has been developed as a legal solution to a commercial requirement. Where the attribution of the obligations of a company is concerned, this is best left to situations where the shareholders are held personally liable and not the directors.<sup>107</sup>

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<sup>106</sup> See M Dendy "Agency and Representation: Preliminary Note" in *Forms and Precedents* (2014) 5.2. Legal separateness is attributed to the agency relationship that exists between managers / directors and the persons who they represent. Irrespective of whether the principals in question are partners of a partnership or a legal person such as a company, that legal separateness exists in both instances between principal and agent irrespective whether the conglomerate of principals have legal personality or not.

<sup>107</sup> This also explains the piercing of close corporations (see the text to part ch 4 par 2 3 4 below). The uniqueness of close corporations lies therein that their members effectively occupy the position of both director and shareholder. Suffice it to say at this stage that close corporations can be pierced because members have a vested ownership interest in the close corporation and not because they manage that legal *persona* as the directors

In conclusion, Cassim et al<sup>108</sup> and *Lategan v Boyes* (“*Lategan*”)<sup>109</sup> appear to be the only authorities to consider the incurrence of personal liability by a company’s directors for the liabilities of that company to have anything to do with the corporate veil. The submission here is that the corporate veil is an entirely separate matter from the directors of a company being held personally liable.

On the strength of the above arguments it is my view that section 20(9) of the Companies Act cannot be applied to hold directors of a company liable, irrespective of the reference to “another person” in that subsection, as this would not result in the “*unconscionable abuse*” of the juristic personality of a company, but at the most the abuse of the company itself.

Although the issue may only involve secondary matters such as using the correct legal label,<sup>110</sup> director liability is excluded from the scope of this dissertation. The incorrect use of the phrase confuses and overcomplicates the application of the legal doctrine.

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of a company would. See also *Atlas Maritime Co SA v Avalon Maritime Ltd: The Coral Rose (No 1)* 1991 4 All ER 779:

“To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders.” [emphasis by Stocker LJ]

<sup>108</sup> Cassim et al *Contemporary Company Law* 63 refer to piercing of the corporate veil when applied to directors as “lifting the veil” (which is somewhat confusing considering the discussion in the text to ch 2 part 3 2 2 below where this phrase is ordinarily reserved for attributing certain characteristics to a company). See the text to n 125 below. See too at n 210 of Blackman et al *Commentary on the Companies Act* which seems to support the notion that directors being held personally liable is linked to the corporate veil, which is not the case. “Veil limitation” as discussed at the references made there is linked to shareholder liability and not that of directors.

<sup>109</sup> See the text to n 93 above. In this case piercing was (incorrectly) found to apply and that purely on the strength of the decision in *Orkin Bros*, which did not conclude that holding directors liable amounted to piercing. Also refer to *Lategan and another NNO v Boyes* 1980 4 All SA 638 (T) 647 for the lack of authority acknowledged by Le Roux J. It appears from this too that the authority referred to does not support the notion of drawing in the liability of directors under the banner of piercing.

<sup>110</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 4.

### 3 2 2 *Lifting distinguished from piercing*

It is a settled principle in South African law that courts are justified in attributing certain characteristics of natural persons who stand in a particular relationship with a company to that company itself, such as a shareholder,<sup>111</sup> director<sup>112</sup> or even a senior employee.<sup>113</sup> In the income tax milieu in particular the attribution of such characteristics would include for example determining what the subjective intent of a company is.<sup>114</sup> All depends on the facts and circumstances at hand.

The rationale behind such attribution is that the law generally requires legal persons to be subject to the same principles that govern natural persons, for example that a legal person is able to commit a crime or delict, enter into contracts, or be subject to tax. To this end it is required that legal *personae* also be awarded certain attributes, even if only fictionally, to allow the appropriate legal consequences to flow. Quite often, these attributes will be afforded to a company based on how these are attached to the individuals who act on behalf of or as the “directing mind” of that company.<sup>115</sup> A company has “no soul to damn and no body to kick”<sup>116</sup> and “acts through its directors”.<sup>117</sup>

The decision whereby a court attributes these characteristics of individuals to legal *personae* has been drawn by some into the realm of the piercing of the

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<sup>111</sup> Refer to the examples in *John Bell and Company (Pty) Limited v Secretary for Inland Revenue* [1976] 38 SATC 87; *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste* [1978] 39 SATC 163 and *Yates Investments (Pty) Ltd v Commissioner for Inland Revenue* [1956] 20 SATC 238.

<sup>112</sup> Refer to the example in *CIR v Richmond Estates (Pty) Ltd* [1956] 20 SATC 355.

<sup>113</sup> SARS’ *Interpretation Note 6 3*; OECD’s *Model Tax Convention on Income and on Capital 2014: Commentary on Article 4* (2014) para 24.1.

<sup>114</sup> See e.g. *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste* [1978] 39 SATC 163.

<sup>115</sup> Benade (1967) *THRHR* 217; *John Bell and Company (Pty) Limited v Secretary for Inland Revenue* 1976 38 SATC 87 100. Williams “Companies: Part I” in *LAWSA* 80 and 81 gives examples of some of these attributes.

<sup>116</sup> Cassim et al *Contemporary Company Law* 31 referring to this statement by Lord Chancellor Thurlow.

<sup>117</sup> *Barkett v SA Mutual Trust & Assurance Co Ltd* 1951 2 All SA 462 (A).

corporate veil.<sup>118</sup> Confusion abounds as far the inconsistent use of the phrase “lifting the corporate veil” is involved.<sup>119</sup> On the one hand one has the *dictum* in *Cape Pacific* which does not seem to distinguish between lifting and piercing:<sup>120</sup>

“Equally trite is the fact that a court would be justified in certain circumstances in disregarding a company’s separate personality in order to fix liability elsewhere for what are ostensibly acts of the company. This is generally referred to as lifting or piercing the corporate veil.” [own emphasis]<sup>121</sup>

On the other hand sources such as Cassim et al<sup>122</sup> and the *Dictionary of Legal Words and Phrases*<sup>123</sup> would have “lifting” refer not to piercing as such, but rather to some quality or human characteristic being fictionally attributed to the

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<sup>118</sup> The Taxpayer “Case Law: CIR v Ocean Manufacturing Limited” (1990) 39 *The Taxpayer* 147-149.

<sup>119</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 4.

<sup>120</sup> 552.

<sup>121</sup> Also refer to Meskin et al *Henochnsberg on the Companies Act* in the text to n 69 above for a discussion of s 19 in their work. See also *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 24 for another example of where the AD seemingly drew no distinction between “lifting” and “piercing”, as well as *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 (T). Cf *Al-Kharafi & Sons for General Trading, General Contracting and Industrial Structures Wll v Pema NO & others* 2010 JOL 25851 (GSJ) and *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 2 SA 303 (C) where piercing is also referred to as “lifting” the veil. See also FP Strydom & JJ du Plessis “Ontsluiering by maatskappye en beslote korporasies: ‘n vergelyking tussen *piercing the corporate veil* en artikel 65 van die Wet op Beslote Korporasies 69 van 1984” (1997) 3 *TSAR* 400.

<sup>122</sup> Cassim et al *Contemporary Company Law* 46. Confusingly, at 63 (as has been discussed in the text to ch 2 part 3 2 1 above), Cassim et al also promote the idea that imposing “liability on the directors and prescribed officers of the company ... are more accurately described as instances of lifting the veil”.

<sup>123</sup> “Corporate Veil” is defined in RD Claassen (ed) *Dictionary of Legal Words and Phrases* (2015) as:

“In order to determine who is responsible for the activities, decisions and control of a company it may be necessary to lift the corporate veil.”

company.<sup>124</sup> “Lifting” as distinguished from piercing therefore does not have the effect to ignore the separate legal existence of a company and to impose liability on shareholders. Staughton LJ’s *dictum* in *Atlas Maritime Co SA*, which sets out the position in English law, aptly describes this:

“To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose.” (emphasis supplied by Staughton LJ)<sup>125</sup>

It would appear as if the distinction is based exclusively on non-South African authorities.<sup>126</sup> While it must be acknowledged that piercing, or lifting for that matter, is an internationally recognised concept, it would seem that the South African courts, right up to the Supreme Court of Appeal (“SCA”), have not subscribed to the idea of differentiating between lifting and piercing. In fact, no South African case law could be found to suggest that South African courts have ever defined lifting as being anything else than piercing.<sup>127</sup> It is submitted that the

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<sup>124</sup> See also FHI Cassim (ed), MF Cassim, R Cassim, R Jooste, J Shev & J Yeats *The Law of Business Structures* (2012) 67 and Cilliers et al *Cilliers & Benade – Corporate Law* 13 *et seq.* The authorities listed by the latter all include cases where courts have not distinctly referred to piercing as such.

<sup>125</sup> *Atlas Maritime Co SA v Avalon Maritime Ltd: The Coral Rose (No 1)* 1991 4 All ER 779, referring to *Adams v Cape Industries plc* 1991 1 All ER 929 as justification for the said distinction. See also *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 150.

<sup>126</sup> This is not to advance the notion that foreign cases do not play an important role in South African law. This would be contrary to ss 232 and 233 of the Constitution. However, it is curious to note that all the cases put forward by Cassim et al to justify some difference between “lifting” and “piercing” of the corporate veil are from outside South Africa and all predate the AD’s muted refusal to accept said distinction in its 1994 and 1995 judgments in *The Shipping Corporation of India* and *Cape Pacific* cases respectively. See also Gower *Principles of Modern Company Law* 113 in respect of the position in English law.

<sup>127</sup> *Ex Parte Gore* has gone as far as to acknowledge that confusion does exist, but again with references to non-South African case law. It also goes no further in deciding on the accuracy of such a distinction.

correct approach would be not to distinguish between “piercing” and “lifting” as different concepts.<sup>128</sup>

The approach whereby the attribution of characteristics is excluded from “piercing” or “lifting” of the corporate veil does no harm to the principle that characteristics of natural persons can be attributed to a company. As is the case in part 3 2 1 above the agency doctrine adequately explains such attribution. Therefore, the human attributes attached to a company are not so attached as a result of the company being a legal *persona*, but rather because of the role which natural persons may play on behalf of the company. It need not involve the corporate veil and thus no distinction should be drawn between “piercing” and “lifting” of the corporate veil.

### 3 2 3 Conclusion

When considering the above variations on the piercing doctrine,<sup>129</sup> one cannot but agree with the sentiment expressed by Van den Heever JA in *Cape Pacific*:

“I am wary in this matter of the metaphor that companies wear veils that sometimes require to be pierced, or partially pierced, or lifted. A metaphor – to use another – may prove to be an unnecessarily confining corset.”<sup>130</sup>

The solution would be to limit piercing or lifting of the corporate veil to those circumstances involving the disregarding of the separate legal personality of a company from that of its shareholders, irrespective of what label it was given in the past. Ascribing attributes of its shareholders or directors to the company should not be referred to as lifting or piercing. If one were to insist on the use of a metaphor to describe such instances, reference to “veil transparency” would be more appropriate.

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<sup>128</sup> Blackman et al *Commentary on the Companies Act* 4-111 and 4-144.

<sup>129</sup> Described in *Botha v Van Niekerk* 1983 4 All SA 157 (W) 162 as the varying degrees of “*versluiering*” (“veiling”).

<sup>130</sup> 1995 2 All SA 543 (A) 558 and 559.

The use of terminology involving the “veil” should be restricted to instances of piercing only. The correct context and content for “piercing” are important in order to ensure that the doctrine itself is not misapplied or developed under the influence of rules that have no real legal bearing on the piercing doctrine.<sup>131</sup>

For the purposes of this research piercing or lifting of the corporate veil will therefore be defined as in *Ex Parte Gore*, namely that piercing or lifting involves “a facts-based determination by the courts in certain cases to disregard some or all of the characteristics of separate legal personality that statute law ordinarily attributes to a duly incorporated company”.<sup>132</sup>

What Cassim et al describe as “lifting”, that is ascribing certain attributes to a company, is therefore excluded from the scope of this research, as well as the attribution of the liabilities of a company to its directors. Disregarding of the corporate veil, whether in terms of general or specific enabling legislation or in terms of the common law, will be included. As was so aptly stated in the plaintiff’s heads of argument in the *Cape Pacific a quo* case:

“As a general principle companies are recognized as legal entities separate from their shareholders, officers and directors. Corporate obligations remain the liability of the entity and not of the shareholders, directors or officers who own and/or act for the entity. ‘Piercing the corporate veil’ refers to the judicially imposed exception to this principle by which Courts disregard the separateness of the corporation and hold a shareholder or controller<sup>133</sup> responsible for the corporation’s action as if it were the shareholder’s own.”<sup>134</sup>

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<sup>131</sup> See also Blackman et al *Commentary on the Companies Act 4-148 et seq.*

<sup>132</sup> Blackman et al *Commentary on the Companies Act 4*; cf *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 16:

“But when we speak of piercing the corporate veil, we are not (or should not be) speaking of any of these situations, but only of those cases which are true exceptions to the rule in *Salomon v A Salomon and Co Ltd* [1897] AC 22, i.e. where a person who owns and controls a company is said in certain circumstances to be identified with it in law by virtue of that ownership and control.” [own emphasis]

<sup>133</sup> This should be understood in the context of the case: the controller referred to here is not in the capacity as a director, but rather a person who is in substance the shareholder and owner of a company, as Lubner was in this case.

<sup>134</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* [1993] 3 All SA 685 (C).

## 4 Piercing distinguished from other common law doctrines

### 4.1 Introduction

Piercing, a unique remedy,<sup>135</sup> should be regarded as a doctrine on its own. Admittedly though, the doctrine has elements of many other common law doctrines and even share certain similarities.<sup>136</sup> These include, *inter alia*, the sham and the substance over form and the *alter ego* doctrines. Nevertheless, the doctrine remains identifiable by its legal effect: it results in the disregarding by a court of the separate legal personality of a company in relation to its shareholders. What should be cautioned against, however, is labelling doctrines as a sub-part of piercing only because the practical effect of these other doctrines may correspond to the practical effect of piercing. Confusing the practical effect of other legal doctrines with that of piercing will inevitably lead to a wrong understanding of the requirements and effect linked to piercing in the proper sense.<sup>137</sup> Piercing is but one remedy which in certain circumstances can afford an aggrieved party relief.<sup>138</sup>

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<sup>135</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 paras 27 and 80.

<sup>136</sup> *Contra ITC 1611* [1995] 59 SATC 126 (see also the judgment of Lord Walker in *Prest*); *Cf Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552. It has been confirmed in other jurisdictions, such as the UK, that piercing is a self-standing remedy: see specifically the judgments of Lords Neuberger and Sumption in *Prest*, and again by Lord Neuberger in *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 127. The position is also confirmed in South Africa in the cases of *The Shipping Corporation of India*, *Cape Pacific* and *Hülse-Reutter* where the SCA has confirmed, expressly and impliedly, that the doctrine is very much a self-standing remedy and part of South African law. The High Court in *Ex Parte Gore* has recently reconfirmed this.

<sup>137</sup> *Larkin* (1989) SA Merc LJ 296:

“Furthermore, [the company] has features which both resemble other institutions, such as agency, and differ from them, and careful regard should always be paid to its relationship with any other such institution which is relevant to the issue at hand.”

The dangers linked to confusing legal doctrines are illustrated in the context of the abuse of trust doctrine by MJ de Waal “The abuse of the trust (or: ‘going behind the trust form’)” (2012) *RabelsZ* 1078 1080.

<sup>138</sup> *Cf* the text to ch 3 part 2 below on whether piercing is a remedy of final resort only, which illustrates this point.

The lines between piercing and non-piercing remedies often become blurred, particularly when non-piercing remedies are applied but mislabelled as piercing.<sup>139</sup> It is necessary to consider the most often used common law remedies which in my view do not constitute piercing and should accordingly not be labelled as such.

## 4 2 Other common law remedies

### 4 2 1 *Substance over form*

The substance over form doctrine involves an enquiry into the substance of a transaction. It involves a comparison of the substance of a transaction with the form in which it is presented. Where that substance differs from the form in which it is presented, the law will recognise the substance of the transaction rather than the form thereof.<sup>140</sup>

The piercing remedy is rooted in the substance over form doctrine,<sup>141</sup> but with the emphasis placed on the form of the transaction.<sup>142</sup> The court in *Cape Pacific* held that:<sup>143</sup>

“a court would (only) then be entitled to look to substance rather than form in order to arrive at the true facts, and if there has been a misuse of corporate personality, to disregard it and attribute liability where it should rightly lie. Each case would obviously have to be considered on its own merits.”<sup>144</sup>

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<sup>139</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 16.

<sup>140</sup> Although most commonly manifesting in a context that involves some dishonesty (see the text to ch 2 part 4 2 2 below for a discussion on the sham and simulation doctrines), it may also occur through honest error in a transaction inaccurately portrayed in a manner which is different from the substance of the transaction.

<sup>141</sup> *Larkin* (1989) SA Merc LJ 290 *et seq*: “[T]he issue transcends the problem of the corporate veil, as it does company law itself.”

<sup>142</sup> This is also particularly relevant in the income tax context: see *Ochberg v CIR* 1931 AD 215 for the minority judgments of Wessels and Stratford JJA.

<sup>143</sup> 1995 2 All SA 543 (A) 553.

<sup>144</sup> See also 1995 2 All SA 543 (A) 552 for an application of the principle set out in *Dadoo*.

Nevertheless, the piercing and substance over form doctrines, although related, must not be considered as one and the same. Piercing is a remedy with unique requirements that must be met before it can be applied. “Substance over form” by itself is however not an unlimited concept. The law will recognise the legal form that is the company,<sup>145</sup> yet will revert to a substance-based approach as opposed to a formalistic one when it is justified.<sup>146</sup> The corporate veil exists as a result of statute creating the fiction of corporate personality, requiring the form to be recognised rather than the economic substance. Only where the form is being used beyond what is allowed will the substance prevail where the corporate veil is concerned.

The case of *Melomed Hospital Holdings Ltd v Wilson NO*<sup>147</sup> serves as an example of such confusion between substance over form and piercing. There the substance over form doctrine was applied, rather than piercing.<sup>148</sup> In fact, the court chose to consider the shareholder not to be the true owner of the company.

Although not all cases on the substance over form doctrine will also involve piercing, it is inevitable that any enquiry involving piercing will to some degree amount to a substance-based approach, but with due respect for the form created by statute.<sup>149</sup>

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<sup>145</sup> Blackman et al *Commentary on the Companies Act 4-146 et seq.*

<sup>146</sup> Discussed in ch 3 below.

<sup>147</sup> 2012 JDR 1489 (LC). The case dealt with the question whether an individual was employed by the company of which he was the sole shareholder, or by the hospital owning company receiving all his services. The court found the latter to be the case.

<sup>148</sup> Had the court explicitly found that Melomed was in substance the shareholder (as was the case in *Cape Pacific* in respect of the relationship between Lubner and LCI, or for Ebrahim Snr in *Airport Cold Storage* in his capacity as in-substance member), then piercing would theoretically have been possible, although the court did not go that far in this case.

<sup>149</sup> Also see *VTB Capital plc v Nutritek International* [2012] EWCA Civ 808 87, as quoted in *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC): “Veil piercing ... is about substance, not form ...”.

#### 4 2 2 *Sham and simulation*

The sham and simulation doctrines<sup>150</sup> share a common feature with piercing in that they all contain elements of the substance over form doctrine.<sup>151</sup> However, for piercing the question of substance is with reference to the substance of a company's legal personality; for simulated transactions the doctrine involves the substance of a specific transaction. This is an important distinction. Whereas simulated transactions are wholly disregarded,<sup>152</sup> piercing disregards only the corporate veil and only for a limited purpose. Piercing does not disregard any transaction: it continues to recognise the form of a transaction in its entirety, but attributes consequences thereto as if the corporate veil did not exist. Simulation disregards transactions; piercing disregards certain effects of a structure while maintaining that structure for all other purposes.<sup>153</sup> This is an extremely important distinction, and this limited effect of piercing also plays a major distinguishing role as applied to the other doctrines discussed in parts 4 2 3 and further below.

The facts of *Cape Pacific* serve as an example of this difference. In this case piercing was applied by the court with the result that performance could be claimed from the sister company (GLI) of the respondent (LCI) since for the purposes of the ownership of the assets to be delivered the two companies could be regarded as the same legal entity. If, hypothetically, in this scenario, the court had found a simulation to be present, the subsequent transfer of assets by LCI to its sister company GLI would have been disregarded with the claim for

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<sup>150</sup> AP de Koker & E Brincker *Silke on International Tax* (2010) 46.5. Also see the text to n 140 above: sham/simulated transactions necessarily involve a degree of dishonesty (*Commissioner of Customs & Excise v Randles Brothers & Hudson Ltd* [1941] 33 SATC 48 67).

<sup>151</sup> See the text to part ch 2 part 4 2 1 above.

<sup>152</sup> *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* [1992] 1 All SA 398 (A) 405.

<sup>153</sup> See the English position in *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 157 which, in my view correctly, confirmed that the use of the word "sham" in a piercing context should not be afforded a strict, legalistic meaning. See too the English case of *Jones v Lipman* [1962] 1 All ER 442 and in the South African context *The Shipping Corporation of India v Evdomon Corporation* 1994 2 All SA 11 (A) 25. See ch 2 part 6 1 below for a discussion on the limited effect that piercing practically has.

performance only being against LCI as the transferring company. The order was ultimately made against GLI, showing the limited effect that piercing has. The court acknowledged that in form GLI remains the owner of the shares.<sup>154</sup>

Save for the above distinction between the two doctrines, they are of course also both independently developed doctrines, each with its own respective criteria which must be satisfied in order to apply.

They should therefore not be confused.<sup>155</sup> There may, however, be one area where they may overlap, and that would be the case for a “sham” company, which also involves the *alter ego* doctrine.

#### 4 2 3 *Alter ego doctrine*

Piercing is generally applicable with reference to a particular transaction only,<sup>156</sup> although theoretically nothing prohibits a court to pierce on the basis that the very existence of a company is a sham.<sup>157</sup> This would result in the corporate veil being pierced for purposes of all assets and obligations belonging to the company, in other words all transactions that the company has ever entered into. Such a finding would be a rather drastic one if supported by the facts. However, there is support that this is possible, although it is questionable whether such total disregard of a company would amount to piercing in a strict sense.<sup>158</sup>

When used in the context of companies the phrase “*alter ego*” embodies two different concepts.<sup>159</sup> The first is where it is used as means to determine the actions and subjective mind of the company in order to mirror such actions and

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<sup>154</sup> The background facts of the case are set out in more detail in ch 3 part 3 3 2 below.

<sup>155</sup> The Taxpayer – Editorial “Employees’ tax” (1989) 38 163-164.

<sup>156</sup> See the text to ch 2 part 6 1 below.

<sup>157</sup> Cf *Larkin* (1989) SA Merc LJ 284; see also the judgment of Denning MR in *Littlewoods Mail Order Store Ltd v McGregor* [1969] 1 WLR 1241 (CA).

<sup>158</sup> Williams “Companies: Part I” in *LAWSA* 87; *Gilford Motor Co v Horne* 1933 Ch 935 (CA) 961.

<sup>159</sup> See also Blackman et al *Commentary on the Companies Act* 4-137 and in particular n 3.

intention from the controllers of the company onto the company itself.<sup>160</sup> Secondly, the *alter ego* doctrine is often used in relation to the application of the piercing doctrine. This means that, as a result of the abusive behaviour by the shareholders of a company, the company is in fact nothing but the shareholder dressed up to appear to be a separate person. Its separate personality should therefore not be recognised.<sup>161</sup> This dissertation is concerned only with the latter.<sup>162</sup>

Clearly the two doctrines are not the same.<sup>163</sup> It is incorrect to state that piercing may be applied based on the *alter ego* doctrine exclusively.<sup>164</sup> The *alter ego* doctrine, although playing a useful role in considering whether piercing should be applied, is not enough on its own. This is also the position under UK law.<sup>165</sup>

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<sup>160</sup> Also known as the “directing mind doctrine”: Blackman et al *Commentary on the Companies Act 4-123 et seq*; cf the text to ch 2 part 3 2 2 above.

<sup>161</sup> Refer e g *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554. Also see the discussion of so-called “one-man companies” in ch 3 part 5 2 2 below.

<sup>162</sup> Refer e g *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 (T) 339 *et seq* where this was considered with reference to companies owned by governments specifically. The court however does not come to a clear conclusion on the matter, nor is it submitted was it necessary to. See also cases from other jurisdictions in *O'Donnell v Weintraub* 67 Cal Rptr 274; *In re Elegant Custom Homes Inc., Debtor. Elegant Custom Homes, Inc., et al, Appellants, v Elaine M. Dusharm, Appellee* as decided by the US District Court for the District of Arizona on May 14, 2007 (unreported) and *Clarkson Co. v Zhelka* [1967] 2 OR 565, 64 DLR (2d) 57.

<sup>163</sup> See Cassim et al *The Law of Business Structures* 70; Cassim et al *Contemporary Company Law* 69; Gower *Principles of Modern Company Law* 125 *et seq* and 137.

<sup>164</sup> Cf D Bhana “Should the doctrines of the ‘undisclosed principal’ or ‘piercing of the corporate veil’ determine the *locus standi* of a party to sue in terms of a contract? The conundrum of *Botha v Gijose t/a Pragon Fisheries*” (2010) 127 SALJ 5-18, 16 *et seq*. Also see *Cape Pacific* where the AD in no uncertain terms listed fraud, dishonesty or improper conduct as necessary prerequisites before piercing can be applied – factors not necessary for the *alter ego* test to apply.

<sup>165</sup> *Mubarak v Mubarak* [2000] EWHC 466 (Fam) (23 October 2000) para 36, approved in *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 206.

Moreover, a subjective element is also required for piercing.<sup>166</sup> The mere fact that a person, although a legal person, is treated by another as though it does not exist or is not recognised or acknowledged, is irrelevant as to whether that person does exist in law. Corporate personality is a thing of substance<sup>167</sup> and mere failure by any person to recognise its existence or to observe certain prescribed formalities in a specific instance does not derogate from the existence of the thing itself.<sup>168</sup> The law will only disregard the corporate veil for limited purposes under the piercing doctrine.<sup>169</sup> Only those specific advantages which the shareholder seeks to exploit will be affected.

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<sup>166</sup> See the text to ch 3 part 3 3 2 1 and ch 4 part 2 3 5 below. Blackman et al *Commentary on the Companies Act* 4-137 seek to argue that the *alter ego* doctrine may apply in the company law context and seek to distinguish this from the piercing doctrine. Blackman et al acknowledge though that the use of “alter ego” as phrase in the company law context has in the past not been used in a technically correct manner. This dissertation argues that a distinction between the piercing doctrine and past references to the company as *alter ego* is artificial and that the term “*alter ego*”, when used in relation to companies, is not used in the strict technical sense. Where Blackman et al therefore seek to argue that the application of the company as *alter ego* of the shareholder is different to piercing, it does so on this non-technical distinction. This dissertation considers the non-technical application of the *alter ego* phrase as being nothing more than part of the broader piercing doctrine. When the term “*alter ego*” has in the past been used in the company law context, it has been used in a non-technical manner that is akin to describing the company as an “instrumentality” to commit fraud, dishonesty, or improper conduct. These circumstances all have in common that the company is subjectively used in a certain manner, whereas the strict *alter ego* doctrine finds application even in the absence of conscious misuse; in other words, based on objective bases. Where a company is referred to as being the “alter ego” of its shareholders, it is done with reference thereto that the company is being purposefully abused on a subjective level to achieve some impropriety. Whether the company is therefore used as “*alter ego*” or “instrumentality”, or to commit fraud, dishonesty or other improper conduct (two bases on which Blackman et al would want to distinguish distinct separate criteria upon which to apply the piercing doctrine), these scenarios could very well be regarded as being the same.

<sup>167</sup> *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 550.

<sup>168</sup> See s 8(4) read with s 9(2) of the Constitution.

<sup>169</sup> See *O'Donnell v Weintraub* 67 Cal Rptr 6 where the court concluded that a company, being the *alter ego* of its shareholders, could still have a separate existence for all other

It is considered below to what extent the *alter ego* doctrine plays a role as a requirement for piercing.<sup>170</sup> It is, however, not enough for a company to be pierced in the absence of some form of intentional abuse at least.<sup>171</sup> Thus, a subjective test also needs to be applied.<sup>172</sup>

To what extent the *alter ego* test is a necessary requirement for piercing warrants further discussion. Williams<sup>173</sup> regards it as a requirement. It is also notable that the court in *Cape Pacific* concluded that the companies there were the *alter egos* of Lubner.<sup>174</sup>

In this regard the approach in the judgment of *In re Elegant Custom Homes*<sup>175</sup> is to be preferred. Without expressing an opinion on the correctness of the test applied there, I regard the case as a good illustration of how the *alter ego* principle

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purposes and benefit from the assignment of a lease (which approach does not accord with the strict interpretation of the *alter ego* doctrine).

<sup>170</sup> The application of the *alter ego* doctrine in the context of the law of trusts is not relevant here. See the *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA). Refer also to the examples of *Jordaan v Jordaan* 2001 3 SA 228 (C) and *Badenhorst v Badenhorst* 2006 2 SA 225 (SCA) as discussed by SA Hyland & BS Smith "Abuse of the trust figure in South Africa: An analysis of a number of recent developments" (2006) 1 *Journal for Estate Planning Law* 4.1.

<sup>171</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554.

<sup>172</sup> Also see the text to ch 3 part 3 3 2 1 below, which accords with the UK approach discussed in ch 3 part 4 1 below, being that the corporate veil must be used to "avoid or conceal liability ...". (*Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 162.) This is an important conclusion where piercing is being considered as remedy in instances of use for tax purposes. For piercing to potentially apply, it must be established that the avoidance of tax was at least one of the purposes for which the veil was employed. See the text to ch 3 parts 3 3 2 1 and 5 1 1 below.

<sup>173</sup> Williams "Companies: Part I" in *LAWSA* 87 and 90; cf Blackman et al *Commentary on the Companies Act 4-140-2 et seq* (as well as the reference there to the requirements listed by Cilliers & Benade *Company Law* 415); Cassim et al *Contemporary Company Law* 52.

<sup>174</sup> 1995 2 All SA 543 (A) 554.

<sup>175</sup> *In re Elegant Custom Homes Inc., Debtor. Elegant Custom Homes, Inc., et al, Appellants, v Elaine M. Dusharm, Appellee* as decided by the US District Court for the District of Arizona on May 14, 2007 (unreported).

is incorporated into a test for piercing, while acknowledging that the principle on its own is not enough:

“It was shown that it has long been the law in Arizona that the corporate form will be disregarded when the corporation is the alter ego of one or more individuals and ‘the observance of the corporate form would sanction a fraud or promote injustice.’” [own emphasis]

In this regard, Blackman et al<sup>176</sup> argue on the strength of *Die Dros (Pty) Ltd v Telefon Beverages CC*<sup>177</sup> that the *alter ego* doctrine presents a second distinct foundation on which piercing can be applied, independent from the requirements of fraud, dishonesty, or improper conduct. Put differently: it represents a different basis on which piercing can be applied without having regard to subjective criteria. This argument is on the strength of the court’s reference to the arguments raised by the applicants in that case.<sup>178</sup> This argument cannot be supported: no finding of the court in that judgment supports the notion that piercing can be applied in the absence of one of the subjective<sup>179</sup> criteria of fraud, dishonesty, or improper conduct.<sup>180</sup> Not one of the cases put forward by Blackman et al<sup>181</sup> supports the notion that the *alter ego* test on its own is a sufficient basis on which to pierce. It is not disputed that the *alter ego* principle may be a relevant criterion in ascertaining whether there has been abuse of the corporate veil by shareholders. It is after all only the shareholders that can perpetrate abuse of the corporate veil.<sup>182</sup> However, control on its own (and therefore the *alter ego* principle by implication) is not enough and it disregards the requirement of fraud,

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<sup>176</sup> Blackman et al *Commentary on the Companies Act* 4-140-1.

<sup>177</sup> [2003] 1 All SA 164 (C).

<sup>178</sup> Para 26.

<sup>179</sup> See the text to ch 3 part 3 3 2 1 below.

<sup>180</sup> See also the criteria on which the court pierced the veil in *Le’Bergo Fashions CC v Lee* 1998 2 SA 608 (C).

<sup>181</sup> Blackman et al *Commentary on the Companies Act* 4-140-2.

<sup>182</sup> See the text to ch 3 part 5 2 below.

dishonesty or improper conduct set by the SCA in *Cape Pacific*.<sup>183</sup> Even if the cases quoted by Blackman et al in some sense support the notion that the application of the *alter ego* principle is a sufficient basis on which to pierce, these cases all precede the judgment in *Cape Pacific*. The principles set out in *Cape Pacific* must now be followed.<sup>184</sup>

While references to the use of the company as “‘sham’, ‘cloak’, ‘device’, ‘stratagem’, ‘puppet’, ‘creature’, etc.”<sup>185</sup> – or, one may add, as *alter ego* – may arguably be indicative of subjective abuse,<sup>186</sup> it remains to consider what exactly is meant by the company as the *alter ego* of its shareholders. Blackman et al infer that this translates into more than ownership and control: what is needed is control and dominance to such an extent that the company cannot be said to have a separate mind, will, or existence of its own.<sup>187</sup> This corresponds with the view that the veil can only be pierced where sole or majority shareholding through which abuse is perpetrated is present.<sup>188</sup> While this may certainly be the case where piercing is to be applied with the usual set of facts (where company liability is attributed to shareholders, restraint of trade terms are extended to companies

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<sup>183</sup> See the text to ch 3 part 3 3 2 below.

<sup>184</sup> The SCA supported this view in *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 25: “[T]hey 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.” As is shown in the text to ch 3 part 3 3 2 1 below, our courts have, in developing the piercing doctrine, made a clear effort to incorporate a subjective element into the doctrine, first from a (perceived) requirement of fraud in *Lategan* and then to fraud or impropriety in *The Shipping Corporation of India Ltd*, to fraud, dishonesty or improper conduct in *Cape Pacific*. Taking cognisance of this development as well as using an *eiusdem generis* approach to the criteria set out, one can only arrive at the conclusion that a subjective requirement must be present for the piercing doctrine to be applied. It is further significant that the SCA in both *Cape Pacific* and *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) applied piercing on different bases than the objective criteria used in both the cases *a quo*.

<sup>185</sup> Gower *Principles of Modern Company Law* as quoted in *Banco de Mocambique*.

<sup>186</sup> See the text to ch 3 part 3 3 2 1 below.

<sup>187</sup> Blackman et al *Commentary on the Companies Act* 85.

<sup>188</sup> See the text to ch 3 parts 3 3 2 3 and 5 2 below.

owned by the restrained shareholders, etc), this cannot be a blanket rule. As is illustrated below,<sup>189</sup> minority shareholders lacking dominance of a company are also able to abuse the corporate veil for improper purposes. From a policy perspective,<sup>190</sup> courts will be less inclined to pierce the corporate veil where minority shareholders would be prejudiced. This, however, does not apply to piercing applied for tax purposes. In this regard, a minority shareholder may use the corporate veil for different purposes from that of a majority shareholder. The majority shareholder is also not necessarily affected where piercing is applied for tax purposes: only the shareholder with the disallowed intent is.

To give an example: two individuals incorporate their share portfolios into a single company. The one, which holds 25% of the shares in the company, does so only to avoid the levying of dividends tax on dividends declared on the share portfolio. The other, majority, shareholder does so only to protect the investment against his potential future creditors. If the intention of the minority shareholder is a legitimate basis upon which to pierce, piercing for tax purposes will only be applied as regards the tax consequences linked to that shareholder on dividends received. For example, if the company were to receive R100 dividends, it is plausible that R75 will be treated as being exempt from dividends tax and received by the company, whilst the remaining R25 will be subject to dividends tax and deemed to have been received by the individual shareholder directly.<sup>191</sup>

It is therefore suggested that the *alter ego* doctrine should not be applied as part of the test for piercing.<sup>192</sup> A strict, purely objective approach would be contrary to one of the fundamental principles of piercing, being that piercing has

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<sup>189</sup> See the text to ch 3 parts 5 2 and 3 3 2 3 below.

<sup>190</sup> See the text to ch 3 part 3 3 2 2 above.

<sup>191</sup> The controlled foreign company rules in the Income Tax Act are examples of legislated piercing provisions and have exactly the same effect as illustrated here.

<sup>192</sup> See Gower *Principles of Modern Company Law* 125 *et seq* and 137: the author at 124 considers that the application of agency as a form of piercing amounts to the inappropriate use of a legal sledgehammer (at 124). The conclusion in this dissertation is that the same would be true where the *alter ego* doctrine is applied under the guise of piercing.

a limited effect on the existence of a company and does not regard an entire company as having ceased to exist.

In the context of piercing it is rather suggested that the *alter ego* test should be interpreted to mean that a shareholder is capable of using the corporate veil to achieve an improper goal which the shareholder subjectively intends to.<sup>193</sup> This would provide for both the instance where majority shareholding<sup>194</sup> and dominance are necessary for piercing in the conventional sense where liabilities are concerned. It would, however, also allow for piercing to be applied to minority shareholders who, without dominance, seek to obtain tax consequences and who are therefore also capable of abuse even in the absence of dominance.<sup>195</sup>

#### 4 2 4 Agency

Agency appears to be widely accepted as forming part of the piercing doctrine.<sup>196</sup> However, if one accepts that the effect of piercing is only to disregard the corporate veil for limited purposes for a specific transaction<sup>197</sup> and that the shareholder is not held liable for all aspects of that transaction, then agency cannot form part of piercing.<sup>198</sup>

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<sup>193</sup> See *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554.

<sup>194</sup> See the text to ch 3 parts 3 3 2 3 and 5 2 below.

<sup>195</sup> See the text to ch 3 parts 3 3 2 3 and 5 2 below.

<sup>196</sup> A Domanski "Piercing the corporate veil – a new direction?" (1986) SALJ224 225 and 226. Also refer to *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C) 23, and the references there at 13 to *Aluminum Company of Canada Ltd v Corporation of the City of Toronto* (1944) 3 DLR 609 and *The Corporation of the City of Toronto v Famous Players' Canadian Corporation Ltd* (1936) SCR 141.

<sup>197</sup> Blackman et al *Commentary on the Companies Act* 4-143; *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 164. See the text to ch 2 part 6 1 below.

<sup>198</sup> Blackman et al *Commentary on the Companies Act* 4-127 and 4-140-2. See too the comments by Pennington and Gower quoted in *Banco de Mocambique* below, which also reflects English law. *Cf Adams v Cape Industries plc* 1991 1 All ER 929 1022 and 1026 where the agency and piercing doctrines are dealt with separately and as distinct remedies. This accords with the approach adopted by the court in the English case of *DHN Food Distributors Ltd v London Borough of Tower Hamlets* (1976) 3 All ER 462, as

The facts in *Ex Parte Gore* serve as an example to illustrate the point. The liquidators of a group of companies, held essentially by three shareholders (family trusts of the three King brothers) through a holding company, successfully applied to the court to pierce the corporate veil of the various subsidiary companies to rule that these fellow group companies were also accountable for the debts of the company under consideration. In other words, the shareholders were not to be held solely liable for these debts, as would have been the case with a finding of agency. The substance of this was that for all other purposes outside the piercing enquiry at hand the assets of the group companies remain their own. Only for the purpose of the piercing order is the corporate veil momentarily disregarded.

Had the court found that the company in *Ex Parte Gore* acted as agent for the rest of the group, the order would have had much more far-reaching implications. A finding of agency would have meant that the debts of the company were in law only that of the fellow group companies or shareholders and not that of the company. All the assets of the company would then have to be considered to belong to the various group companies and not to the agent company. This result will be a finding regarding ownership and will extend beyond the matter before the court. In this regard Kerr<sup>199</sup> confirms that an agent is not party to an agreement between the principal and creditor. Conversely piercing requires that both the company and its shareholder be involved.

It is therefore important to distinguish between the company acting as agent, not being part of the agreement in question, and it being a party thereto together with its shareholder in the case of piercing.

It is not surprising that agency can so easily be regarded as part of the piercing doctrine. The practical legal effect of agency may frequently correspond with the

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well as that proposed by Cassim et al *Contemporary Company Law* 55. In both of these sources agency and piercing are mentioned as alternative and different remedies. Also see the UK judgment of *Burman v Hedges & Butler* [1979] STC136; *Larkin* (1989) SA *Merc LJ* 290 and the discussion there of *Salomon's* case. In the case of *CIR v Sanson* [1921] 2 KB 492 Lord Sterndale MR, whilst in principle willing to pierce for tax purposes, makes it quite clear at 505 that this would not be as a result of a finding of agency.

<sup>199</sup> AJ Kerr *The Law of Agency* (2006) 129.

practical relief sought in terms of a piercing action, but the legal mechanics behind each mechanism are very different.

A finding of agency, even in the absence of a formal agency agreement,<sup>200</sup> can only be made with reference to a transaction in its entirety; it cannot be entered into and regarded as being part-agency and part not. Further, the very nature of agency requires the recognition that an agent is not bound to the person with whom the agent is contracting on behalf of the principal. Piercing by contrast means that the company will be jointly implicated at least.<sup>201</sup>

In this regard the judgment in *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* (“*Banco de Mocambique*”)<sup>202</sup> illustrates the correct approach taken by Goldstone J, where the court was unwilling to pierce, even though it found that an agency agreement had been in place in that case.<sup>203</sup> This interpretation is largely founded on the views of Pennington and Gower as quoted:

“Of this and other cases where the corporate veil was apparently lifted by the English Courts, the following is stated in Pennington Company Law 4th ed at 54:

‘The tenuous evidence from which the Court has implied an agency or trusteeship in some of the foregoing cases naturally leads one to question whether the agency or trusteeship is not merely a convenient legal fiction used by the Court to enable it to give decisions which it thinks just. The description of the subsidiary as the holding company’s agent or trustee often appears to be merely an epithet used to indicate the subsidiary’s complete subjection to the holding company, and not a statement of their legal relationship at all. For example, in *Smith, Stone and Knight Ltd v Birmingham Corporation* Atkinson J described the subsidiary company as ‘the agent or employee,

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<sup>200</sup> *Aluminum Company of Canada Ltd v Corporation of the City of Toronto* (1944) 3 DLR 16.

<sup>201</sup> Piercing involves as basic principle a limited application to a specific transaction only, as pertains only to the question at hand. The doctrine also has the effect of ascribing the assets, liabilities, or profits of the company and shareholder to one another to a certain extent. On both these counts, agency differs from piercing. See also Cassim et al *The Law of Business Structures* 69 and 70; Cassim et al *Contemporary Company Law* 42.

<sup>202</sup> *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 (T).

<sup>203</sup> 343.

or tool or simulacrum' of the holding company, words which are obviously intended to be read in a metaphorical rather than a legal sense...'

And Professor Gower in his *Principles of Modern Company Law* 4th ed says the following at 124:

'When, however, they have been asked to treat the company as an agent of its individual controlling shareholder and to make the shareholder liable on that basis they have not been willing to do so except where that is necessary to frustrate some grave impropriety, and in such circumstances they have coupled the description of the company as an agent with more pejorative descriptions, such as "sham", "cloak", "device", "stratagem", "puppet", "creature", etc. In truth they themselves seem to have been using a cloak, that of agency principles, to give legal respectability to the use of a sledgehammer.' [own emphasis]

And more pertinently in *Salomon*, as quoted with approval in *Dadoo*:

"[T]he company is at law a different person altogether from the subscribers to its memorandum; and though it may be that, after incorporation, the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them."<sup>204</sup> [own emphasis]

The "sledgehammer approach" mentioned above by Gower,<sup>205</sup> referring to the company or shareholder relationship as one of agency in the context of piercing, should thus be avoided.<sup>206</sup> Not only does it cause confusion when used in a metaphorical sense, but it is also technically incorrect.

#### 4 2 5 *Nominees*

Piercing, for the reasons advanced in the discussion on agency above, does not amount to a situation where the company acts only as a nominee. Although it is quite possible for a company to act in the capacity of a nominee on behalf of its shareholders, a nominee relationship between a company and a shareholder would not amount to piercing.

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<sup>204</sup> *Salomon v A Salomon & Co Ltd* 1897 AC 22 51.

<sup>205</sup> Gower *Gower's Principles of Modern Company Law* 124.

<sup>206</sup> Williams "Companies: Part I" in *LAWSA* 90.

A nomination agreement would affect the entire transaction entered into and would also result in the nominee company not being a party to the transaction.

#### 4 2 6 *Actio Pauliana*

A detailed consideration of the *actio pauliana* is not required for the purposes of this dissertation as the *actio* only arises where the collection of debts is involved, that is on a balance sheet level.<sup>207</sup> Piercing in this dissertation is only concerned with piercing as it may be applied at an income statement level, that is affecting the **calculation** of a tax liability or determining for which person a tax debt arises.<sup>208</sup> As the *actio* can never be applied for this purpose, it is not strictly relevant here.

Nevertheless, as the *actio pauliana* was mentioned in the recent case of *CSARS v Metlika Trading Ltd* (“*Metlika*”)<sup>209</sup> which involved piercing, the relationship between the two remedies is briefly discussed.<sup>210</sup>

It is interesting to note again how easily piercing can be confused with other remedies. The *Metlika* case serves as example of how the *actio pauliana* differs from piercing. This again highlights the basis upon which piercing is to be distinguished from nominee or agent relationships as discussed above.<sup>211</sup>

In *Metlika* the applicant (SARS) sought to pierce the corporate veil of the respondent, claiming that assets owned by Metlika Ltd, which had been transferred by Ben Nevis to its fellow group company, were available for attachment in order to settle a tax debt owing by Ben Nevis. Alternatively, SARS relied on the *actio pauliana* to claim that the transfer of assets by Ben Nevis to Metlika was invalid.

The court, originally found that “... the facts of this justify the piercing of the corporate veil” and ordered that:

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<sup>207</sup> See the text to ch 1 part 2 2 above.

<sup>208</sup> See the text to ch 1 part 2 2 above.

<sup>209</sup> *CSARS v Metlika Trading Ltd* [2010] 72 SATC 241. The judgment was not appealed.

<sup>210</sup> See also *ITC 1611* [1995] 59 SATC 126.

<sup>211</sup> See the text to ch 2 parts 4 2 4 and 4 2 5 above.

- “i) The transfer of assets referred to in paragraph 5 from Ben Nevis to Metlika is set aside.
- ii) It is declared that the assets in paragraph 5 are owned by Ben Nevis.
- iii) It is declared that the assets referred to in paragraph 5 above, in so far, as the liability of Ben Nevis for income tax is recoverable or as it becomes recoverable, may be attached and be sold in execution to satisfy in whole, or in part, the liability of Ben Nevis to SARS ...”

However, some two months later Ledwaba J corrected this and issued an amended order<sup>212</sup> which reads:

- “1.1 The separate corporate personalities of the second defendant (Ben Nevis) and the first defendant (Metlika) should be disregarded to the extent of the transfers referred to in paragraph 5 of the particulars of claim; and
- 1.2 That in so far as the liability of the second defendant for income tax recoverable, or as it becomes recoverable, the assets referred to in paragraph 5 of the particulars of claim are to be regarded as assets owned by the second defendant and that they may be attached and sold in execution to satisfy in whole, or in part, the liability of the second defendant to the plaintiff.”<sup>213</sup>

From the above it can be deduced that in terms of the original judgment the transfer of assets was disregarded, as would be the case with the *actio pauliana*, but not with piercing. According to the amended order the assets were to be regarded as those of the transferor company,<sup>214</sup> but only to the extent necessary for discharging the tax debts of the transferor.

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<sup>212</sup> The amended order itself is not part of the reported judgment, but is quoted in the applicant’s heads of argument para 18 in the matter between *Metlika Trading Ltd and Ben Nevis Holdings Ltd v CSARS: In re CSARS v Metlika Trading Ltd and Ben Nevis Holdings Ltd* case no 20827/2002 (reported judgment at *CSARS v Metlika Trading Ltd* [2010] JOL 26102 (GNP)).

<sup>213</sup> Applicant’s heads of argument para 18 in the matter between *Metlika Trading Ltd and Ben Nevis Holdings Ltd v CSARS: In re CSARS v Metlika Trading Ltd and Ben Nevis Holdings Ltd* case no 20827/2002 (reported judgment at *CSARS v Metlika Trading Ltd & others* [2010] JOL 26102 (GNP)).

<sup>214</sup> See the comparable order in *Jones v Lipman* [1962] 1 All ER 442.

#### 4 2 7 Partnerships

In the English case of *DHN Food Distributors Ltd v London Borough of Tower Hamlets* (“*DHN Food Distributors*”)<sup>215</sup> Lord Denning found that the group of companies in question was “virtually the same as a partnership”. This was a statement of fact rather than one of principle and therefore limited to that matter. In the Australian case of *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (“*Pioneer*”)<sup>216</sup> Young J advanced the notion that “if the court can see that there is in fact or in law a partnership between companies in a group ...” it can then pierce the corporate veil. No example has been found in South African case law to support that piercing would *per se* be justified where companies are involved in a partnership agreement.<sup>217</sup>

In the South African legal framework and other jurisdictions too the *dicta* in *Pioneer* and *DHN Food Distributors* would not be accurate<sup>218</sup> if they seek to convey that companies in the same group are always part of an implied partnership. It is possible that the two judgments above did not intend to go this far. However, what is implied in both cases is that piercing in a group of companies may be applied if a tacit partnership agreement can be factually shown to exist between the companies involved. This too is incorrect. Although piercing and the application of partnership principles may have the same effect, the two principles have vastly different requirements to be satisfied before either can apply. Piercing is possible due to the existence of a statutory relationship between the company as legal person and its shareholders. In contrast, partners’ relationship *inter se* is contractually regulated. To enforce the partnership principles one must determine the terms of the agreement between the partners.

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<sup>215</sup> 1976 3 All ER 462.

<sup>216</sup> 1986 11 ACLR 108.

<sup>217</sup> Also see Cassim et al *Contemporary Company Law* 42 and 50 *et seq.*

<sup>218</sup> It is possible that the term “partnership” is not used here in the strict legal sense, although it appears unlikely. If what is intended is that companies within a group can be pierced on the basis that they form part of the same economic unit, the statement would be less contentious. However, this in itself also does not constitute a sufficient basis for the application of piercing. See the discussion in the text to ch 3 part 5 2 1 below for piercing within groups of companies.

Piercing the corporate veil on the other hand involves a court disregarding a statutory relationship established by Parliament.

Piercing in the South African context means that the separate legal personality of a company is disregarded for example to make the fellow group companies or shareholders thereof jointly liable to the creditors of the company. If it were a partnership agreement, the company(ies) or shareholders party thereto would be jointly and individually liable for each other's debts and entitled to the partnership assets by virtue of such an agreement. The existence of a partnership agreement therefore does not amount to piercing. In fact, it negates the motivation for piercing the veil in the first place as the parties would already be jointly liable in terms of the law of contract, and not for the limited purposes to which the piercing doctrine may be applied.<sup>219</sup>

One can see that the confusion arises due to the similar relief that is available to a claimant. If for example such a claimant were to attempt to recover debts from another group company, it may be able to do so either through proving the existence of a partnership agreement or by applying for piercing to be applied. However, the requirements for proving such remedies are very different.<sup>220</sup> The existence of a partnership agreement would be one of fact, the requirement to pierce a question of law.

#### 4 2 8 *Beneficial ownership*

"Beneficial ownership" is sometimes referred to in cases involving piercing.<sup>221</sup> In this regard Botha J in *Metlika* said that "the words 'beneficial owner' do not constitute a clearly defined juristic concept ..., but they are appropriate in the context of a situation where it is alleged that someone who is the ostensible owner of property is in fact not its real owner."

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<sup>219</sup> See the discussion in the text to ch 2 part 6 1 below to this effect.

<sup>220</sup> See also Blackman et al *Commentary on the Companies Act* 4-145.

<sup>221</sup> See for example *CSARS v Metlika Trading Ltd* [2003] 66 SATC 345; *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 (T).

In contrast Hyland and Smith,<sup>222</sup> referring to *Yarram*,<sup>223</sup> seek to define the term with reference to trust law, dividing ownership into two categories, viz the “bare” or “legal” owner *vis-à-vis* the “beneficial” owner; a distinction not dissimilar to that present in the bewind trust or for a bare dominium holder and a usufructuary in Roman Dutch law.

Since there is no distinct and settled domestic law on “beneficial ownership” in South Africa, it would not be appropriate to speculate on a possible link with piercing.<sup>224</sup> In any case, if the doctrine only relates to who the “real owner” of an asset is, then it is also not relevant for the purposes of this dissertation, which concerns itself only with piercing on an income statement level.

It is, however, necessary to refer briefly to piercing as applied in DTAs containing “beneficial owner” clauses.<sup>225</sup> In such agreements the term is used on an income statement level to determine to which entity income from cross-border activities should be attributed. The “beneficial ownership” doctrine as applied by

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<sup>222</sup> Hyland & Smith (2006) *Journal for Estate Planning Law* 3.

<sup>223</sup> *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd* [2006] JOL 18830 (SCA)10 (“*Yarram*”):

“His title is usually described as ‘bare ownership’ (‘nudum dominium’) – sometimes also called ‘legal ownership’ – while ‘beneficial ownership’ (‘utile dominium’) is said to vest in the beneficiaries of the trust (see for example *The Master v Edgecombe’s Executors & Administrators* 1910 TS 263 at 274–275; *Braun v Blann & Botha NNO* 1984 (2) SA 850 (A) at 859–860; *Honoré* para [170] 288). In short, the provisions of the Act and the Deed are, in my view, quite clear: upon registration in its name, qua trustee, the respondent became the ‘legal owner’ of the property and holds it in trust for the investors as ‘beneficial owners’.”

<sup>224</sup> This accords with the UK position – see *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 43 *et seq* where “beneficial ownership” is considered on a distinctly different basis from piercing. See also the text to ch 3 part 4 4 below.

<sup>225</sup> For the reasons set out in ch 5 below, this is not considered in detail as part of this dissertation.

the OECD<sup>226</sup> is not known in either South African legislation or common law.<sup>227</sup> Instead, in the South African context beneficial ownership refers to the ownership of assets as a descriptive label only,<sup>228</sup> rather than to the ownership of an income stream, if such a notion can be said to exist in South African domestic law at all.<sup>229</sup> The term, as used in the DTAs concluded by South Africa and indeed as used by the rest of the world, should therefore be seen and interpreted within a context of its own and not within the context of South African domestic law.<sup>230</sup> It should also not be utilised as a tool to interpret South African domestic non-tax law, including the piercing doctrine.

#### 4 3 Conclusion

The above analyses confirm how narrow the piercing doctrine in the South African common law context actually is. It follows that piercing is an independent doctrine which has unfortunately often been subjected to very wide, loose and inaccurate application.

The doctrine should not be confused with the other doctrines discussed above. Although it may incorporate other doctrines,<sup>231</sup> itself form part of others,<sup>232</sup> or have

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<sup>226</sup> See M Lang *Source versus Residence. Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (2008) 69, specifically ch 5: S van Weeghel “Dividends (Article 10) OECD Model Convention”.

<sup>227</sup> See Olivier’s report in IFA *Cahiers de droit fiscal international (2010 Rome Congress) Volume 95a. Tax treaties and tax avoidance: application of anti-avoidance provisions* (2010) 726; L Olivier & M Honiball *International Tax: A South African Perspective* (2011) 542-544.

<sup>228</sup> Cf De Koker & Brincker *Silke on International Tax* 9.10; and the definition of “beneficial interest” in s 1 of the Companies Act (see also De Koker & Brincker *Silke on International Tax* 9.12).

<sup>229</sup> Cf De Koker & Brincker *Silke on International Tax* 9.9.

<sup>230</sup> Cf para 12.1 of the OECD Commentary on Article 10; De Koker & Brincker *Silke on International Tax* 9.3.

<sup>231</sup> Predominantly the *alter ego* doctrine. See the text to ch 2 part 4 2 3 above.

<sup>232</sup> Such as the principles of substance over form and sham or simulation. See the text to ch 2 parts 4 2 1 and 4 2 2 above.

a similar effect as other legal principles,<sup>233</sup> the doctrine must be recognised and treated as a distinct, separate legal doctrine and remedy. Failing to do so will ultimately reinforce the confusion that unfortunately already exists and which is evident in the many examples of the loose and confused manner in which the doctrine was applied in the past. Much of this can be ascribed directly to courts effectively piercing, yet labelling it as something else, or applying a different legal principle yet mistakenly referring thereto as an instance of piercing. The doctrine should be narrowly construed and applied with reference to its own developed criteria only.<sup>234</sup>

## 5 Piercing as applied for tax purposes

In the law of taxation piercing can conceivably be applied to counter two instances of abuse of corporate personality.<sup>235</sup> The first is the avoidance of paying an existing tax liability, in other words frustrating the collection of tax debts, on a balance sheet level. The second is to avoid, minimise or postpone the coming into existence of a tax liability in the first place, that is on an income statement level. This involves the use of companies to benefit from the beneficial tax regimes that may be afforded to them *vis-à-vis* other non-company taxpayers. It is therefore necessary to distinguish between piercing as applied to **recover** tax debts and piercing as applied to **calculate** tax debts.<sup>236</sup>

### 5 1 Balance sheet piercing: Piercing tax debts

It is not difficult to contemplate how piercing can be applied on a balance sheet level to counter the intentional self-improvement of a taxpayer to frustrate the

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<sup>233</sup> Such as that of agency and nominee relationships. See the text to ch 2 parts 4 2 4 and 4 2 5 above.

<sup>234</sup> These criteria are discussed and analysed in chs 3 and 4 below.

<sup>235</sup> Williams "Companies: Part I" in *LAWSA* 86 similarly refers to two kinds of veil piercing which are not entirely dissimilar, but which are not defined with reference directly to the law of taxation.

<sup>236</sup> For the purposes of this dissertation the beneficial tax regimes often abused through use of corporate personality will be those created specifically by the Income Tax Act.

collection of tax debts. This perhaps presents the most common set of facts in which piercing is applied, both in and beyond the realms of the law of taxation. In its crudest form this occurs when a tax-owing company is stripped of its assets, for example through disposal at less than market value prices, in order to frustrate attempts by revenue authorities to recover that tax debt.<sup>237</sup> An example of this is to be found in the *Metlika* case<sup>238</sup> where a subsidiary company transferred most of its assets to a fellow subsidiary when learning of an impending tax assessment to be issued against it. In that case common law piercing was applied as the court found that the corporate veils through which the assets had passed were not of sufficient substance and that the tax debt in question could therefore be recovered from the fellow subsidiary of the taxpaying company.

*Airport Cold Storage (Pty) Ltd v Ebrahim* (“*Airport Cold Storage*”)<sup>239</sup> serves as example where balance sheet piercing was applied to assign a liability<sup>240</sup> to a different person than the company and not to determine the ownership of assets, as was the case in *Ex Parte Gore* and *Metlika*. If the facts in the *Airport Cold Storage* case<sup>241</sup> were different with the SARS being the creditor claiming the sought-after relief, it is conceivable that piercing in those circumstances may have been applied to attribute the tax liability of the taxpayer-company to its shareholder.

This dissertation, however, does not consider piercing on a balance sheet level. It limits itself to the application of piercing as remedy against abuse of corporate personality for tax purposes, in other words to piercing as applied on an income statement level.<sup>242</sup>

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<sup>237</sup> Specific piercing provisions to counter this are present in s 181 of the Tax Administration Act.

<sup>238</sup> *CSARS v Metlika Trading Ltd* [2010] 72 SATC 241 – refer to the amended order issued on 1 October 2012.

<sup>239</sup> 2008 2 SA 303 (C).

<sup>240</sup> Which conceivably may also be a tax liability.

<sup>241</sup> Set out briefly in n 710 below.

<sup>242</sup> See the text to ch 1 part 2 2 above.

## 5.2 Income statement piercing: Piercing to calculate tax debts

Some of the various beneficial income tax regimes linked to companies were already mentioned above.<sup>243</sup> Income statement piercing for tax purposes involves the disregarding by a court of the corporate veil to such an extent that the beneficial tax results gained from misuse are refused and the company treated as a see-through entity for the purposes of calculating and assigning tax consequences. Through various provisions in the Income Tax Act corporate personality can be used to obtain beneficial tax consequences and to the abuse of which the legislature responded in a targeted fashion.<sup>244</sup>

It is argued below that not only the legislature is entitled to disregard the corporate veil as a remedy in case of the abuse thereof for tax purposes, but that the SARS too can avail itself of this remedy by applying to court, either in terms of the common law, the GAARs in the Income Tax Act or section 20(9) of the Companies Act. The remedy has always been available to SARS in terms of the common law and is now also specifically provided for in section 20(9) of the Companies Act. It is further argued below that piercing is also available in appropriate circumstances through the application of the GAARs in the Income Tax Act.

Typical scenarios where the corporate veil may potentially be misused by taxpayers to reduce tax include:

- when so-called conduit companies are employed to repatriate dividends from abroad through the use of reduced withholding tax rates in applicable DTAs;

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<sup>243</sup> See the text to n 76 above.

<sup>244</sup> See for example the provisions of ss 9D(2), 57 and paragraph 2(2) of the Eighth Schedule to the Income Tax Act on the tax consequences linked to a “personal service company”, as well as the abuse identified for which the “Passive Investment Company” regime in s 9E was introduced. An excellent example is also to be found in s 50A of the Value-Added Tax Act 89 of 1991.

- the avoidance of dividends tax by non-exempt entities by typically interposing a dividends tax exempt entity such as a South African company between itself and its investments;
- incorporating a business to circumvent the provisions of section 20A;<sup>245</sup>
- utilising a company to escape dividends tax on deemed dividends;<sup>246</sup> and
- instead of an individual receiving a salary directly from an employer and therefore subject to income tax at potentially maximum marginal rates, this may be manipulated by interposing a company to render these services to the employer as a personal service company of which the individual is the sole shareholder to ensure that the same amount is taxed at the lesser corporate tax rate.

If piercing were to be applied to these examples, it would mean that for tax purposes the income in question is treated as though the shareholder received it directly. The tax consequences that would arise would then be determined as if the company had not existed. The resultant tax consequences would therefore not arise for the company, but for the shareholder in question directly and as though the company's tax beneficial attributes had not existed.<sup>247</sup>

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<sup>245</sup> S 20A, which applies to natural persons only, seeks to limit the availability of assessed losses in certain instances in which such losses would otherwise have been available for set-off against taxable income.

<sup>246</sup> A deemed dividend arises for example when a company extends an interest free loan to a natural person shareholder (s 64E(4) of the Income Tax Act). If the facts were the same, but the individual holds his shares through an intermediate company, no dividends tax arises, as the deemed dividend is declared to a dividends tax exempt entity.

<sup>247</sup> As discussed above in the text to n 244 above the controlled foreign company rules contained in s 9D of the Income Tax Act are examples of piercing applied for tax purposes, albeit by authority of statute. So too are s 57 and paragraph 2(2) of the Eighth Schedule to the Income Tax Act. Also see the "thinking-away" approach adopted in *Furniss v Dawson* [1984] STC 153 (HL) as discussed by *Derksen* (AG Derksen "Should the South African courts adopt the English anti-tax-avoidance rule in *Furniss v Dawson*?" (1990) 107 SALJ 416-433. In *Furniss* the court "thought away" a certain step in a transaction. What can be done through a piercing for tax purposes is to "think away" the

Few judgments can be found where piercing was applied by the South African courts to counter the misuse of legal personality of a company in an attempt to gain a more beneficial income tax treatment for a transaction.<sup>248</sup> The absence of

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company itself for the purposes of calculating the tax consequences that would otherwise have arisen.

<sup>248</sup> In *ITC 1611* the court, although finding in favour of the Commissioner, refused to apply piercing. In *ITC 1606* [1995] 58 SATC 328 the court did not apply piercing as such, although the reference there to the judgment of Zulman J in Income Tax Special Court cases 9592 and 9593 [1993] (unreported; the *a quo* judgment of *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* [1996] 58 SATC 229) suggests that the court in *ITC 1606* may have been inclined to rule that piercing ought to have been applied, although it appears from the judgment that this was not considered in detail (nor that it was required given the facts at hand). In *Erf 3183/1 Ladysmith*, although the court *a quo* ostensibly sought to apply piercing (considering the quoted *dictum* from that judgment in *ITC 1606*), the SCA did not follow this approach (it is submitted correctly, in the absence of a company-shareholder relationship with the pension fund), although it still dismissed the taxpayer's appeal. Also see *CIR v Berold* 1962 3 SA 748 (AD) 755; *CIR v Meyerowitz* 1963 3 SA 863 (AD) 875 and *Smith v Commissioner for Inland Revenue* [1964] 2 All SA 83 (A) where piercing was applied in terms of the relevant provisions of the Income Tax Act. In *Commissioner for Customs & Excise v Tayob* [2002] JOL 9944 (T) 56 *et seq* the court considered whether it would be appropriate to pierce for tax purposes, but left the question open. See also M Glaser *Piercing the corporate veil: a review of the concept; and consideration of its relevance in South African tax law*, LLM thesis, University of Cape Town (1994), as well as the *dictum* referred to by NF van Zyl *The Corporate Veil in Tax Law* LLM (Tax Law) thesis, University of the Witwatersrand (1986) 42 *et seq* in *Apthorpe (Surveyor of Taxes) v Peter Schoenhofen Brewing Co Ltd* 4 TC 111 where piercing was applied for tax purposes in the UK and upheld on appeal. Various other examples are also cited there where piercing was applied for tax purposes in the UK and Canada. See too *Littlewoods Mail Order Store Ltd v McGregor* [1969] 1 WLR 1241 (CA) for piercing for tax purposes and *Furniss v Dawson* [1984] STC 153 (HL). In *CIR v Sanson* [1921] 2 KB 492, Lord Sterndale MR unambiguously stated at 502 *et seq*:

“An appeal was made to us ... not to lay down the principle that when once you have what I may call a Salomon v. Salomon case, no further inquiry can be made, and that it never can be possible to make any person liable to taxation in respect of the business of the company. Now I never had the slightest intention of laying down any such principle ...”.

In the USA, piercing for tax purposes has been expressly envisaged in *Gregory v Helvering* 293 US 465 (1935) and *Nelson v CIR* 281 F2d (5<sup>th</sup> Cir 1960).

a great body of case law to serve as an example of income statement piercing for tax purposes<sup>249</sup> does not advance the idea that piercing on this level cannot be done. The Transvaal Income Tax Special Court has indeed expressly held that tax purposes can serve as an appropriate basis for the courts to apply piercing, even in the absence of dishonesty and fraud.<sup>250</sup> That same court, and the Transvaal Provincial Division as well, has subsequently also been willing to disregard the interposition of a company when used for tax purposes.<sup>251</sup>

The lack of many examples of piercing in cases of tax avoidance is indicative of the unwillingness with which South African courts have in the past approached veil piercing in terms of the common law. In addition, SARS has also not sought to use the remedy before (arguably due to other, less controversial, remedies also being at its disposal). As will be discussed in chapters 3 to 6 below, the approach in future is bound to be different. This will not so much be a question of developing the law but rather due to a more informed application of the existing legal principles.<sup>252</sup>

### 5.3 Conclusion

There is nothing to suggest that piercing should be approached any differently where the law of taxation is involved as opposed to the law of obligations.<sup>253</sup> The

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<sup>249</sup> *ITC 1611* is an example of how piercing on an income statement level would be applied for income tax purposes if piercing were to be done.

<sup>250</sup> Income Tax Special Court cases 9592 and 9593 [1993] (unreported) 31.

<sup>251</sup> See *Bailey v CIR* [1933] 6 SATC 69.

<sup>252</sup> Income statement piercing (in other words outside the context of the law of taxation) has already been acknowledged to apply in instances involving the circumvention of a restraint of trade agreement. See the examples in *Gilford Motor Co Ltd v Horne* 1933 Ch 935 (CA) and *Le'Bergo Fashions CC v Lee* 1998 2 SA 608 (C).

<sup>253</sup> It must be noted that, apart from s 20(9), there are various other provisions in the Companies Act in terms of which piercing can potentially be applied or in terms of which similar relief can be achieved. These provisions are not considered in this dissertation as the general piercing clause in s 20(9) is considered the only remedy in the Companies Act potentially available to prevent the abuse of corporate personality for tax purposes in particular.

only difference is that the debt will always be due to the state and that such debts arise from statute. This is not enough for piercing to be applied in a stricter manner than would be the case with “ordinary” debts. If anything, both factors justify a more permissive approach to the application of the doctrine if one has regard to the policy considerations at play in the context of tax avoidance.<sup>254</sup>

This dissertation will therefore not consider the abuse of corporate personality to frustrate the recovery of already existing tax debts. It only deals with cases where the abuse of legal personality for tax purposes is aimed at reducing or postponing a future potential liability, in other words income statement piercing. This will be discussed under the headings: anti-avoidance measures forming part of the common law,<sup>255</sup> section 20(9) of the Companies Act,<sup>256</sup> and the GAARs in the Income Tax Act.<sup>257</sup>

## **6 Ancillary matters**

### **6 1 The limited effect of piercing**

The above analysis of balance sheet and income statement piercing for income tax purposes raises the issue of the extent of the legal effect when piercing is applied: Is the entire legal personality of the company tainted, so to speak, or is piercing only applied to the extent that it provides the sought-after relief? For example, if the corporate veil is pierced to collect assets to recover a company’s debt from a shareholder, does that company cease to exist as such, even retroactively, or is the separate corporate personality being ignored simply for the purpose of the collection of that specific debt?

In the absence of a court declaring the company a total sham, which is almost inconceivable,<sup>258</sup> the corporate veil is disregarded only to the extent necessary to

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<sup>254</sup> See the text to ch 3 part 3 3 2 2 below.

<sup>255</sup> See ch 3 below.

<sup>256</sup> See ch 4 below.

<sup>257</sup> See ch 5 below.

<sup>258</sup> See the text to ch 2 part 4 2 2 above.

provide the requisite relief.<sup>259</sup> This is also the case with the piercing provisions contained in respectively section 65 of the Close Corporations Act and section 20(9) of the Companies Act, both of which give a discretion<sup>260</sup> to a court to disregard the corporate veil “in respect of” the purpose for which the veil is being unconscionably abused.

Since piercing for tax purposes will be applied on an income statement level, manifesting in the refusal of tax benefits for the specific shareholder involved, other shareholders or creditors are not prejudiced by such piercing and the balance sheet position of the company is also left unaffected. In other words, a tax liability arises for the shareholder in question as though the company did not exist and piercing for tax purposes is limited to that liability. It does not affect for

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<sup>259</sup> Williams “Companies: Part I” in *LAWSA* 85, especially n 2; Blackman et al *Commentary on the Companies Act* 4-136-1; BS Smith “Statutory discretion or common law power? Some reflections on ‘veil piercing’ and the considerations of (the value of) trust assets in dividing matrimonial property at divorce – Part One” (2016) 41 *JJS* 68 73; *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554:

“Thus if a company, otherwise legitimately established and operated, is misused in a particular instance to perpetrate a fraud, or for a dishonest or improper purpose, there is no reason in principle or logic why its separate personality cannot be disregarded in relation to the transaction in question (in order to fix the individual or individuals responsible with personal liability) while giving full effect to it in other respects.”

See however Williams “Companies: Part I” in *LAWSA* 89 where it is envisaged that the company itself may be a sham. Although the exception, such a scenario would amount to a court finding that for the purpose of all contracts ever entered into by that company, and not just for the purpose of examining the true nature of a single debt or transaction entered into by the company, the company had been a sham or the alter ego of the shareholders. With piercing already considered a “drastic remedy” (see *Amlin* and also *Banco de Mozambique*) and the corporate veil as something which courts should not be “lightly disregard” (*Cape Pacific*), it is not surprising that no examples could be found where a South African court declared the very existence of a company a sham. This accords with the position in the UK: see the text to ch 3 part 4 1 below.

<sup>260</sup> See *Haygro Catering BK v Van der Merwe* 1996 4 SA 1063 (C) 1070; *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) 26; *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552 and *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA)20; N Schoeman “Piercing the corporate veil under the new Companies Act” (2012) *De Rebus* 26-28.

example the ownership of assets for all other purposes. For income tax purposes only will the income of the company be deemed to be that of its South African shareholder(s).<sup>261</sup>

## 6.2 Piercing for own benefit

Can piercing also be applied as relief for the company itself or for its shareholders?<sup>262</sup> In South Africa the 1979 case of *Gien v Gien*<sup>263</sup> is the only example where “reverse piercing”<sup>264</sup> was applied, *in casu* as part of a procedural matter. Although the *Gien* decision was not approved of in the judgment *a quo* in *Cape Pacific*, the reason for this appears not to have been the application of “reverse piercing” as such. It was rather that the veil should not have been pierced so easily. On appeal the AD remained silent on the matter.

Since it cannot be seen how reverse piercing can be applied in the context of abuse of the corporate veil for tax purposes, it is not considered in further detail in this dissertation.

## 7 Conclusion

The company is a separate legal person. The separate corporate and legal personality of a company clearly serves an important commercial purpose. However, certain circumstances may arise which require the separate existence

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<sup>261</sup> This is well illustrated by the legislated piercing provisions in the Income Tax Act, such as the “controlled foreign company” regime contained in s 9D thereof.

<sup>262</sup> Referred to by Williams “Companies: Part I” in *LAWSA* 86 as “reverse veil piercing”. See also the article in PwC “Piercing the corporate veil: s 20(9) of the Companies Act 2008” (2013 *PwC South Africa Synopsis Tax Today* 2-3) where this is considered in the context of s 20(9) of the Companies Act.

<sup>263</sup> 1979 2 SA 1113 (T).

<sup>264</sup> Williams “Companies: Part I” in *LAWSA* 86, as well as the examples mentioned from other jurisdictions listed in n 6 thereof. *Cf Al-Kharafi & Sons for General Trading, General Contracting and Industrial Structures Wll v Pema NO & others* 2010 JOL 25851 (GSJ) where “reverse veil piercing” was requested by the applicants, but denied by the court based on the facts at hand. See also *Ochberg v CIR* 1931 AD 215 where the taxpayer effectively sought to have piercing applied to absolve him from an income tax liability.

of the company *vis-à-vis* its shareholders to be disregarded for certain limited purposes. This disregarding can be applied by force of either general or specific enabling legislation or the common law. Where piercing is applied in terms of the common law it should be treated as a distinct and separate remedy; not to be confused with other legal constructions, particularly the agency and *alter ego* doctrines which may have the same practical outcomes. Similarly, it should not be extended to the company-director relationship,<sup>265</sup> or to the attribution of certain characteristics to the company.

For tax purposes piercing could conceptually be applied both where a company's tax debt is enforced against a shareholder or a fellow group company<sup>266</sup> and where the tax debt is regarded as having arisen directly in the hands of the shareholders or of a fellow group company. This dissertation will only consider the latter.

Piercing therefore involves the attribution to the owners of a company of the legal consequences of a transaction to which the company, in form, was a party. It acknowledges that the legislature creates a form through a legal fiction. However, where that form is stretched too far or is abused, the law will for that limited situation ignore the fiction and recognise the substance of the matter.

The circumstances in which the law will go behind the veil for tax purposes will be discussed in the following chapters of this dissertation.

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<sup>265</sup> As to the potential liability of company directors (as opposed to shareholders), it is the writer's opinion that this should be excluded from piercing. Therefore, it is not dealt with in this dissertation. However, it is a fact that, due to the very loose use of the term "piercing" in recent times, it would be an exercise in legal semantics to insist that piercing excludes the possibility to hold the directors of a company liable for the company's debts. For example, *Lategan's* case, which refers to director liability as a result of piercing, provides a very useful analysis of the principles involved in "actual" piercing (indeed an analysis which has often been referred to as authority in subsequent cases). One would therefore be unwise to exclude this case from a study of the piercing doctrine.

<sup>266</sup> See the text to ch 3 part 5 2 1 below for piercing discussed in the context of groups of companies.

## CHAPTER 3: COMMON LAW PIERCING AND THE CASE FOR JUDICIAL ACTIVISM

### 1 Introduction

It was established in chapter 2 that a company at incorporation acquires a statutory legal personality separate from that of its shareholders. This is a fundamental principle of law and is observed by the courts unless exceptional circumstances exist to disregard it.<sup>267</sup> The reluctance on the part of the courts to apply piercing in terms of the common law effectively amounts to the common law overriding a statutory provision. This can only be justified in exceptional circumstances if one has regard to the basic principles of the rule of law and the separation of powers. In principle the judiciary should not usurp the role of the legislature,<sup>268</sup> unless it is satisfied that the statutory provisions have been abused to such an extent that it cannot but intervene. This makes the provisions of section 20(9) of the Companies Act even more relevant. For the first time now the courts are expressly authorised by the legislature to disregard the separate legal personality of a company.

Where the courts in the past did act in such circumstances, they acted in terms of the common law. The common law was in this regard not replaced by the new statutory possibilities in for example the Companies Act of 2008.<sup>269</sup>

The piercing doctrine remains an accepted part of the common law and the courts should not shy away from applying and developing it. As was recently confirmed by the Constitutional Court in *Paulsen v Slip Knot Investments 777 (Pty) Ltd*,<sup>270</sup> the common law is the law of the courts<sup>271</sup> and the courts have a duty to develop it in

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<sup>267</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 23.

<sup>268</sup> *In re: Certification of the Constitution of the Republic of South Africa*, 1996 10 BCLR 1253 (CC) and *Glenister v President of the Republic of South Africa* 2009 2 BCLR 136 (CC) 29.

<sup>269</sup> See the text to ch 4 part 1 1 below.

<sup>270</sup> [2015] ZACC 5.

<sup>271</sup> I Currie & J De Waal *The Bill of Rights Handbook* 5 ed (2005) 67.

accordance with the spirit of the Constitution.<sup>272</sup> The two are intertwined “and do not constitute separate concepts”.<sup>273</sup> However, if Parliament wishes to override an acknowledged common law principle by legislation, then it is entitled and able to do so.<sup>274</sup>

If one accepts that separate legal personality was developed to satisfy a certain commercial need, its consequences are also justified by that need. However, when the purpose for which legal personality is used in a particular case is not in line with the purpose for which statute created it,<sup>275</sup> the question whether the law should still accommodate the existence of the legal personality becomes problematic.

This chapter will consider whether the law as applied in South Africa should address the use of legal personality for unintended purposes, such as for instance to facilitate tax avoidance. However, a subsidiary matter needs to be considered first, namely when it would be appropriate for a court to consider whether common law piercing may be applied or not. There has over the past two decades been a significant debate about whether piercing can only be used as a remedy of last resort. Only thereafter will it be appropriate to consider the contents of the common law piercing doctrine itself.

## **2 A remedy of last resort?**

The legislated piercing remedy available in terms of section 20(9) of the Companies Act contains no restriction on it being invoked as a remedy of first instance.<sup>276</sup> Yet, for the reasons set out in chapter 4 part 3 below, the section 20(9) remedy should be developed and interpreted in line with the common law.

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<sup>272</sup> S 173. See the majority judgment of Moseneke DCJ in *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 113 *et seq*, supported by the minority judgment of Cameron J at para 120.

<sup>273</sup> *Pharmaceutical Manufacturers Association of SA: In re Ex Parte Application of the President of RSA* 2000 3 BCLR 241 (CC).

<sup>274</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 115.

<sup>275</sup> In other words, where legal personality is “misused” or “abused.”

<sup>276</sup> See the text to ch 4 part 3 3 below.

This creates a potential debate on whether section 20(9) may also, like some would suggest is the case for the common law remedy, only be applied as a remedy of last resort.<sup>277</sup>

The common law position is uncertain.<sup>278</sup> Although not relevant in deciding on the substantive criteria, it remains an important preliminary matter. There would be little use in ascertaining whether the requirements for applying piercing are present in a particular case when a court would not be willing to venture into such an exercise to begin with.

When comparing the seemingly contradictory AD judgment in *Cape Pacific* in 1995 and the SCA's judgment in *Hülse-Reutter v Gödde* ("*Hülse-Reutter*")<sup>279</sup> in 2001, it is clear why this confusion exists. The AD in *Cape Pacific* was quick to distance itself explicitly from the notion advanced by the court *a quo*<sup>280</sup> that piercing is to be used only in the absence of any other remedy. Smalberger JA ruled:

"In principle I see no reason why piercing of the corporate veil should necessarily be precluded if another remedy exists. As a general rule, if a person has more than one legal remedy at his disposal he can select any one of them; he is not obliged to pursue one rather than another (although there may be instances where once he has made an election he will be bound by it). If the facts of a particular case otherwise justify the piercing of the corporate veil, the existence of another remedy, or the failure to pursue what would have been an available remedy, should not in principle serve as an absolute bar to a court

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<sup>277</sup> In light of the judgment in *Hülse-Reutter*.

<sup>278</sup> See Cassim et al *Contemporary Company Law 49 et seq* where the seemingly conflicting judgments of the AD in *Cape Pacific* and *Hülse-Reutter* are discussed, as well as the application of this principle in *Amlin*. In the latter judgment, Dlodlo J (at 23) held:

"I accept that 'opening the curtains' or piercing the veil is rather a drastic remedy. For that reason alone it must be resorted to rather sparingly and indeed as the very last resort in circumstances where justice will not otherwise be done between two litigants. It cannot, for example, be resorted to as an alternative remedy if another remedy on the same facts can successfully be employed in order to administer justice between the parties."

It is unclear whether the court set down this principle of its own accord, or with the judgment of *Hülse-Reutter*, not explicitly referenced to, in mind as authority. Cf Williams "Companies: Part I" in *LAWSA 87: n 2* who supports veil piercing not being applied merely as a "matter of convenience", although he distances himself from the application of veil piercing as a remedy of last resort only.

<sup>279</sup> 2001 4 SA 1336 (SCA).

<sup>280</sup> *Cape Pacific* judgment *a quo*.

granting consequential relief. The existence of another remedy, or the failure to pursue one that was available, may be a relevant factor when policy considerations come into play, but it cannot be of overriding importance.”<sup>281</sup>

The apparent contrary position adopted in *Hülse-Reutter* is:

“The very exceptional nature of the relief which the respondent seeks against the appellants requires, in the circumstances of the present case, that he should have no other remedy”.<sup>282</sup>  
[own emphasis]

The fact that our then highest court handed down both these judgments necessitates a consideration of the *stare decisis* doctrine.

In accordance with the Constitutional Court’s judgment in *Camps Bay Ratepayers’ and Residents’ Association v Harrison*<sup>283</sup> the approach used in the earlier case should be followed unless the SCA finds the later judgment to be “clearly wrong”.<sup>284</sup> It follows then that only if the SCA in *Hülse-Reutter* found that the judgment in *Cape Pacific* was “clearly wrong” (which it did not) can there be a departure from the principle that piercing may be applied even if the doctrine does not present the only remedy available. Indeed, *Hülse-Reutter* appears to acknowledge the correctness of the *Cape Pacific* judgment,<sup>285</sup> thereby avoiding a clear conflict. One should therefore apply the judgment in *Hülse-Reutter* in the context of *Cape Pacific*.

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<sup>281</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 555.

<sup>282</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) para 23.

<sup>283</sup> 2011 2 BCLR 121 (CC)28:

“What [the doctrine of *stare decisis*] boils down to ... is: ‘certainty, predictability, reliability, equality, uniformity, convenience: these are the principal advantages to be gained by a legal system from the principle of *stare decisis*.’ Observance of the doctrine has been insisted upon, both by this Court and by the Supreme Court of Appeal. And, I believe rightly so. The doctrine of precedent not only binds lower courts but also binds courts of final jurisdiction to their own decisions. These courts can depart from a previous decision of their own only when satisfied that that decision is clearly wrong. *Stare decisis* is therefore not simply a matter of respect for courts of higher authority. It is a manifestation of the rule of law itself, which in turn is a founding value of our Constitution. To deviate from this rule is to invite legal chaos.” [own emphasis]

<sup>284</sup> Also see the various cases cited in S Ryan “The balance between certainty and flexibility in horizontal and vertical *stare decises*: *Bosch v CSARS*” (2015) 132 SALJ 237.

<sup>285</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 23:

The principle established in *Cape Pacific* is that piercing need not be a remedy of last resort, but that the availability of alternative remedies is not unimportant when a court is requested to apply piercing.<sup>286</sup> *Hülse-Reutter* focused this principle to a certain extent.

Scott JA in *Hülse-Reutter* drew a distinction.<sup>287</sup> Where rights exist against the company, those rights must be exercised before the corporate veil may be pierced. Where the rights enforceable against the company are however commercially worthless, for example where the company would be unable to pay if sued or there is no remedy against the company, then piercing may be applied.<sup>288</sup>

The finding is one that establishes a clear principle. Where alternative remedies are available to a claimant against the company, it is not entitled to ask for piercing of the corporate veil. Piercing may, however, be granted if the alternative remedies are not exercisable against the company, but against its shareholders or fellow group companies. This is an important development and entails that piercing is only available where no other remedy exists against **the company** to afford the necessary relief. In other words, only where other remedies are available against the company will piercing be a remedy of last resort.

Scott JA concluded in this regard that there can be no “unfair advantage”<sup>289</sup> against a company’s shareholders if another remedy is available against the applicable company for which piercing is considered in the first instance. His dictum below supports this:

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“I do not understand the learned judge as having suggested that the existence of another remedy is an irrelevant consideration nor, I think, should the dictum be read out of context.

The facts of the case were very different from the present one.”

*Cf Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) n 38 where Binns-Ward J also sought, in my view correctly so, to reconcile the approaches taken by the SCA in *Cape Pacific* and *Hülse-Reutter*.

<sup>286</sup> 1995 2 All SA 543 (A) 555 and 556.

<sup>287</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 21: “There is no evidence that the corporation would be unable to pay if sued ...”.

<sup>288</sup> See e.g. *Cape Pacific* where the question regarding the doctrine of notice rather was at issue and applicable, not against LCI (being the contracting company sought to be pierced), but against its sister company (GLI). See also the similar arguments of the UK Supreme Court in *VTB Capital plc v Nutritek International* [2012] EWCA Civ 808 para 139 specifically.

<sup>289</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20; see the text to ch 3 part 3 3 3 below.

“There is no evidence that the corporation would be unable to pay if sued; there is nothing to suggest that the respondent was unfairly prejudiced by the distinction which exists between the company and those who control it.”<sup>290</sup>

The test goes further than to establish whether a remedy exists against the company. *Hülse-Reutter* not only considers the availability of a remedy, but also if the company would be able “to pay if sued”. This test brings another more practical element to the fore. The presence of an alternative remedy against the company is only relevant if it results in practical relief for the claimant. An insistence that a claimant exercise a remedy available against a company who cannot pay if sued will prejudice that claimant. It will be precluded from applying for piercing, even though no real relief is available in terms of alternative remedies against the company.<sup>291</sup> It is for this reason that both *Cape Pacific* and *Hülse-Reutter* provide for an exception to the rule: piercing may be applied where no other real relief is available to a claimant when exercising alternative remedies against the company. Piercing may then be applied in the first instance, regardless of the fact that an alternative yet hollow remedy exists.<sup>292</sup> If such an alternative remedy does exist, courts should not even consider applying piercing. However, where piercing is one of the remedies available against the shareholder rather than the company, a court would not be prohibited from piercing.<sup>293</sup>

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<sup>290</sup> Para 21.

<sup>291</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 21.

<sup>292</sup> Although preceding *Hülse-Reutter*, the court *a quo* in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 719 came to the same conclusion in its disapproval of the judgment in *Gering v Gering* [1974] 1 All SA 65 (W). The SCA did not address the matter.

<sup>293</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 28. *Cf Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 555 and 556 for authority that the existence of an alternative remedy could be a consideration opposed to piercing. See the text to part 3 3 2 2 of this chapter below. The position in the UK appears to be somewhat different. Four of the seven judges (the remaining three preferring not to take a view on the matter) in *Prest v Petrodel Resources Ltd* 2013 UKSC 34 expressed their clear preference that piercing may be applied as a last and final remedy only. The majority in that case therefore agreed with the approach in *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 as opposed to that of *Antonio Gramsci Shipping v Stepanovs* [2011] EWHC 333 (Comm).

The conclusion therefore is that the *Cape Pacific* and *Hülse-Reutter* cases should not be regarded as conflicting with each other. *Hülse-Reutter* should rather be seen as only limiting the potential circumstances under which piercing may be applied.<sup>294</sup>

It is in any case doubtful whether this will have any impact if piercing is sought to counter tax avoidance, that is on an income statement level. The reason for this is that tax avoidance through the misuse of corporate personality necessarily implies that no action exists against the taxpaying company. By its nature, to address the abuse of the corporate veil, SARS would require a remedy against the shareholder. The principle is therefore only relevant where piercing is sought to be applied on a balance sheet level.<sup>295</sup>

The principle remains therefore that common law piercing in the tax avoidance context may be applied even if not all other remedies to counter the perceived impermissible tax avoidance by shareholders have been exhausted. Where a corporate structure is abused nothing precludes such piercing from being applied, even where the GAARs or the provision in section 20(9) of the Companies Act potentially come into play to counter abuse by a company's shareholders.

### **3 The common law requirements for piercing of the corporate veil**

#### **3 1 Introduction**

In the many judgments that have ostensibly dealt with the piercing doctrine in the past,

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<sup>294</sup> The subsequent judgment and conclusion in 2008 by the Cape High Court in *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C) (where the conclusion was drawn *obiter* that piercing can only be applied as a final remedy) is therefore, with respect, in conflict with the principle laid down by the SCA. So too the judgment in *Knoop NO and Others v Birkenstock Properties (Pty) Ltd* FSHC case no 7095/2008 of 4 June 2009. See also Olivier & Honiball. 2010. *The Taxation of Trusts in South Africa*. Siberink, Cape Town at 74.

<sup>295</sup> Even on a balance sheet level it is questionable whether piercing as a remedy will nowadays only be available as a remedy of last resort. This is based on the conclusion in ch 4 (specifically part 3) that s 20(9) of the Companies Act has practically usurped the common law remedy; this section makes no provision for piercing to be applied only after all other remedies have been exhausted. See also *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34.

a lot of controversy is apparent.<sup>296</sup>

The following analysis will consider the piercing doctrine as developed in South African common law within the confines set out in the previous chapter.<sup>297</sup> These principles will thereafter be applied to the law of taxation to determine how piercing may be applied in the context of tax avoidance structures.

### 3 2 Development of the doctrine – history

In *Dadoo's case*<sup>298</sup> a South African court for the first time confirmed that a company is a person separate in law from its owners.<sup>299</sup> That case can be regarded as the South African equivalent of the English *Salomon* case. The two questions before the court in *Dadoo* were whether the corporate veil existed in the first place and whether a transfer of properties to said company was *in fraudem legis*, which doctrine does not fall within the ambit of the piercing doctrine.<sup>300</sup>

In confirming the principle of the separate legal existence of a company, Innes CJ simply stated that “[a] registered company is a legal persona distinct from the members who compose it.”<sup>301</sup>

*Bark and Another NNO v Boesch*<sup>302</sup> is arguably the earliest example where a South African court was confronted with the question of piercing. Although the court did not use the words “piercing” as such, it effectively applied the doctrine. It is interesting that the court then already acknowledged that piercing could be applied between two

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<sup>296</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552: “The law is far from settled with regard to the circumstances in which it would be permissible to pierce the corporate veil ...”.

<sup>297</sup> See the text to ch 2 part 4 above.

<sup>298</sup> *Dadoo Ltd & Others v Krugersdorp Municipal Council* 1920 AD 530.

<sup>299</sup> See *Botha v Van Niekerk* 1983 4 All SA 157 (W); *Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 24; *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A).

<sup>300</sup> See the text to ch 2 part 4 2 2 above for the discussion on simulated/sham transactions.

<sup>301</sup> *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 550.

<sup>302</sup> 1959 2 SA 377 (T).

companies with common shareholders, that is not between a company and its shareholder as would be the usual situation.<sup>303</sup>

Others may consider *Orkin Bros. Ltd*<sup>304</sup> or *Robinson*<sup>305</sup> to be the first South African cases to have involved piercing, though neither of these judgments explicitly refer to “piercing” as such. *Orkin’s* case revolved around whether piercing would be justified in the event of fraud on the part of a director (which the court answered in the affirmative). In *Robinson* the fiduciary duty of directors towards a company was considered. Since both these cases involved the director/company relationship they are not, for purposes of this dissertation, regarded as relating to piercing in the proper sense.<sup>306</sup>

The first South African case to consider piercing (the disregarding of this separate existence) in any significant detail *and* labelling it as such, was that of *Lategan* in 1979.<sup>307</sup>

### 3 2 1 *Lategan v Boyes – the requirement for fraud*

Although *Lategan’s* case did not concern piercing in the strict sense,<sup>308</sup> a proper analysis of the concept cannot be done without considering this judgment. Le Roux J sought to address the piercing doctrine directly and did so in considerable detail. In addition his judgment was also the subject of further consideration in subsequent piercing cases.<sup>309</sup> Crucially, *Lategan* introduced a theme which would feature in the

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<sup>303</sup> See the discussion in the text to ch 3 part 5 2 1 on piercing within company groups, or “horizontal” piercing.

<sup>304</sup> *Orkin Bros. Ltd v Bell* 1921 TPD 92.

<sup>305</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

<sup>306</sup> See the text to ch 2 part 3 2 1 above.

<sup>307</sup> Since *Bark’s* case the judgments in *Gering*, *Gien* and *RP Crees (Pvt) Ltd v Woodpecker Industries (Pvt) Ltd* [1975] 2 All SA 665 (R) were handed down. However, these did little to develop the doctrine and it is doubted whether they are appropriate examples of piercing to begin with. It is therefore not necessary to deal with them in any detail as part of this dissertation.

<sup>308</sup> The company/director relationship was under scrutiny here rather than the company/shareholder relationship.

<sup>309</sup> Refer e g *Botha v Van Niekerk* 1983 4 All SA 157 (W) and *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A).

South African common law piercing context for more than a decade, viz whether fraud is a requirement for piercing to be applied.

*Lategan* is often regarded as the original source for fraud as a requirement.<sup>310</sup> This view is based on the following *dictum* of Le Roux J:

“I have no doubt that our Courts would brush aside the veil of corporate identity time and again where fraudulent use is made of the fiction of legal personality.”<sup>311</sup>

Fraud should, however, not be regarded as an absolute requirement for piercing to apply. Such an approach relies on reading the above *dictum* out of context.<sup>312</sup> The mention of fraud in the *dictum* is based on the case of *Orkin Bros*. The *dictum* should be understood as a comment by Le Roux J that piercing was in that case based on the presence of fraud. Instead of requiring fraud in all cases, Le Roux J was merely expressing his agreement with the court’s finding in the *Orkin Bros* case that fraud is an appropriate basis upon which to justify piercing.<sup>313</sup>

This corresponds with subsequent judgments by the SCA,<sup>314</sup> holding that although the presence of fraud *may* be an appropriate basis on which to apply piercing, it is by no means *the only* basis upon which to do so.

After *Lategan* the first significant case in which piercing was again considered was *Banco de Mocambique*. However, the doctrine was not developed further in that case where it was found that piercing was inappropriate on the facts, even though an agency relationship existed.<sup>315</sup>

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<sup>310</sup> Blackman et al *Commentary on the Companies Act* 4-139; *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C) 20; Domanski (1986) SALJ 225.

<sup>311</sup> 648.

<sup>312</sup> See *Botha v Van Niekerk* 1983 4 All SA 157 (W) 160 in support.

<sup>313</sup> The reference in *Lategan and another NNO v Boyes* 1980 4 All SA 638 (T) 648 to Canadian case law may arguably be regarded as confirmation that fraud is the only basis on which to pierce, but this amounts to an *obiter* statement at most. It is also notable that the court in the quoted Canadian case of *Clarkson Co. v Zhelka* [1967] 2 OR 565, 64 DLR (2d) did not conclude that piercing may only be applied in instances of fraud.

<sup>314</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) and *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 25.

<sup>315</sup> See the text to ch 2 part 4 2 4 above.

The next significant judgment was *Botha v Van Niekerk* (“*Botha*”), which introduced the first common law test<sup>316</sup> for piercing in the appropriate context and labelled it as such.<sup>317</sup>

### 3 2 2 *Botha v Van Niekerk*

At issue in *Botha* was whether the seller of a property (*Botha*), having sold it to Van Niekerk “or his nominee”, was able to enforce the sale agreement against Van Niekerk. Van Niekerk, after concluding the agreement, exercised the nomination right provided for in the agreement by nominating a dormant company of which he was the sole shareholder. The court refused to apply piercing.

The court made the following important comments,<sup>318</sup> which are relevant also for the purposes of interpreting section 20(9) of the Companies Act:<sup>319</sup>

*“Die werklike debat gaan egter daarvoor of daar gronde is om verby daardie afsonderlikheid te kyk in hierdie bepaalde geval in die lig daarvan dat die regspraak onmiskenbare tekens toon dat hy nie sonder voorbehoud by die afsonderlikheid sal volstaan nie en die ontwyfelbaarheid van die billikheid daarvan dat die Hof soms by die afsonderlikheid moet verbykyk.”*<sup>320</sup> [own emphasis]

*“Dit sou ten minste besondere gronde verg; iets wat 'n redelik dwingende noodsaak skep in die belang van geregtigheid om die elementêre van maatskappystigting uit te skryf sodat 'n aandeelhouer of direkteur persoonlik aanspreeklik is op 'n maatskappy se kontrakke. Blote billikheid, op sy beste 'n redelik onhanteerbare perd, is nie voldoende nie.”*<sup>321</sup> [own emphasis]

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<sup>316</sup> It has been argued that the test set out in *Botha v Van Niekerk* 1983 4 All SA 157 (W) was merely *obiter* (cf *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C)). The correctness of such a claim is doubtful, especially in the light thereof that the court in *Cape Pacific* commented on the test laid down in *Botha*'s case, a clear indication of its relevance.

<sup>317</sup> Although the court considered whether piercing should be applied in the *Banco de Mozambique* case, it did not address the criteria necessary to pierce to any extent.

<sup>318</sup> Refer particularly to the discussion of the judgment of the SCA in *Cape Pacific* in ch 3 part 3 3 2 below.

<sup>319</sup> The reference in the judgment to “*onduldbare onreg*” is of particular relevance: See ch 4 part 2 3 5 below.

<sup>320</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) 161.

<sup>321</sup> 165.

*“Ek meen dat daar in hierdie geval ook net tot 'n konklusie van persoonlike aanspreeklikheid sou kon kom as daar ten minste 'n oortuiging was dat applikante 'n onduidbare onreg aangedoen word en wel ten gevolg van iets wat vir die regdenkende duidelik onbehoorlike optrede aan die kant van eerste respondent is.”*<sup>322</sup> [own emphasis]

There are a number of aspects to these *dicta*.

The first is that piercing can be justified in certain circumstances for reasons of fairness and/or equity.<sup>323</sup> However, such consideration of fairness or equity, although a prerequisite, is not enough. The remedy should only be resorted to in cases where exceptional grounds exist. Piercing should therefore only be applied where an “unconscionable injustice” is being done to the aggrieved party, coupled with improper conduct on the part of the shareholder through his or her use of the corporate veil.

This comprehensive statement requires further analysis, particularly since the SCA later thought this to be “perhaps too rigid a test”.<sup>324</sup>

Of particular interest in Fleming J’s judgment are two key requirements: an unconscionable injustice to the claimant or applicant and improper conduct perpetrated by the shareholder through use of the company form.

It is unnecessary at this point to consider the phrase “*onduldbare onreg*” (or “unconscionable injustice”) in the common law context as it was not applied in any subsequent piercing cases.<sup>325</sup> The important principle to note from *Botha* is that piercing requires a two-pronged approach. It is insufficient to have regard only to the manner in which corporate personality is misused; one must also have regard to the effect that this misuse has on the aggrieved party.

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<sup>322</sup> 167.

<sup>323</sup> It is interesting to note that the sentiments portrayed in the judgment regarding that equity and fairness considerations not being enough is implied in the phrase “*onduldbare onreg*”: an injustice or “*onreg*” in itself is ostensibly not enough to pierce. See also the text to ch 4 part 2 3 5 below for a similar position in terms of s 20(9) of the Companies Act.

<sup>324</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 555.

<sup>325</sup> The requirement of an “unconscionable” injustice (or abuse) in s 20(9) of the Companies Act will be discussed below in ch 4. The possible influence of *Botha v Van Niekerk* 1983 4 All SA 157 (W) on the formulation of the test in that section is also considered in detail there.

“Improper conduct” or “*onbehoorlike optrede*”, the second requirement from the judgment, did not appear for the first time in *Botha*. Gower<sup>326</sup> also referred to this as a factor which would justify piercing as an alternative to fraud only. The obvious question is: what would constitute “improper conduct”? Because the SCA subsequently applied this test in *Cape Pacific*,<sup>327</sup> the scope thereof will be considered in the discussion of that case below.<sup>328</sup> Suffice it to say for the moment that improper conduct must involve the company / shareholder relationship. In this regard, it is important to distinguish between improper conduct perpetrated by the company and improper conduct using the legal personality separating the company and its shareholder. In the first situation piercing would not be justified. In the latter piercing does become relevant. The *dictum* of Scott JA in *Hülse-Reutter* that “there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it ...”<sup>329</sup> [own emphasis] supports this distinction.

Following this survey of the initial important cases on piercing<sup>330</sup> the further development of the doctrine by the SCA is considered next. These judgments must necessarily be regarded as the final authority on the matter.

### 3 3 The developed doctrine

The SCA had three opportunities to consider piercing. These three judgments are *Shipping Corporation of India Ltd v Evdomon Corporation* (“*Shipping Corporation of India Ltd*”),<sup>331</sup> *Cape Pacific* and *Hülse-Reutter*.

It should be noted from the outset that the principles decided in these cases should be read together. None of them contradicts any of the other judgments by the same court.<sup>332</sup>

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<sup>326</sup> LCB Gower *Principles of Modern Company Law* 3 ed (1969) 216 as referred to in *Lategan and another NNO v Boyes* 1980 4 All SA 638 (T) 646.

<sup>327</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553.

<sup>328</sup> See the text to ch 3 part 3 3 2 below.

<sup>329</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) para 20.

<sup>330</sup> See also *Dithaba Platinum (Pty) Ltd v Erconovaal Ltd* 1985 4 SA 615 (T) which did not add much to the contents of the doctrine.

<sup>331</sup> *Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A).

<sup>332</sup> Refer the discussion on *stare decisis* as applied by the Constitutional Court in n 283 above.

### 3 3 1 *The Shipping Corporation of India Ltd*

This case shares two commonalities with *Banco de Mocambique*. The facts in both cases concerned the possible piercing of the veil of wholly owned state-owned companies.<sup>333</sup>

A further shared feature is that the court did not give significant guidance in either of them as to when piercing would be considered appropriate. The facts in both cases made such a discussion unnecessary.<sup>334</sup> Perhaps the most relevant *dictum* to come out of *The Shipping Corporation of India* case is that of Corbett CJ:

“Suffice it 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.”<sup>335</sup>  
[own emphasis]

The judgment by itself is thus not very helpful, but it was referred to in the important *Cape Pacific* decision.

### 3 3 2 *The important Cape Pacific case*

Though the separate legal identity of a company was recognised in *Salomon* and *Dadoo*, the leading South African case on the doctrine of piercing the corporate veil is undoubtedly *Cape Pacific*.<sup>336</sup> Not only was the piercing doctrine significantly developed and refined, which refinements have gone untested since then,<sup>337</sup> but the doctrine as a whole was considered in some detail.<sup>338</sup>

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<sup>333</sup> The fact that the companies were state-owned was irrelevant but interesting (*The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 24).

<sup>334</sup> In *Shipping Corporation of India* the court rather abruptly concluded that “no ground has been shown for piercing the corporate veil in the present case”, while in *Banco de Mozambique* the court in similar fashion held “that in the present case I can conceive of no principle of law whereby such a radical step would be justified”.

<sup>335</sup> *Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 25.

<sup>336</sup> See also *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 20.

<sup>337</sup> *Cape Pacific* was not considered in detail in *Hülse-Reutter*, nor is it submitted was it necessary to do so.

<sup>338</sup> Significant matters dealt with in the judgment include that piercing need not be a remedy of final resort (see the text to ch 3 part 2 above) and further that even though the incorporation of a company may have been legitimate, the particular use thereof may nonetheless warrant

As in *Bark v Boesch* (“*Bark*”) *Cape Pacific* involved piercing within a group of companies. At stake was therefore not the corporate veil between a company and its shareholder, but the corporate veils between companies forming part of the same group *inter se*.<sup>339</sup>

The individual behind the companies, Lubner, transferred certain assets from one company which he controlled (“LCI”), to another company (“GLI”) which was wholly owned by him. This was done in order to frustrate the delivery of assets that LCI had originally agreed to sell.<sup>340</sup>

The current principles underlying common law piercing are arguably best set out in the following *dictum* in *Cape Pacific*:

“It is undoubtedly a salutary principle that our courts should not lightly disregard a company’s separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) are

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piercing irrespective of the purpose or intent exhibited at incorporation of the company (see the text to n 342 below). It also directs that piercing does not amount to the disregarding of the company’s separate legal personality for all intents and purposes, but only to the extent necessary to counter the abuse perpetrated – refer ch 2 part 6 1 above.

<sup>339</sup> See the text to ch 3 part 5 2 1 below.

<sup>340</sup> The court regarded Lubner as being the effective shareholder of LCI even though he was not the registered owner or even ultimate owner of any of the company’s shares. The court found at 548 that LCI “was essentially none other than Lubner personally, albeit in a different guise.” This is worth noting for two reasons: the first is that a court can pierce where a shareholding relationship is in place in substance (even if not in form), which relationship needs to be in place if the separate corporate existence of LCI and GLI are to be disregarded. The second matter of note is that, as is the case with piercing, such shareholding relationship can be inferred only for limited purposes: Smalberger JA at 546:

“[I]t is not in my view necessary to determine whether Lubner had complete control of LCI. The real issue is rather whether he exercised absolute control over LCI in relation to its dealings with the Findon shares.”

Control as referred to here is not control exercisable by a director of a company. Rather, it is control as would exist over an asset and which can be exercised by the owner thereof, with a company being controlled by its shareholders. Provision for piercing persons who are shareholders in substance is also found in s 20(9) of the Companies Act, which foresees piercing where a shareholder or “another person” is abusing the juristic personality of a company. (Also see s 65 of the Close Corporations Act.)

found to be present, other considerations come into play. The need to preserve the separate corporate identity (sic) would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil (cf Domanski: 'Piercing The Corporate Veil - A New Direction': 1986 SALJ 224). And a court would then be entitled to look to substance rather than form in order to arrive at the true facts, and if there has been a misuse of corporate personality, to disregard it and attribute liability where it should rightly lie."<sup>341</sup> [own emphasis – refer below discussion]

The above raises several issues regarding the current state of the doctrine, as well as its future development.

### 3.3.2.1 Fraud, dishonesty or improper conduct: the threshold requirement for piercing

To summarise the conclusions reached in *Cape Pacific*: if fraud, dishonesty or other improper conduct, defined within the context of reigning policy considerations, is present, a court would be justified to pierce if this is coupled with a misuse of the corporate veil.<sup>342</sup> The sentiment is consistent with that expressed in *The Shipping Corporation of India Ltd*.<sup>343</sup>

This dissertation considers piercing and where it can be applied to otherwise legally sound corporate structures used primarily for impermissible tax **avoidance** purposes. As a result a focus on "improper conduct" and what it entails is appropriate. In the tax milieu one would typically expect to find "fraud" or "dishonesty" to be present where

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<sup>341</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553.

<sup>342</sup> Such impropriety (or dishonesty or fraud) need not be the purpose with which the company was incorporated – see the *dictum* of Hoffman AJ in *Le'Bergo Fashions CC v Lee* 1998 2 SA 615 (C) and reference there to *Gilford Motor Co Ltd v Horne* 1933 Ch 935 (CA), *Cape Pacific* as well as Gower as quoted and referred to in that judgment. See too *Pioneer Concrete Services Ltd v Yelnah Pty Ltd & Ors* 1986 11 ACLR 108 (Australian case Reference) and *J Louw and Co (Pty) Ltd v Richter* 1987 2 SA 237 (N)). Also see *Cape Pacific Ltd* 553 *et seq*, in particular Gower as quoted there. The impropriety should, however, be the reason why the company's separate corporate personality was utilised in that instance.

<sup>343</sup> *Shipping Corporation of India Ltd v Evidomon Corporation* 1994 2 All SA 11 (A) 25. Although "dishonesty" (listed specifically in *Cape Pacific* as a potential criterion to justify piercing) is not mentioned here by name, one can assume that it formed part of the "other improper conduct" required in *Shipping Corporation of India*.

illegal acts are perpetrated, such as tax **evasion**.<sup>344</sup> This dissertation therefore does not consider these alternative bases upon which to apply piercing. Suffice it to say that it has already been established in the discussion of *Lategan*'s case in the text to chapter 3 part 3 2 1 above that fraud is not a requirement for piercing to be applied. As shown by *Cape Pacific*, it is but one of the possible criteria to justify piercing.<sup>345</sup>

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<sup>344</sup> See text to n 482 below.

<sup>345</sup> Notwithstanding the above it is interesting to note that under the judgment in *Cape Pacific*, even if fraud or dishonesty is present, one must still revert to the question whether in terms of policy considerations such fraudulent or dishonest activities are fraudulent or dishonest enough to warrant piercing. It is therefore curious is that the Court appears to diverge from the statement in *Lategan* that "our Courts would brush aside the veil of corporate identity time and again where fraudulent use is made of the fiction of legal personality" without any further considerations being taken into account. It is submitted that the interpretation of "fraud" as used in *Cape Pacific* differs from the interpretation in *Lategan* and that the requirement of "fraud" in *Cape Pacific* should not be interpreted too strictly. It would seem that the content of the word according to *Cape Pacific* is similar to that of "*dolus*" in *Bark and another NNO v Boesch* 1959 2 SA 377 (T) 384-385:

"[I]f from the nature of a contract it can be implied that a moral or legal duty rests on a debtor not to effect the fulfilment of a resolutive condition which can relieve him of his obligation, deliberately to act in breach of that duty with the intention of ridding himself of his obligation constitutes *dolus* ..."

(Also see TK Cheng "The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines" (2011) 34 *BC Int'l & Comp L Rev* 328-412, 357.) Although "*dolus*" was considered in *Bark v Boesch* as a requirement for the application of the doctrine of fictional fulfilment, the court did in effect pierce the corporate veil. I cannot see how a deliberate and intentional action by a taxpayer in breach of his/her obligation to pay tax cannot be considered "fraudulent" or "improper" as contemplated in *Cape Pacific*. This is not to say that the breach of the duty to pay tax is sufficient to pierce the corporate veil. But a wide interpretation of "fraud" would increase the need for a court to undertake a detailed consideration of whether such breach is significant enough in terms of policy considerations to warrant piercing. For tax purposes, having regard to the considerations against piercing, a moral obligation to pay tax (if such an obligation exists) should in my view not be sufficient to warrant piercing. The question becomes even more pertinent where the actions involve the intentional and deliberate misuse of corporate personality primarily to rid that taxpayer of what would otherwise have been a legal duty to pay tax. Whether this is the case will to a large extent depend on the specific facts to be determined on a case by case basis (*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552).

Gower, clearly the source of the phrase “improper conduct” in *Cape Pacific*,<sup>346</sup> does not explain what this potentially loaded term means. Notwithstanding this, it is clear that the SCA’s intention was to include an element of *mala fides* therein.<sup>347</sup> This suggests that improper conduct should be determined subjectively, as is the case with fraud or dishonesty. The SCA confirmed as much in *WT v KT*,<sup>348</sup> preferring to refer to “improper purpose” rather than “improper conduct”.<sup>349</sup> The application of a subjective test for piercing also accords with the English approach, as will be seen later.<sup>350</sup>

A further argument in favour thereof that piercing necessarily involves a subjective requirement can be found in the SCA and the AD’s approach to the judgments in *Ebrahim*<sup>351</sup> and *Cape Pacific*. In *Ebrahim*, the SCA, based on the same objective criteria cited by the court *a quo*, sought to apply section 64 rather than the piercing provision in section 65 of the Close Corporations Act applied by the court *a quo*,<sup>352</sup> in

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<sup>346</sup> Gower *Principles of Modern Company Law* 3 ed 216.

<sup>347</sup> If an *eiusdem generis* interpretation is followed (LM du Plessis “Statute law and interpretation” in WA Joubert (ed) *Law of South Africa XXV* 2 ed (2011) 359). In the context of the piercing provision in s 20(9) of the Companies Act, see E Nel “Two sides of a coin: piercing the veil and unconscionability in trust law” (2014) *Obiter* 570 575.

<sup>348</sup> 2015 3 SA 574 (SCA).

<sup>349</sup> Although *WT v KT* is a case dealing with trusts, that case is relevant. See the text to ch 4 part 2 3 5 below.

<sup>350</sup> See the text to part 4 1 below where the UK Supreme Court in *Prest v Petrodel Resources Ltd* 2013 UKSC 34 agreed with the approach suggested in *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 162 that the company must be used with the **purpose** to “avoid or conceal liability”. Further at para 163 the court concluded that motive would be extremely relevant and at paragraph 164 impropriety was likened to “deceptive **intent**”. See also *Prest* para 21 the UK Supreme Court concluded that *Adams* is authority that the corporate veil can only be pierced where it “was being used for a deliberately dishonest **purpose**”. [own emphasis]

<sup>351</sup> *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA).

<sup>352</sup> S 64 of the Close Corporations Act is not strictly a piercing provision given the absence of member-company relationship. That section allows a court to apply that provision potentially based on objective criteria alone to hold others liable for the debt of the close corporation in question. S 65 is an example of a statutory piercing provision and which in my view would require a court to take account of the subjective purpose of a member in order to apply that provision. It is in my view arguable that the SCA in *Ebrahim* therefore decided to apply s 64 in arriving at its conclusion rather than s 65 due to the absence of an enquiry haven taken place into the subjective purpose of the members in that case. See also n 710 below.

my view due to the absence of subjective criteria being present. In *Cape Pacific*, the *a quo* judgment was emphatic in its finding that the companies in question were on a strictly objective basis determined to be *alter egos* of the defendant (Lubner). Conversely, on appeal this was not the criteria on which the court based its application of the piercing doctrine. In the AD a subjective element clearly also had a bearing on the court's conclusion. It is submitted that in both instances, the courts of appeal – correctly and in line with the UK's approach<sup>353</sup> – considered a subjective element necessary to apply piercing. As much is clear due thereto that the appeals in both *Ebrahim* and *Cape Pacific* were dismissed, yet on different bases than were the case in the courts *a quo*. Based on the objective approach taken by the *a quo* court in *Ebrahim* the SCA preferred not to apply section 65 of the Close Corporations Act, but rather section 64. In *Cape Pacific*, the subjective purpose of the defendant inclined the AD to apply the piercing doctrine, rather than the strictly objective *alter ego* doctrine.<sup>354</sup>

An analysis of the historical development of the test further supports the presence of a subjective enquiry in the piercing doctrine.<sup>355</sup> As discussed in part 3 3 2 1 above, *Lategan* has long been regarded as authority that piercing may only be applied where fraud is present. The court clarified in *Shipping Corporation of India* that fraud is not the only test, but that “other improper conduct” may also suffice. In *Cape Pacific* the court further extended the potential for piercing by adding “dishonesty” as a further criterion to the existing bases of “fraud” and “improper conduct”. Whilst “dishonesty” would, in the view of the court, be a justifiable ground for piercing, an even less restrictive test should be applied. From this it is clear that courts may pierce, even absent fraud or dishonesty, where improper conduct is present to such an extent that policy considerations would regard the circumstances as severe enough to pierce.

The development of the doctrine shows a further significant pattern. From *Lategan's* often misinterpreted “fraud test” and through *Shipping Corporation of India* to *Cape Pacific*, one sees a gradual relaxation of the rule in *Salomon*: from “fraud”, to “fraud or other improper conduct” and then to “fraud, dishonesty or other improper conduct”.

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<sup>353</sup> See the text to ch 3 part 4 1 below.

<sup>354</sup> See the text to ch 2 part 4 2 3 above.

<sup>355</sup> In *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554 the court suggested that motive would be a “highly relevant consideration”.

The test for improper conduct is, as with fraud and dishonesty, necessarily a subjective one. In a tax context it this means that the veil may only be pierced for tax purposes where a taxpayer **intentionally** used the corporate veil to achieve a tax benefit.<sup>356</sup> Where the corporate veil is used as a “device”, “stratagem” “cloak” or “sham”, this may be indicative of such impropriety, but the motive of the shareholder for deploying the corporate veil is decisive.<sup>357</sup> Whether, as a question of law, the veil should be pierced when used primarily for tax purposes is considered in more detail in part 5 1 of this chapter below.

Finally, it should be emphasised that the “improper conduct” must not be that of the company, but rather that of the shareholders behind the company using the veil for their own benefit with an improper subjective purpose.<sup>358</sup> As will be discussed below,<sup>359</sup> it is precisely when shareholders who control the corporate veil are able to exert control to such an extent that the corporate veil is used for “fraud, dishonesty or other improper conduct”, that such use amounts to “misuse”.

It is important to understand what is meant by “policy considerations” in Smalberger JA’s *dictum* as quoted above. Even where impropriety is perpetrated through a misuse of the corporate veil, policy considerations should be taken into account first to determine whether piercing should be applied.

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<sup>356</sup> In *RP v DP* 2014 6 SA 243 (ECP) the assertion is made at 20 that “improper conduct” involves instances where the corporate veil is used as *alter ego*, agent, puppet or mask. While such situations may very well include elements of impropriety, these would involve only objective elements. For piercing to be applied, the correct question to be asked is rather why the corporate veil has been used as such, rather than whether if it has been employed in a manner which can be described as *alter ego*, agent, puppet or mask. Also see *J Louw and Co (Pty) Ltd v Richter* 1987 2 SA 237 (N) where the court distinguished *Gilford Motor Co Ltd v Horne* 1933 Ch 935 (CA) and refused to pierce the corporate veil where it was found that the company had been used “innocently, honestly and for purposes that were quite above board”. Also see *Le’Bergo Fashions CC v Lee* 1998 2 SA 608 (C).

<sup>357</sup> *The Shipping Corporation of India* as quoted in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553; cf *Williams* “Companies: Part I” in *LAWSA* 89.

<sup>358</sup> Which appears to have been the reason why the court was unwilling to pierce in *Hülse-Reutter*: no evidence was presented to show impropriety on the part of the shareholders. See the text to ch 3 part 3 3 3 below.

<sup>359</sup> See the text to ch 3 part 3 3 2 3 below.

### 3 3 2 2 Policy considerations

It is important to recognise at the outset that policy considerations cannot determine the legality or illegality of an act. It cannot trump legal principle. To quote Lord Neuberger in *VTB Capital plc v Nutritek International* (“VTB”):<sup>360</sup>

“However, such pejorative expressions are often dangerous, as they risk assisting moral indignation to triumph over legal principle, and, while they may enable the court to arrive at a result which seems fair in the case in question, they can also risk causing confusion and uncertainty in the law.” [own emphasis]

Policy considerations can only assist with piercing to determine when the use of a company has gone too far. In circumstances where such use involves an already legally “improper” purpose, such considerations can only help to determine whether it is improper *enough* and not whether it is improper *per se*.<sup>361</sup>

Smalberger JA’s mention of policy considerations in *Cape Pacific* obviously refers to the “balancing test” proposed by Domanski, quoted with approval by the court.<sup>362</sup> Domanski’s balancing test relies on *Glazer v Commission on Ethics for Public Employees*, a judgment of the USA Court of Appeal of Louisiana<sup>363</sup> where “(t)he court ruled that the test for piercing the corporate veil is a balancing of ‘the policies behind recognition of a separate corporate existence’ against the ‘policies justifying piercing’”.<sup>364</sup>

Domanski does not set out what all the policies in favour of piercing<sup>365</sup> would be *vis-à-vis* those considerations opposed thereto. It is also not intended to try and do so here. Suffice it to say that considerations against the veil being pierced would include

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<sup>360</sup> *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 124.

<sup>361</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553 and 561.

<sup>362</sup> See the text to ch 3 part 4 1 below where the distinction between the “evasion” and “concealment” principles made by the UK Supreme Court is considered.

<sup>363</sup> (1983) 431 So.2d 752.

<sup>364</sup> Domanski (1986) SALJ 232. Cf Benade (1967) *THRHR* 227 arguing that piercing should be applied based on “*billikheidsoorwegings*” (“considerations of fairness”).

<sup>365</sup> *Williams* “Companies: Part I” in *LAWSA* 88 identifies the interests of justice, fairness and right dealing.

the interests of minorities and of other third parties potentially adversely affected<sup>366</sup> as well as the maintenance of legal certainty.<sup>367</sup>

Ryan,<sup>368</sup> considering the role of *stare decisis* and to what extent it is limited to allow for changing societal needs, writes that “[t]he inherent flexibility of a common law system is perhaps one of its greatest strengths, and a particular system must find the appropriate balance to allow for the incremental development of the law while retaining a sufficient degree of certainty”. This approach is as much applicable to the piercing doctrine as it is to the common law in general. The common law should be developed to serve the needs of society if these needs outweigh the demand for legal certainty. In my view, our common law already allows piercing for tax purposes.<sup>369</sup> Even if this is not the case, it is argued below that development of the common law is now necessary, if not overdue.

The considerations against piercing are not at all as flexible as those in favour thereof. Especially those policy considerations in favour of piercing are therefore very relevant when interpreting a vague criterion for piercing such as “improper conduct”. The test for impropriety can easily become a moving target:<sup>370</sup> What is considered a

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<sup>366</sup> See e.g. *Al-Kharafi & Sons for General Trading, General Contracting and Industrial Structures Wll v Pema NO & others* 2010 JOL 25851 (GSJ). See the text to ch 2 parts 4 2 3 and 6 1 and ch 3 part 5 2 below for why piercing for tax purposes can never be to the detriment of any third parties or other shareholders. See also *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 146 where an English court confirmed that the presence of minority shareholders does not *per se* render a company immune from piercing.

<sup>367</sup> Domanski goes as far as to state that “abuse of juristic personality” should in itself provide sufficient grounds for policy considerations in favour of piercing to outweigh the considerations listed above opposed thereto. Although this may be correct, it is submitted that such abuse can only be determined with reference to whether the abuse is coupled with “*fraud, dishonesty or improper conduct*” in other words the question of abuse should be addressed separately from policy considerations (as supported by the *Cape Pacific* judgment which was delivered subsequent to the Domanski article).

<sup>368</sup> Ryan (2015) SALJ 234.

<sup>369</sup> See the text to n 248 above.

<sup>370</sup> Refer to Brand JA’s comments on policy considerations in *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* [2008] JOL 22803 (SCA) 7 which, although in a different context, would also be applicable to of the law of taxation:

“[W]hat are the considerations of policy that should be taken into account for purposes of the enquiry? By what criteria should the relevant considerations of policy be identified?”

minor impropriety today may very well be regarded as severely improper tomorrow because of a shift in policy considerations.<sup>371</sup> This will undoubtedly influence the contents that a court will give to the phrase “fraud, dishonesty and (in particular) improper conduct”.<sup>372</sup>

The Constitutional Court recently decided that policy considerations when developing the common law should include cognisance of “reasonableness”, the “*boni mores*” and “public policy”.<sup>373</sup>

An illustration of this principle can be found when one applies the *Cape Pacific* test to the facts of *Dadoo*. Had “policy considerations” applied in 1920 and had the modern approach to statutory interpretation been applicable,<sup>374</sup> it is very likely that a different judgment would have been handed down.

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Must we accept that policy considerations are by their very nature incapable of pre-determination and that the identification of the policy considerations that should find application in a particular case are to be left to the discretion of the individual judge? ... I believe the answer ... must be ‘no’. Liability cannot depend on the idiosyncratic views of an individual judge. That would cloud the outcome of every case in uncertainty. In matters of contract, for example, this Court has turned its face against the notion that judges can refuse to enforce a contractual provision purely on the basis that it offends their personal sense of fairness and equity. Because, so it was said, that notion will give rise to legal and commercial uncertainty ... A legal system in which the outcome of litigation cannot be predicted with some measure of certainty would fail in its purpose ... We therefore strive for certainty. The question is, how can that be achieved in an area directed by considerations of public or legal policy? I believe we must accept at the outset that absolute certainty is unattainable.”

<sup>371</sup> See Strydom & Du Plessis (1997) *TSAR* 399. Cf De Koker & Brincker *Silke on International Tax* 46.9.

<sup>372</sup> See Nugent JA in *AB Ventures Ltd v Siemens Ltd* [2011] ZASCA 58 (31 March 2011) (as quoted in *Hyde Construction CC v Blue Cloud Investments 40 (Pty) Ltd* [2012] JOL 28470 (WCC)) on the extension of the realms of the common law based on policy considerations.

<sup>373</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 117.

<sup>374</sup> See *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 550 where a literal interpretative approach was preferred, contrary to what has now been prescribed by the SCA in *Natal Joint Municipal Pension Fund* (see the text to ch 3 part 5 1 2 below).

It is therefore not surprising that the doctrine has been described as one that is “far from settled”.<sup>375</sup> Any doctrine that is linked to the ever-changing criteria of “policy considerations” is likely to remain unsettled.<sup>376</sup> This does not mean that the doctrine must be discarded as useless due to its variability. Evolution to address changing circumstances is part of the nature of the law itself. Our courts strive continuously to develop the law, but along a path leading in a consistent direction. This is arguably what the courts in South Africa have done where the piercing doctrine is concerned.<sup>377</sup>

### 3 3 2 3 Misuse of corporate personality

It is important to appreciate that fraud, dishonesty or some other improper conduct is not enough on its own to pierce the corporate veil. It should be determined whether the presence of these subjective elements, whilst also considering the applicable policy considerations at play, is sufficient to then proceed to the objective test to decide whether said fraud, dishonesty or impropriety has been perpetrated by way of “misuse” of the corporate personality of the company.

The terms “misuse” or “abuse”, which are used interchangeably in the *Cape Pacific* judgment,<sup>378</sup> imply that the corporate personality is being used or exploited for purposes which it was not intended for or to depart from the legal use thereof.<sup>379</sup> Larkin,<sup>380</sup> as quoted with approval in *Cape Pacific*, “reminds us that ‘the company is something which has a clear purpose, the facilitation and encouragement of business

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<sup>375</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552; *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20; Blackman et al *Commentary on the Companies Act* 4-133.

<sup>376</sup> See n 370 above.

<sup>377</sup> See the discussion in the text to part 3 3 2 1 below on the relaxation of the test necessary to apply piercing as developed by *Lategan*, then *The Shipping Corporation* and finally by *Cape Pacific*.

<sup>378</sup> Also refer *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20. Cf De Koker & Brincker *Silke on International Tax* 46.20 where the authors note that no real distinction can be said to exist between the words “misuse” and “abuse”. Also refer *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20.

<sup>379</sup> S Hawker & M Waite (eds) *Concise Oxford Thesaurus* (2007); BA Garner (ed) *Black’s Law Dictionary* (2004).

<sup>380</sup> *Larkin* (1989) SA Merc LJ 295 and 296.

enterprise by large and small numbers of people' and that: 'The entity concept is not an absolute but was designed to serve certain purposes.<sup>381</sup> To utilise the concept outside the framework of those purposes would turn a mere means to an end into an end on itself. If the entity concept is allowed to frustrate the law it would go against everything which it was intended to achieve.'<sup>382</sup>

To use the company to limit exposure to tax was clearly not one of the purposes envisaged by the legislature when it conceived the concept of separate legal personality. That is still the case. There is in principle nothing objectionable about tax benefits becoming an ancillary benefit to trading through a company. However, when the legal personality of the company is employed primarily to seek that tax benefit, this amounts to a misapplication, or a misuse or abuse, of corporate personality.<sup>383</sup> The conclusion drawn in part 3 3 2 1 of this chapter above is that such misuse would at a minimum be improper and necessitate piercing if such impropriety was the dominant factor in seeking to utilise the corporate veil.<sup>384</sup>

The only person who can potentially misuse the corporate personality of a company and directly benefit from this, is the shareholder. It is the owner of the company with its separate personality.<sup>385</sup> There should be a clear distinction between a company perpetrating fraud, dishonesty or other impropriety for its own benefit and the shareholders of a company using the corporate personality of that company to perpetrate that fraud, dishonesty or other improper conduct for their benefit.<sup>386</sup> Misuse or abuse requires the ability to use, which in turn requires ownership-control. Majority control of the company is not required to achieve a tax advantage by using the corporate veil.<sup>387</sup> All that is required is ownership-control which is achieved through

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<sup>381</sup> Cf the text to ch 2 part 2 2 above.

<sup>382</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 560.

<sup>383</sup> See the text to ch 3 part 5 below.

<sup>384</sup> See also the text to ch 3 part 5 1 below.

<sup>385</sup> Which explains why it was necessary for the court in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A)546 to consider whether Lubner controlled LCI. The question the court had to answer was whether Lubner could in fact exercise control over the company as a shareholder rather than whether Lubner was in a position to exercise "complete control".

<sup>386</sup> Refer to the discussion of *Hülse-Reutter* in the text to ch 3 part 3 3 3 below.

<sup>387</sup> See also the text to ch 3 part 5 2 below.

the shareholding relationship between the company and its shareholders that establishes ownership, not of the company, but of a portion of the shares in the company.<sup>388</sup> While it true that majority shareholder control has in the past been taken into account by courts when considering the application of the piercing doctrine,<sup>389</sup> it should be remembered that even a minority shareholder is afforded the protection of the corporate veil. It is entirely possible that a majority shareholder's main purpose when using the company's separate legal personality may be legitimate. However, if tax reasons primarily drive the main purpose of a minority shareholder, there is no reason why a court should not be able to pierce the corporate veil only for the minority shareholder and not for the majority shareholder.<sup>390</sup> Both the minority and majority shareholders share the advantages of employing the corporate veil and both are able in law to exert ownership-control over that portion of the veil that they are "entitled to" by virtue of their shareholding. For both sets of shareholders the corporate veil's protection is absolute and equal and the percentage shareholding of each does not reduce this. Therefore, although misuse requires control, it should not require control of the company as a whole.<sup>391</sup> It rather requires control over at least a portion of the corporate veil, which only a shareholding relationship can establish. This means that

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<sup>388</sup> Which again shows why it is inappropriate to refer thereto as piercing in those instances where the directors are held liable personally for the company's obligations. See the text to ch 2 part 3 2 1 above.

<sup>389</sup> *Williams* "Companies: Part I" in *LAWSA* 87; see also Blackman et al *Commentary on the Companies Act* 4-134 where curiously no South African authority is quoted for the assertion. It is important to note though that the requirement of "control" here would have existed had minority shareholders been financially prejudiced due to the improper actions of the majority shareholders. Policy considerations therefore require control in those instances where attribution of liability or assets is involved – see e g *Al-Kharafi*. As said in the text to ch 3 part 5 2 though, this is not the case where piercing for tax purposes is concerned, because no persons other than the shareholder involved are prejudiced where piercing is applied for tax purposes. See the text to n 366 above.

<sup>390</sup> See the example in the text to ch 2 part 4 2 3 above; also see the text to ch 2 part 6 1 above.

<sup>391</sup> Refer to the text to ch 3 part 5 2 below for the discussion on the principle that piercing, although it may impact the position of unrelated, third-party creditors or minority shareholders, should not impact them where piercing is applied for tax purposes (as opposed to where it is applied for the collection of debts due by a shareholder).

the purpose with which the corporate veil is used by minority and majority shareholders may differ.

Improper conduct is a subjective question, but misuse involves an enquiry into whether objectively *de facto* control through “ownership of the corporate veil” exists. In addition such control must indeed have been exercised in order to use the corporate veil to perpetrate fraud, dishonesty or an impropriety. The requirement of *de facto* control, as opposed to *de jure* control, is necessary, given the scenario where shareholder control is exercised not by the registered shareholder,<sup>392</sup> but by the shareholder in substance. Examples hereof can be found in the facts of both *Cape Pacific* and *Airport Cold Storage*,<sup>393</sup> or in groups of companies where there is indirect shareholding.<sup>394</sup>

Regardless, “misuse” as contemplated in *Cape Pacific* should merely amount to the use of a company’s separate corporate personality by its shareholders for purposes of fraud, dishonesty, or other improper conduct.<sup>395</sup> In other words, use of the corporate veil for prohibited purposes. It should be acknowledged that the corporate veil is not only at the disposal of a majority shareholder, but provides the same benefits, including tax advantages, for all its shareholders.

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<sup>392</sup> That is, the shareholder on a company’s share register.

<sup>393</sup> See the text to n 340 above for a discussion on the position of shareholder in substance.

<sup>394</sup> Refer to the text to ch 3 part 5 2 1 below. *Cf Adams v Cape Industries plc* 1991 1 All ER 929 1023 where a similar challenge was launched in England (unsuccessfully, on the facts) based on shareholding held in that case by an individual, one Morgan. Also refer the English case of *UBS AG v HMRC; DB Group Services (UK) Ltd v HMRC* [2016] UKSC 13 para 38 where the court had to decide whether the individuals there were the real shareholders of the companies involved. Although it is argued here that piercing necessarily involves control by way of a company-shareholder relationship, it is quite possible that the corporate veil can be misused outside this relationship and within, for example, a contractual relationship where shareholder control is effectively passed on to a non-shareholder by agreement. Refer the factual scenarios in the income tax “pension fund cases” in the text to n 248 above as examples where this may be applicable. Although not piercing as such, there is in principle no reason why the test for piercing cannot be applied in favour of the *fiscus* in such cases.

<sup>395</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553 to 554.

### 3 3 2 4 Conclusion

To date *Cape Pacific* is the leading authority on the common law piercing doctrine in South Africa.<sup>396</sup> Only once since has the doctrine been revisited by the SCA in *Hülse-Reutter*. In that case the *Cape Pacific* judgment was impliedly accepted.<sup>397</sup>

Not only did the court in *Cape Pacific* clearly seek to relax the requirements for piercing by endorsing the “balancing test” proposed by *Domanski*, but it also continued the trend of broadening the potential scope for the application of the remedy.

The test for piercing as formulated in *Cape Pacific* requires:

- 1 fraud (interpreted widely), dishonesty or some other improper conduct that has been perpetrated subjectively;<sup>398</sup>
- 2 by any of the shareholders of the company concerned using the corporate veil (objectively determined); and
- 3 that the conduct involved is sufficiently objectionable for the policy considerations in favour of piercing to outweigh those considerations against it.

It is surprising that very few piercing cases have since *Cape Pacific* been considered by the South African courts. The lack of cases on tax avoidance is particularly striking, though there is clear authority for tax avoidance as a ground on which to apply piercing.<sup>399</sup> This could be due to three reasons. The first could be the uncertainty on the content of the piercing doctrine. A further reason could be SARS’s apparent ignorance of the potential implications of the *Cape Pacific* judgment. The third reason can perhaps be the fact that piercing as an impermissible tax avoidance remedy has not yet been substantively tested in a court of law. Given the international debate on tax avoidance and tax morality, it is probably only a matter of time before SARS will take a strong enough test case to court and request the court to pierce the corporate veil as remedy to counter the misuse of the corporate veil for tax purposes.

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<sup>396</sup> See *Le’Bergo Fashions CC* 1998 2 SA 612 (C).

<sup>397</sup> See the text to ch 3 part 3 3 3 below.

<sup>398</sup> It is submitted that this requirement has been met where the avoidance of tax is the principal purpose.

<sup>399</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W)164; *Gower Principles of Modern Company Law* 112.

This, combined with SARS's apparent preference to use common law remedies to address impermissible tax avoidance<sup>400</sup> as opposed to the GAARs,<sup>401</sup> will probably in future lead to more judgments on attempts at piercing in defence of the *fiscus*.

The absence of provisions in the Income Tax Act to address the use of the corporate veil for tax reasons is not due to policy considerations,<sup>402</sup> but an inability on the part of governments the world over to sufficiently address tax abuse through use of the corporate veil by introducing such legislative measures. The international tax context provides pertinent examples which include how the "beneficial ownership" and "limitation of benefits" clauses in tax treaties have failed to address the manifestation of treaty shopping and the use of conduit companies to avoid tax. The latest BEPS action plan, dealing in part with treaty shopping, acknowledges as much.<sup>403</sup> The root cause of the problem is arguably that the law of taxation is largely subservient to other branches of law. It attaches tax consequences to rights and obligations which other branches of law create. The abuse of the company form for tax purposes is therefore likely to persevere until this root cause is addressed by the relevant branch of law, in this case company law. Just as there are no policy considerations against applying for example the common law simulation doctrine in the tax context,<sup>404</sup> there is also no evidence to suggest that such considerations would exist against the application of other remedies in that context (such as piercing). The only policy consideration

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<sup>400</sup> *CSARS v NWK Ltd* [2010] 73 SATC 55, *Commissioner SARS v Bosch* 2015 2 SA 174 (SCA) and *Sasol Oil (Pty) Ltd v CSARS* (923/2017) [2018] ZASCA 153 (9 November 2018) (as yet unreported) are recent examples.

<sup>401</sup> PJ Hattingh & AJ Marais "Retroactive amendments: Value Shifting and Residence of Companies" (2014) 63(3) *The Taxpayer* 42.

<sup>402</sup> SARS' draft guide on the GAARs (SARS. 13 December 2010. *Draft Comprehensive Guide to the General Anti-Avoidance Rule*) makes mention thereof that common law remedies may be used in addition or in the alternative to the GAARs to address impermissible tax avoidance.

<sup>403</sup> Refer to Organisation for Economic Co-Operation and Development *Action Plan on Base Erosion and Profit Shifting* (2013) OECD Publishing. Available at: <<http://dx.doi.org/10.1787/9789264202719-en>> (accessed July 2013) and Organisation for Economic Co-Operation and Development *BEPS Action 6: Preventing the Granting of Treaty Benefits in inappropriate circumstances* (2014) OECD Publishing Available at: <<https://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf>>.

<sup>404</sup> As discussed in n 881 below, the UK only recently introduced a legislated anti-abuse rule after previously applying only a common law rule to address impermissible tax avoidance.

opposed to the application of the piercing remedy in a tax context is legal certainty.<sup>405</sup> The law of taxation does not operate as an exclusive regime, but forms part of a larger legal framework which includes that created by the common law and the Companies Act.<sup>406</sup>

### 3 3 3 *Hülse-Reutter*

*Hülse-Reutter* is the latest judgment in which the SCA dealt with piercing. The judgment did not further develop the piercing doctrine nor did it cast new light on the content thereof, probably because the court found on the facts that the applicability of the doctrine should not even be considered since there was an alternative remedy against the company itself.<sup>407</sup>

For purposes of this dissertation *Hülse-Reutter* is only relevant as a confirmation of the principles established in *Cape Pacific*. There is one exception in this regard:<sup>408</sup>

“Nonetheless what, I think, 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.”<sup>409</sup> [own emphasis]

This *dictum* raises two questions: When will an “unfair advantage” be present and for whose benefit must that unfair advantage arise?

Due to the lack of any explanation of what the court meant when referring to the need for an “unfair advantage”, it is submitted that these comments should be read in line with *Cape Pacific*. In the absence of any express or implied comment whereby the

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<sup>405</sup> See the text to ch 4 part 4 1 below.

<sup>406</sup> See n 400 above for the examples where SARS has preferred to address instances of impermissible tax avoidance by applying common law doctrines as alternative to the GAARs.

<sup>407</sup> See the text to ch 3 part 3 2 above.

<sup>408</sup> See the text to ch 3 part 3 2 above on the application of the *stare decisis* doctrine.

<sup>409</sup> The remaining comments were primarily aimed at justifying piercing as a remedy of last resort – refer discussion in the text to ch 3 part 2 above. The court also confirmed at 20 the principle that “(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.”

court distanced itself from *Cape Pacific*, the SCA surely followed the reasoning and approach of its own earlier judgment.

The conclusion is therefore that “unfair advantage” should be interpreted as having the same meaning as “fraud, dishonesty or other improper conduct” in *Cape Pacific*, subject of course to the condition that the conduct perpetrated was objectionable enough to warrant piercing despite possible policy considerations against piercing.<sup>410</sup>

The second question in *Hülse-Reutter* is for whom the unfair advantage should arise. It is not a new one. As said in *Cape Pacific*, piercing is a remedy against the shareholders of the company and not against the company itself. There is a clear distinction between a company perpetrating a “wrong”,<sup>411</sup> using a company to perpetrate such a “wrong” and using the distinction between the company and shareholder to commit the “wrong”. Only in the latter instance will piercing find application<sup>412</sup> and only if no other real remedy is available for the claimant against the company itself.

### 3 3 4 Conclusion

The fiction of legal personality is not absolute.<sup>413</sup> Van den Heever JA in his concurring minority judgment in *Cape Pacific* quotes with approval from PJJ Olivier’s doctoral thesis dealing with legal fictions: They “warp our thought ruthlessly if they become masters of our intellectual processes and are applied without rigorous scrutiny... Even more, in becoming a legal imperative and closed to constant scrutiny, the fiction perpetuates its falseness and harbours the real danger of being extended to socially and scientifically undesired consequences. It becomes a social and scientific lie.”<sup>414</sup>

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<sup>410</sup> Ignoring the policy considerations contemplated in *Cape Pacific* would probably result in the “unfair advantage” test lowering the bar to unacceptably low levels applied.

<sup>411</sup> *United States v Milwaukee Refrigerator Transit Company* (1905) 142 Fed 247 (Fed SC) as quoted in *Cape Pacific*.

<sup>412</sup> See the text to ch 3 part 3 3 2 3 above; Larkin (1989) SA Merc LJ 295; see the discussion on *Hülse-Reutter* in the text to ch 3 part 2 above.

<sup>413</sup> Benade (1967) THRHR 215: “Die regsreël met betrekking tot die selfstandigheid van die regspersoon is per slot van sake ’n doelmatigheidsreël en geen vooropgestelde absolute waarheid nie.”

<sup>414</sup> Which itself in the quoted extract is partly quoting from GW Paton *A Textbook of Jurisprudence* (1951).

Cameron JA in *Ebrahim* applied this approach to the fiction of corporate personality.<sup>415</sup>

The cases analysed above form the basis of the current South African law on the piercing of the corporate veil at common law. The subsequent reported cases (none of them in the SCA) have not significantly developed or dealt with the piercing doctrine. It is therefore not necessary to discuss these in any detail.<sup>416</sup>

What these cases do show is that fraud is not the only basis on which piercing can be applied. In fact fraud, even if interpreted widely, may in some instances not be enough. Piercing is a drastic remedy and a court does not have a general discretion to disregard a company's separate corporate personality for the sake of convenience or justice.<sup>417</sup>

#### 4 International approach and recent developments

Recent developments in other countries are briefly considered below. This includes two UK Supreme Court cases which deal with the piercing doctrine as applied in that country in detail.

South African courts are obliged to consider international law.<sup>418</sup> International policy considerations favouring piercing must by implication also be considered when local courts consider whether an improper purpose is improper enough to warrant piercing. In this context there has been a dramatic shift in specifically the tax area over the past few years.<sup>419</sup>

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<sup>415</sup> *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 15.

<sup>416</sup> These include the judgments in *Metlika*, *Van Heerden v The State* [2010] 73 SATC 7, *Amlin* and *Al-Kharafi*. The first judgment is discussed in greater detail in the text to ch 2 parts 4 2 6 and 4 2 8 above. The relatively recent case of *Al-Kharafi*, although containing a detailed discussion of the development of the piercing doctrine, especially its application to groups, did not reach a conclusion on when appropriate circumstances to pierce would be present. Rather, a fact-based approach was taken (refer para 39), leading Malan J to conclude that piercing was inappropriate. This case is therefore not helpful in deciding on when it would be appropriate to pierce the corporate veil.

<sup>417</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553 and confirmed in *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20. JB Cilliers & SM Luiz "The Corporate Veil – An Unnecessarily Confining Corset?" (1996) 59 *THRHR* 523. See also the English case of *Adams v Cape Industries plc* 1991 1 All ER 929 1019.

<sup>418</sup> Ss 232 and 233 of the Constitution. And see too s 39 thereof.

<sup>419</sup> See the text to n 507, 508 and 511 below.

The Companies Act confirms that “[t]o the extent appropriate, a court interpreting or applying this Act may consider foreign company law”.<sup>420</sup> Given the rich history of foreign precedent being applied in our courts in considering the piercing doctrine, one cannot contemplate a more appropriate context for considering foreign company law.<sup>421</sup>

#### 4 1 United Kingdom

The UK’s position is particularly important given South Africa’s own close historical connection thereto. One need only reflect on the host of British case law that has come to serve as the basis for many of South Africa’s own company law principles.<sup>422</sup>

The UK Supreme Court – previously the House of Lords – has only at three prior occasions considered the piercing doctrine in any significant detail. The first of these being *Woolfson v Strathclyde Regional Council* (“*Woolfson*”) where the court only briefly considered the doctrine and limited itself to *obiter* remarks.<sup>423</sup> This makes the two 2013 judgments of *VTB* and *Prest* so much more valuable. The Court in these two cases considered both the remedy and all case law preceding these judgments in significant detail.

Both these cases refer with approval to the judgment of Munby J in *Faiza Ben Hashem v Shayif* (“*Ben Hashem*”) and in particular to his six principles<sup>424</sup> regarding the application of the piercing doctrine in the UK. All are in accord with the South African approach to the piercing doctrine in general.

The principles identified in *Ben Hashem* are that:

- i) ownership and control<sup>425</sup> of a company are not sufficient to warrant piercing;

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<sup>420</sup> S 5(2) of the Companies Act.

<sup>421</sup> This is true of both the common law and its statutory equivalent in s 20(9) of the Companies Act.

<sup>422</sup> *Salomon’s* case being a case in point. Also see the text to ch 2 part 2 1 above.

<sup>423</sup> *Woolfson v Strathclyde Regional Council* 1978 SLT 159. See *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 121 for a discussion of the relevance of that case.

<sup>424</sup> *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 paras 159 to 164 and the authorities cited there.

<sup>425</sup> It is unclear what the court would regard as “control”. Presumably this would refer to shareholder control, that is control over the company by virtue of majority shareholding (as

- ii) piercing is not justified merely because it is in the interests of justice;<sup>426</sup>
- iii) “impropriety” is a necessary requirement to pierce;<sup>427</sup>
- iv) the impropriety must be linked to the use of the company structure to avoid or conceal liability;<sup>428</sup>
- v) both impropriety and control are necessary, with the motive for perpetrating the impropriety being highly relevant; and
- vi) whether or not the company was incorporated with the impropriety in mind is irrelevant and courts will only pierce to the extent necessary to provide appropriate relief. It will not apply piercing to declare a company non-existent for all extents and purposes.

These six principles serve as an appropriate basis for a discussion of the current state of UK law concerning piercing.

This list accords with the conclusions drawn thus far in this dissertation. As a starting point, for piercing to apply it requires consideration of both a question of fact<sup>429</sup>

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opposed to minorities). The court did not consider whether the piercing doctrine can also be applied against minority shareholders only. It is my view that *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) should not be interpreted as authority for the view that the piercing doctrine cannot be applied against minority shareholders. See the discussion in the text to ch 3 part 3 3 2 3 above as to why minority shareholders should also be capable of having the piercing doctrine applied against them, even where the remedy is not applied against majority shareholders. Also see *Adams v Cape Industries plc* 1991 1 All ER 929 1026 in relation to piercing in the context of company groups.

<sup>426</sup> *Adams v Cape Industries plc* 1991 1 All ER 929 1019; N Grier *UK Company Law* (1998) 28.

<sup>427</sup> This with reference to the court’s comments in *Ord v Belhaven Pubs Ltd* [1998] 2 BCLC 447 457 and of *Salomon’s* judgment. See also Grier *UK Company Law* 28. The requirement of impropriety was thus expressly recognised as a piercing requirement in the UK too, as was the case in South Africa in *Cape Pacific* a few years earlier. See also the definition of “impropriety” in Davies & Worthington *Gower and Davies’ Principles of Modern Company Law* 222.

<sup>428</sup> Refer Lord Sumption’s distinction in *Prest* between the concealment and evasion principles. His views there are that only the latter presents a true example where piercing would be appropriate.

<sup>429</sup> See the proposed South African approach in the text to ch 3 part 5 2 below.

and a question of law.<sup>430</sup> Furthermore, control of the company by the wrongdoer<sup>431</sup> and impropriety intentionally aimed at the misuse of the corporate veil must exist. Only where all elements are present can there be said to be misuse<sup>432</sup> to the extent that the corporate veil should be pierced.

These principles also confirm that the courts in the UK too will not be prepared to apply piercing merely when a company is found to be the *alter ego* of a shareholder on an objective basis. A further subjective enquiry is required.<sup>433</sup> Where the *alter ego* doctrine can thus be invoked even in the absence of a deceptive motive or deceptive intent, a company used “to avoid or conceal liability” may not be pierced without these subjective factors also being present. Thus, the piercing doctrine in the UK, as is the case in South Africa, goes further than the *alter ego* doctrine.

Lord Sumption aptly summarised in *Prest* that piercing may be applied “when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control”.<sup>434</sup>

It is important to note that *Prest*, unlike the South African *Cape Pacific*, does not expressly require the consideration of public policy to decide if piercing will be appropriate.<sup>435</sup> This does not mean that policy considerations are not a part of the piercing test under UK law as described by the Supreme Court in *Prest*. In the words of Lord Sumption: “The difficulty is to identify what is a relevant wrongdoing.”<sup>436</sup>

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<sup>430</sup> See the proposed South African approach in the text to ch 3 part 5 1 below.

<sup>431</sup> In my view this means that a shareholder rather than a director of the company must exercise the impropriety. It also implies that this does not require majority shareholder control.

<sup>432</sup> *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 128.

<sup>433</sup> Also see *Mubarak v Mubarak* [2000] EWHC 466 (Fam) (23 October 2000) 36, approved in *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 206. The latter judgment held that even where a company is the *alter ego* of its shareholder, all the requirements for piercing would still not have been met.

<sup>434</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 35.

<sup>435</sup> Save to state at paragraph 35 that where it is not necessary to pierce, there is no public policy requirement that would justify such a course of action. Cheng (2011) *BC Int'l & Comp L Rev* 350 *et seq* notes the unwillingness of UK courts (pre-*VTB* and *Prest*) to take policy considerations into account in considering whether to pierce or not.

<sup>436</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 28.

Policy considerations are incorporated in the UK piercing doctrine through Lord Sumption's distinction between the "concealment principle" and the "evasion principle", with only the latter justifying a court to pierce.<sup>437</sup> In essence the evasion principle, although intertwined with the concealment principle, involves a person's deliberate use of the company form to evade obligations or frustrate the exercise of rights against him. Conversely, the concealment principle involves using the corporate form to conceal the true facts pertinent to the position of the shareholder.<sup>438</sup> The question therefore turns on whether, if the concealment achieved by using a company has been laid bare, the use of the company would still have the effect of frustrating or evading the exercise of rights by another, which would not have been possible had the company not been used.

Returning for a moment to the South African context, it appears to have been this distinction that Scott JA tried to make in *Hülse-Reutter*. In that case the SCA refused to pierce the corporate veil, ostensibly as the company was not interposed to evade any obligations although it may have been used to conceal the identity of the

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<sup>437</sup> Para 28:

"The concealment principle is legally banal and does not involve piercing the corporate veil at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant. In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing. The evasion principle is different. It is that the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement. Many cases will fall into both categories, but in some circumstances the difference between them may be critical."

See also the judgment of Lord Neuberger *Prest v Petrodel Resources Ltd* 2013 UKSC 34 paras 61, 71 and 73 where he agrees with Lord Sumption on the distinction between the concealment principle and the evasion principle and that only the latter presents an appropriate basis on which to pierce. He goes on to mention that he does not consider the cases of *Jones v Lipman* [1962] 1 All ER 442 and *Gifford Motor Co Ltd v Horne* 1933 Ch 935 (CA) to have involved the evasion principle and to have presented true examples of piercing.

<sup>438</sup> In the South African context *Dadoo's* case is an excellent example of the concealment principle, and also one in which the AD did not find sufficient basis on which to pierce.

shareholders behind it.<sup>439</sup> Yet, although the shareholders behind the company were unknown to the appellants in *Hülse-Reutter*, there was no misuse of the corporate veil to the detriment of the appellants. To put it differently: there was no evasion or frustration of a legitimate claim which the appellants would otherwise have had against the shareholders. As Lord Sumption put it in *Prest*:

“It may be an abuse of the corporate legal personality of a company to use it to evade the law or to frustrate its enforcement. It is not an abuse to cause legal liability to be incurred by the company in the first place.”<sup>440</sup>

Where the company is used to the disadvantage of another by evading or frustrating an otherwise legitimate exercise of a right rather than for purposes of concealment, such use of the company will be considered improper, regardless of policy considerations.

It is suggested that by applying the evasion principle in *Prest*, UK law does make provision for policy considerations to be taken into account. It would seem that policy considerations in the UK are dealt with in a more indirect way. Where the evasion principle applies, considerations would be weighted sufficiently in favour of piercing.

In the context of impermissible tax avoidance the evasion principle would clearly find application.<sup>441</sup> It should also pass the test for improper conduct in *Cape Pacific*, even after taking policy considerations into account.<sup>442</sup>

## 4 2 Australia

Australian influence on the South African approach to piercing has been much less noticeable than the British impact. The High Court of Australia has not considered piercing in such detail as the UK Supreme Court has.<sup>443</sup> The limited weight that recent

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<sup>439</sup> *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 21.

<sup>440</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 para 34.

<sup>441</sup> See the text to ch 3 part 5 1 1 below for an interpretation of what “evasion” would entail. Also see Van Zyl *The Corporate Veil in Tax Law* 57.

<sup>442</sup> See the text to ch 3 parts 5 1 2 and 5 3 below.

<sup>443</sup> See the discussion in ch 3 part 4 1 above.

piercing judgments, both in the UK Supreme Court in *VTB* and *Prest*, and in the South African High Court in *Ex Parte Gore*, attached to Australian case law supports this.<sup>444</sup>

In Australia too various bases have been identified as appropriate to pierce the corporate veil.<sup>445</sup> As has been suggested in part 2 4 of this chapter above, it would however be inaccurate to group all these bases under the piercing doctrine.

What is significant is that, as in the UK, there is authority in Australia for the application of the “evasion principle” as justification for piercing to apply where the corporate veil has been used to evade legal obligations.<sup>446</sup> Although no judgments were found where the piercing doctrine was considered in the context of tax avoidance, the minority judgment of Windeyer J in *Gorton v Federal Commissioner of Taxation*<sup>447</sup> should be noted. Here the court expressed its frustration on how formalism linked to separate corporate personality can be employed successfully to construct schemes aimed at reducing a person’s liability for tax. The court would no doubt, and in my view correctly so, have been willing to pierce the corporate veil under the common law in this instance had it been asked to do so.

#### 4 3 United States of America

The courts in *Ex Parte Gore*, *VTB* and *Prest* took even less account of the American position on piercing.

In *Prest* the UK Supreme Court noted that the piercing doctrine in the USA is far more developed than in the UK. This may also be a reference to the fact that the case law in the USA, due to its federal system, has led to an irreconcilable divergence of approaches to the doctrine.<sup>448</sup>

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<sup>444</sup> Australian authority is also absent from the judgments in *Cape Pacific* and *Hülse-Reutter*.

<sup>445</sup> *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* 1986 11 ACLR 108 264; Ramsay & Noakes (2001) *Company and Securities Law Journal* 8 *et seq.*

<sup>446</sup> *Pioneer Concrete Services Ltd v Yelnah Pty Ltd & Ors* 1986 11 ACLR 108 267.

<sup>447</sup> [1965] HCA 1 para 7 of Windeyer J’s judgment.

<sup>448</sup> See Anderson (2009) *Melb UL Rev* 360; also the comments of PI Blumberg “The Transformation of Modern Corporate Law: The Law of Corporate Groups” (2005) 37 *Connecticut Law Review* 605 612, together with the *dictum* quoted from *Secon Service System Inc v St Joseph Bank & Trust Co*, 855 F 2d 406 414 (7th Cir, 1988); Cheng (2011) *BC Int’l & Comp L Rev* 353 *et seq.*

In the USA, more so than in other jurisdictions, it is impossible to identify a consistently applied approach. The piercing doctrine continues to be mired in controversy. Nevertheless, it can be said that most states in the USA have adopted a two-prong test to piercing.<sup>449</sup> Firstly, a confusion of the distinction between shareholder and company, akin in more than one way to the *alter ego* doctrine, is required. This leads to a more conservative approach than the South African one, although it is by no means settled to what extent shareholder domination should be proven.<sup>450</sup> Secondly, the test involves conduct that results in fraud, wrong or an injustice being committed. In this sense the USA's application of the doctrine is much more liberal than in South Africa.

In respect of the second prong of the test Anderson refers to the "laundry list" approach used in the USA. Several grounds are identified whereupon a court would be justified to pierce the corporate veil. These include instances of fraud and misrepresentation, agency, an objective lack of separation between the company and its shareholders and an undercapitalisation of the company.<sup>451</sup> The American courts have also been willing to pierce to remedy instances of impermissible tax avoidance.<sup>452</sup>

The list suggests an approach not necessarily unique to the USA, but rather one that is consistent with that adopted previously in South Africa and in the UK.<sup>453</sup> These instances do not all involve piercing *per se*. Rather, it very often amounts to separate doctrines which have the same effect as piercing, being applied, although with different prerequisites for each. As such, the USA provides very few examples of "pure" piercing which would be of any significant assistance.

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<sup>449</sup> TK Cheng "Form and substance of the doctrine of piercing the corporate veil" (2010) 80 *Mississippi Law Journal* 497-585 503 *et seq*; NB Allen "Reverse piercing of the corporate veil: a straightforward path to justice" (2011) 85 *St. John's Law Review* 1147 1150 *et seq*.

<sup>450</sup> Allen (2011) *St. John's Law Review* 1151 *et seq*.

<sup>451</sup> See also Benade (1967) *THRHR* 228 *et seq*.

<sup>452</sup> K Vandekerckhove *Piercing the Corporate Veil: A Transitional Approach*, Doctor in de Rechten, Katholieke Universiteit Leuven 438.

<sup>453</sup> *Pre-VTB and Prest*; see for example *O'Donnell v Weintraub* 67 Cal Rptr 274 277 *et seq*.

The USA's approach to piercing is a far more liberal one than the South African one. Piercing will be applied more easily, because it may be invoked if justice<sup>454</sup> or even equity<sup>455</sup> so requires. This approach has been explicitly ruled out as basis for piercing in both South Africa<sup>456</sup> and the UK.<sup>457</sup>

#### 4 4 Canada

The position under Canadian law requires a brief mention due to the relatively recent cases of *Prévost*<sup>458</sup> and *Velcro*,<sup>459</sup> even though no other significant recent developments in the Canadian piercing doctrine could be found.<sup>460</sup>

*Prévost* and *Velcro* both expressly refer to the piercing doctrine, but this is limited to the context of “beneficial ownership” as used in DTAs. This is not really relevant to this dissertation which is concerned only with the application of the piercing doctrine for tax purposes through legislative instruments of general application (being the GAARs in the Income Tax Act and section 20(9) of the Companies Act) and the

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<sup>454</sup> Most notably confirmed in *In re Elegant Homes*. See also Benade (1967) *THRHR* 229; *United States v Milwaukee Refrigerator Transit Company*; *Nassau County v Richard Dattner Architect PC* (2011) NY Slip Op 31537 (U); *O'Donnell v Weintraub* 67 Cal Rptr 4; see also discussion by Cheng (2010) *Mississippi Law Journal* 508 *et seq.*

<sup>455</sup> *Roepke et al v Western National Mutual Insurance Company* 302 NW 2d 350 (1981).

<sup>456</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552.

<sup>457</sup> *Adams, Trustor AB v Smallbone (No 2)* [2001] 1 WLR 1177, *Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) and *Prest v Petrodel Resources Ltd* 2013 UKSC 34.

<sup>458</sup> The judgment *a quo* by Rip ACJ in *Prévost Car Inc v The Queen*, (2008) TCC 231 is of particular importance, although the judgment on appeal in *Her Majesty the Queen v Prévost Car Inc*. (2009) FCA 57 is also significant.

<sup>459</sup> *Velcro Canada Inc v HM the Queen* (2012) TCC 57.

<sup>460</sup> A further recent judgment is that of the Nova Scotia Court of Appeal in *White v E.B.F. Manufacturing Ltd* 2005 NSCA 167, but which does not introduce any new developments. It does however appear to confirm the attitude also taken in the USA that piercing may be applied in the interests of justice (a position first established in *Kosmopoulos v Constitution Insurance Co.* [1987] 1 SCR 2, although subject to later criticism – TG Heintzman & B Kain “Through the looking glass: Developments in Piercing the Corporate Veil” (2013) 28 *Banking and Finance Law Review* 541).

common law. It is in any case questionable whether these two cases involve true examples of piercing.<sup>461</sup>

## 5 The developed doctrine as applied for income tax purposes

For the reasons set out in part 3 3 2 1 of this chapter above,<sup>462</sup> using the separate legal personality of a company to ensure a reduction of taxes payable<sup>463</sup> will indeed amount to a misuse of legal personality by a shareholder if the purpose for which the corporate veil is used is mainly to achieve such a reduction in tax costs. It follows that the perceived right of taxpayers to arrange their affairs in the most tax beneficial manner possible is not always unlimited:

“Within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If eg the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax. But, when it comes to considering whether by doing so he has succeeded in avoiding or reducing the tax, the court will give effect to the true nature and substance of the transaction and will not be deceived by its form.”<sup>464</sup>

The same “choice principle” should apply where a taxpayer uses the corporate form predominantly to avoid tax.

In such instances corporate personality is not used to advance commerce, the purpose which it was designed to achieve,<sup>465</sup> but rather to frustrate the goals which the legislature seeks to promote through the levying of taxes.<sup>466</sup> South African courts

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<sup>461</sup> S Jain *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases* (2013) 149.

<sup>462</sup> Expanded on in the text to ch 3 part 5 1 below.

<sup>463</sup> In other words, the amount of tax due by the shareholder had no company been part of the structure/transaction compared to the amount of tax due by the shareholder and his/her company had a company been used.

<sup>464</sup> *CIR v Conhage (Proprietary) Limited* [1999] 61 SATC 391 1.

<sup>465</sup> See the text to ch 2 part 2 above.

<sup>466</sup> See the text to ch 2 part 2 1 above for the development of the company form. Its existence as a statutorily created creature is bound to the purpose of the Companies Act being. Also see the text to ch 3 part 4 1 above for a discussion of the UK “concealment principle” and how this could find application in a South African tax context.

should under these circumstances have regard to the substance of the transaction and treat the company and shareholder as if they were one. The substance over form and sham doctrines<sup>467</sup> cannot adequately address this. The piercing doctrine is best placed to deal with such a scenario against the background of the *dictum* that a person may arrange his affairs to his own advantage.

A taxpayer may arrange his own affairs to minimise his tax liability.<sup>468</sup> If a company is however used for fraud, dishonesty or improper conduct, the company's separate legal personality is being abused. A court may then pierce the corporate veil of the company, taking policy considerations into account. It is argued below that where a person involves another party, specifically a company, and there is little or no commercial purpose in the company's involvement but taxation is avoided, and it is the purpose of the person to avoid tax by involving the company, the corporate veil should be pierced.

This is not to say that tax avoidance *per se* is improper.<sup>469</sup> However, the use of corporate personality primarily for tax purposes is.<sup>470</sup> This is the case not only because the separate corporate identity of a company was not conceived by Parliament to serve such a purpose,<sup>471</sup> but also as this is obviously more than a mere conversion of a transaction into a tax efficient scheme. Where legal persons are involved predominantly for tax purposes, such transactions or structures are clearly engineered

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<sup>467</sup> See the text to ch 2 parts 4 2 1 and 4 2 2 above.

<sup>468</sup> *CIR v Conhage (Proprietary) Limited* [1999] 61 SATC 391 1. A similar right exists for taxpayers in Australia, the USA and the UK (BT Kujinga "Factors that limit the efficacy of GAARs in income tax legislation: lessons from South Africa, Australia, and Canada" (2014) 47 *CILSA* 429 440). See also J Cassidy "The holy grail: the search for the optimal GAAR" (2009) 128 *SALJ* 740 744 *et seq.*

<sup>469</sup> *Commissioner for the South African Revenue Service v Bosch* 2015 2 SA 174 (SCA) para 40.

<sup>470</sup> See the text to ch 3 part 3 3 2 4 above.

<sup>471</sup> See the text to ch 2 part 2 1 above. No evidence could be found to suggest that the company form was ever conceived in either South Africa or elsewhere to be primarily used to accommodate taxpayers.

for purposes which should not be recognised in law.<sup>472</sup> Cameron JA accurately summarised the position in *Ebrahim*:<sup>473</sup>

“[T]heir separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted.”<sup>474</sup> [own emphasis]

And Binns-Ward J in *Ex Parte Gore*:

“Juristic personality is a legal fiction (or a ‘figment of law’ as it has on occasion been referred to) and thus, when the circumstances of a particular case make it appropriate to do so – inevitably in matters in which the concept has been used improperly, in a manner inconsistent with the rationale for the creation and maintenance of the legal fiction [by Parliament] – courts will disregard it.”<sup>475</sup> [own emphasis]

As will have appeared from the analysis of *Cape Pacific*,<sup>476</sup> piercing for income tax purposes can be divided into a question of law and a question of fact.

The legal question entails that a court should satisfy itself that the corporate veil is being used for improper purposes and that policy considerations in favour of piercing outweigh those opposed to piercing. Once this question of law has been answered, the court must decide, based on the facts, whether ownership-control existed through which the owner in a shareholder capacity is capable of using the corporate veil and did so predominantly for the stated improper purpose.

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<sup>472</sup> See the text to n 248 above for the examples discussed in *ITC 1606*, *ITC 1611* and *Erf 3183/1 Ladysmith*, as well as the cases of *Bailey* and unreported cases 9592 and 9593. Of specific note is Gower’s comment quoted with approval in the *a quo* judgment of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 715, that “... they (the cases) reveal no consistent principle beyond a refusal by the Legislature and the judiciary to apply the logic of the principle laid down in Salomon’s case where it is too flagrantly opposed to justice, convenience or the interests of the revenue.” [own emphasis]. Cf *Van Heerden v The State* [2010] 73 SATC 7 44. In *Botha v Van Niekerk* 1983 4 All SA 157 (W) 164 the court also acknowledged that the corporate veil could be misused for tax purposes. See also *Briggs v James Hardie & Co (Pty) Ltd* (1998) 15 NSWLR 549 579.

<sup>473</sup> Also see *Larkin* (1989) SA Merc LJ 295.

<sup>474</sup> *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 16.

<sup>475</sup> Para 4.

<sup>476</sup> See the text to ch 3 part 3 3 2 above.

5 1 A question of law

5 1 1 “Improper conduct” in a tax avoidance context

Wessels JA said in *Ochberg* that the misuse of the corporate veil for tax purposes is by no means a new problem:

“We know from our experience in the Law Courts that juggling with shares of a private company is a favourite method adopted by certain persons who control such companies in order to seek to evade the income tax laws, and therefore the Courts must be careful to ... insist on the principle that the individual who controls the private company is not to be regarded as if he were the company.”<sup>477</sup>

It remains to be considered whether “improper conduct” could include instances when tax is intentionally avoided. Although the question was not directly answered by Zulman J in the unreported 1993 Transvaal Income Tax Special Court cases, 9592 and 9593, it is clear that he considered that piercing could be applied specifically in the tax context, even where fraud and dishonesty were absent:

“... [I]n appropriate circumstances, namely circumstances which dictate the arriving at the reality of the transaction and despite what is stated in the well-known case of *Dadoo v Krugersdorp Municipality* 1920 AD 530 there may well be situations, even where fraud or dishonesty are absent, where it is proper and permissible to pierce the corporate veil.”<sup>478</sup>

There are numerous other examples where our courts and academic writers have in the past concluded that piercing may be justifiable in principle where tax related purposes as primary motivation were present. And there seem to be no examples where the opposite was argued.<sup>479</sup>

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<sup>477</sup> *Ochberg v CIR* 1931 AD 215 238.

<sup>478</sup> It is interesting to note that this judgment, concluding that fraud and dishonesty may not be the only appropriate criteria in terms of which piercing would be justified, predates the two SCA judgments where “improper conduct” was for the first time recognised as an alternative basis upon which the courts could pierce.

<sup>479</sup> See the text to n 248 above.

From the *Cape Pacific* judgment it is evident that “improper conduct” is linked to the evasion of legal obligations:

“The transfer was ... at the very least ... carried out with an improper purpose – the evasion of legal obligations – in mind.”<sup>480</sup>

In the tax context it is therefore necessary to consider when an evasion of legal obligations (or another action driven by an “improper purpose”) is taking place, as this would amount to “improper conduct” as envisaged by the court in *Cape Pacific*.

When investigating whether an “evasion of legal obligations” is taking place for tax purposes, one should not confuse it with illegal tax evasion, as “evasion” as referred to in *Cape Pacific* is not within the tax context, but is rather used in a general sense. “Evasion” as used in *Cape Pacific* is within the context of a non-tax related sense. Therefore “evade” as per Smalberger JA should be understood within its ordinary meaning as synonymous with “avoid”<sup>481</sup> and should not be associated with “tax evasion” as opposed to “tax avoidance”.<sup>482</sup>

In this regard “evasion” in the context of *Cape Pacific* should be considered to include the act whereby one would “escape or avoid ... something especially by guile or trickery”, including to “act contrary to the intention of a law ..., especially while complying with its letter”;<sup>483</sup> “to get away from or avoid, especially by deception”.<sup>484</sup> This accords with the judgment in *Bark* where the court found that it was “entitled to

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<sup>480</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 554.

<sup>481</sup> Hawker & Waite *Concise Oxford Thesaurus*.

<sup>482</sup> Cf Wessels JA in *Ochberg v CIR* 1931 AD 215 238. See also *VTB Capital and Prest*. The difference between “tax evasion” and “tax avoidance” is controversial. “Tax evasion” and “tax avoidance” both involve taxpayers attempting to limit their tax exposure. The former seeks to achieve such a lesser tax burden by way of unlawful means typically associated with fraudulent or dishonest behaviour, whereas “tax avoidance” involves an attempt to limit exposure to tax by way of honest means. See AP de Koker & RC Williams *Silke on South African Income Tax* (2011) ch 25.1C [e-book]; SARS. 13 December 2010. *Draft Comprehensive Guide to the General Anti-Avoidance Rule at 2 et seq.*

<sup>483</sup> C Soanes & A Stevenson (eds) *Oxford Dictionary of English* (2005).

<sup>484</sup> W Allen (ed) *The Penguin Reference Dictionary* (1985).

peer behind the facade of a fictitious separate legal persona” where *dolus*<sup>485</sup> (in this context not dissimilar to “improper conduct” as used in *Cape Pacific*) was present on the part of the defendant. A similar principle should apply to statutory obligations. Taxpayers may choose the most tax efficient method available to them by choosing to adopt the best alternative structure by which to achieve a desired commercial outcome. However, if a company is used to evade (within the meaning discussed above) a legitimate and statutorily imposed tax obligation that would otherwise have arisen, the conduct is, on the strength of *Cape Pacific*, clearly improper. For example, if a further party (a company) is unnecessarily involved in a transaction to serve mainly as a conduit and purely to escape or evade a legitimate tax liability, its use would be improper.<sup>486</sup> In such a case the taxpayer goes beyond deciding on the most beneficial transactional structure to use.

Where a company is used primarily for tax purposes rather than for other commercial purposes, the company is being utilised for something for which it was not intended.<sup>487</sup> This would therefore amount to a misuse of corporate personality.<sup>488+489</sup>

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<sup>485</sup> *Dolus* in a wide sense, being “a deliberate intention to defeat the fulfilment of the condition when having regard to the nature of the contract it was his duty moral or legal to assist or not to obstruct its fulfilment” (*Koenig v Johnson and Co. Ltd.* 1935 AD 262).

<sup>486</sup> See *Furniss v Dawson* [1984] STC 153 (HL) for a comparable approach adopted by the UK courts. Derksen (1990) SALJ 431 aptly describes the “problem of avoidance” as one that often involves tax planning through ensuring that facts exist and are manufactured so that the transaction may fall within the ambit of specific wording in the relevant statute, while “community opinion” would dictate that it should not. The relevance of using “community opinion” as a yardstick against which to measure “improper conduct” as contemplated in *Cape Pacific*, is at issue here. As Derksen (1990) SALJ 432 points out, “the law should satisfy the requirements of the community opinion”. The UK’s “concealment principle” should find application too: see the text to ch 3 part 4 1 above.

<sup>487</sup> See Lewis & Malcolm “Notion of ‘piercing the corporate veil’ extended” (31-03-2013) *TaxManSA.co.za* <http://taxmansa.co.za/notion-piercing-corporate-veil-extended/> (accessed 12-07-2013). One should be careful not to confuse the piercing doctrine with the simulation or sham doctrine (see the text to ch 2 part 4 2 2 above).

<sup>488</sup> See the text to ch 3 part 3 3 2 3 above.

<sup>489</sup> It is interesting to note that the argument advanced here appears to be contradicted by the judgment in *Dadoo’s* case. That case, however, not only did not consider the piercing doctrine but was also decided with significant reliance on a literal statutory interpretative approach (542 *et seq*). Had the approach in that judgment corresponded with the approach which is

The SCA has in the past given clear guidance on the requirement that a transaction should have a clear commercial purpose for its tax consequences to be recognised.<sup>490</sup> Even though this guidance was given in the context of the simulation doctrine, it also holds true for the piercing doctrine. Conceptually there is very little difference between a transaction being entered into with no or little commercial purpose and a company being used in the same way. Even though the rights and obligations created by virtue of a company's separate legal existence would ordinarily be considered of greater legal substance than those created by commercial agreements, any reason to continue to treat the company with greater circumspection in a particular case falls away once it has been ascertained that that company serves no commercial purpose other than to avoid tax being levied.

Using a company for unintended purposes would not necessarily be enough to amount to a misuse of corporate personality, but where those unintended purposes take the form of fraud, dishonesty or improper conduct, a misuse of corporate personality as contemplated in *Cape Pacific* occurs. This dissertation argues that such a misuse will take place when the corporate veil is used primarily for tax related reasons.

There is some force in the argument that piercing can only be applied to existing legal obligations, liabilities or restrictions and by implication not to future potential obligations or liabilities.<sup>491</sup> This poses a challenge to the application of the piercing doctrine in a tax context where the existing structure through which a taxpayer conducts business has not yet given rise to an existing tax liability, but only to an expected future liability based on prevailing fiscal legislation. In other words, when it cannot be said that an existing legal liability is being avoided by incorporating a business today to avoid an anticipated future tax liability.

Where courts have considered the issue,<sup>492</sup> their remarks should not be considered out of context. Till now these involve only contractual obligations and liabilities that

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nowadays adopted in South African law (see the text to ch 4 part 2 1 below), it is doubtful whether the AD would have arrived at the same conclusion that it had in 1920.

<sup>490</sup> See *Roshcon (Pty) Ltd v Anchor Auto Body Builders* CC 2014 4 SA 319 (SCA) and the cases referred to at para 33 and 37.

<sup>491</sup> See *Prest v Petrodel Resources Ltd* 2013 UKSC 34 and 35; *Adams v Cape Industries plc* 1991 1 All ER 929 1026.

<sup>492</sup> 1026.

arise under private law as opposed to tax liabilities that arise under legislation. There is in my view though, no reason why the private law principle should not be extended to the law of taxation.

The law of taxation imposes obligations arising out of statute (and not *ex contractu*) and within an enabling legislative framework, which regulates when and how these obligations arise. Therefore, anticipating such a statutory obligation and getting around it through use of the corporate veil amounts to an evasion of the imposition of such a tax liability. Circumventing a future tax liability amounts to the avoidance of an existing statutorily imposed obligation in exactly the same manner as a party to an agreement may avoid certain obligations from arising. There is no reason in principle why a private law obligation being avoided should be treated any differently for the purposes of the piercing doctrine than a tax liability being avoided.

It is true, both in South Africa and in the UK, that “[i]t may be an abuse of the corporate legal personality of a company to use it to evade the law or to frustrate its enforcement. It is not an abuse to cause legal liability to be incurred by the company in the first place.”<sup>493</sup> Nevertheless, what may be unique when this *dictum* is applied to the law of taxation and not to the law of contract or delict, is that causing a tax liability to be incurred by the company in the first place may very well be a good example where legal personality is used intentionally to evade prevailing tax laws imposing an existing obligation. In the law of taxation separate personality is often used to escape an anticipated tax liability for a shareholder. This should not be countenanced. The law condones an escape from liabilities in the private law context as the company was designed for these purposes in order to encourage commercial activity, but on condition that the liability arise in the company. The law of taxation should be no different. There is no reason to suggest that the company may be used as tax mitigation tool and to escape existing taxing statutes.<sup>494</sup>

Having established that piercing for tax purposes extends to the avoidance of anticipated tax liabilities, the *dictum* in *CIR v Conhage (Proprietary) Limited* (“*Conhage*”) cited above<sup>495</sup> still allows for affairs to be arranged within the confines of

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<sup>493</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34.

<sup>494</sup> See the text to ch 3 part 5 1 2 below; see also the text to n 471 above.

<sup>495</sup> See the text to n 464 and 474 above.

the law. It is submitted that the situation where the company form created by the legislature is used for no purpose other than to defeat the levying of tax that the very same legislature seeks to impose,<sup>496</sup> falls outside the confines of what can reasonably be regarded as legitimately arranging one's affairs. This is not only true on a "transaction-to-transaction" basis, but logically extends to where a company is artificially introduced into a structure to make the structure itself more tax efficient in future, for example to alter the tax consequences linked to the future flow of dividends through the structure.<sup>497</sup> If the company from its shareholders' perspective serves no "real world"<sup>498</sup> purpose, its existence should not be recognised to serve the tax purposes which its owners primarily wanted to achieve.

The conclusion is that a taxpayer engages in "improper conduct" as contemplated in *Cape Pacific* if he or she uses a company to enter into a transaction or set up or alter a structure in order to avoid or escape paying tax in a manner that is contrary to

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<sup>496</sup> *Digesta* 1 3 29: "Contra legem facit qui id facit quod lex prohibet; in fraudem vero qui salvis legis verbis, sententiam ejus circumvenit." (A person does something that is contrary to the law if he does that which the law prohibits. Nonetheless he does it fraudulently if he, within the wording of the law, circumvents the purpose of the law.)

<sup>497</sup> It appears that the UK would certainly see tax reasons as primary purpose for the use of the corporate veil as passing the threshold test for piercing and consider it improper at the very least. In the judgment in *UBS AG* the court referred with approval to the following judgments whilst commenting as follows:

"First, 'tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, "in the real world". Secondly, tax avoidance schemes commonly include 'elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge'. In other words, as Carnwath LJ said in the Court of Appeal in *Barclays Mercantile*, [2002] EWCA Civ 1853; [2003] STC 66, para 66, taxing statutes generally 'draw their life-blood from real world transactions with real world economic effects'. Where an enactment is of that character, and a transaction, or an element of a composite transaction, has no purpose other than tax avoidance, it can usually be said, as Carnwath LJ stated, that 'to allow tax treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic.'"

In this context, see also the comments by Strydom & Du Plessis (1997) *TSAR* 403 that piercing should not be applied to *bona fide* business transactions.

<sup>498</sup> 403.

the intention of the provisions of the Income Tax Act.<sup>499</sup> Wide-spread tax planning should not obfuscate the rationale for corporate personality and detract from the principles of the piercing doctrine.

It has already been said that a court's power to pierce the corporate veil in a particular instance largely depends on the analysis of the specific facts at hand, considered on a case-by-case basis.<sup>500</sup> The key question is: When will fraud, dishonesty or improper conduct be fraudulent, dishonest or improper enough, where other non-tax considerations are also present, to abuse the corporate veil?

As will be discussed in chapter 5, the GAARs in the Income Tax Act require as one of their criteria that at least the main purpose of the transaction (or "arrangement") in question must be to achieve the sought-after tax benefit in order for them to be applicable. Given the exceptionality of the piercing doctrine,<sup>501</sup> our courts should adopt a similar approach, viz that piercing should only be applied where tax was the primary reason for employing the corporate veil.

A company may of course be used simultaneously for more than one purpose. If it is accepted that the use of a company mainly for tax purposes is improper, the principle-based approach should logically apply as long as the tax purpose outweighs the other legitimate purposes for which the company may be used. In other words,

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<sup>499</sup> In this regard one must distinguish between provisions of the Income Tax Act introduced to encourage certain taxpayer behaviour (e.g. the "small business corporation" provisions in s 12E), and using the group relief rules in s 42 to interpose a company at no tax cost between an individual and his/her listed share portfolio solely to avoid the imposition of dividends tax.

<sup>500</sup> Cilliers & Luiz (1996) *THRHR* 523.

<sup>501</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) 163: "Dít bevestig op sy beurt dat daar geen vrye rigtinglose of willekeurige diskresie bestaan vir 'n Hof om inkorporasie te negeer nie."; *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553: "It is undoubtedly a salutary principle that our courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it."; *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 20: "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." Cf *Adams v Cape Industries plc* 1991 1 All ER 929 1020; Gower, as quoted in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 714. Cilliers & Luiz (1996) *THRHR* 527.

whether the company is used solely or mainly for tax purposes is unimportant: it remains improper in terms of the common law.<sup>502</sup>

Although the doctrine admittedly presents a drastic remedy, it is suggested that it should only be applied when an equally drastic misuse has occurred. Once the hurdle has been crossed by proving an action improper enough to warrant piercing, there is no reason why a stricter or less strict test than the “main purpose” test should be applied to such an arrangement.<sup>503</sup>

### 5 1 2 Policy considerations in the tax avoidance context

The evolving nature of policy considerations<sup>504</sup> (and by implication reasonableness, “*boni mores*” and “public policy”) means that this aspect becomes ever more complicated where income tax issues are concerned. This is valid in particular for South Africa, which has one of the highest Gini coefficients internationally and where the equal redistribution of wealth through a progressive tax system is used to address these socio-economic concerns.<sup>505</sup> The collection of taxes is important to serve the public interest.<sup>506</sup> It is within this context that a weighing up of competing policy considerations pertaining to piercing should occur. It is submitted that in South Africa,<sup>507</sup> as in many other countries,<sup>508</sup> there has been a definite shift in policy over

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<sup>502</sup> This is recognised in the international tax context too: see the OECD report *Double taxation conventions and the use of conduit companies R(6)* where the use of companies mainly for tax purposes is labelled as being “improper”. I cannot see any reason why this description would be inappropriate in the domestic tax context.

<sup>503</sup> As is discussed in ch 5 below, the same statutory bar is prescribed by the legislature for the application of the GAARs in the Income Tax Act.

<sup>504</sup> Discussed in the text to ch 3 part 3 3 2 2 above.

<sup>505</sup> SAPA “World Bank: SA must fight inequality” (24-07-2012) *iol Business Report* <<http://www.iol.co.za/business/business-news/world-bank-sa-must-fight-inequality1.1348058>> (accessed 6-03-2013).

<sup>506</sup> *Metcash Trading Ltd v CSARS* 2001 1 SA 1109 (CC); *Pienaar Bothers (Pty) Ltd v CSARS* HC case no 87760/2014 of 29-05-2014 para 36; *South African Reserve Bank v Shuttleworth* 2015 5 SA 146 (CC) para 87.

<sup>507</sup> The public outcry over the tax avoidance structures of multi-national groups such as SABMiller and Lonmin is but one of a few examples.

<sup>508</sup> The examples in the text to n 511 below and the publications in Platform *Making a killing: Oil companies, tax avoidance and subsidies* (2013) and Actoinaid (also February 2013) *Sweet*

the past few years that could well see corporate structures being regarded with increasing suspicion, especially in the area of taxation. The effect of the shift to general voting rights should also not be disregarded as the majority of South Africans who now elect the government would probably prefer our courts to adopt a pro-*fiscus* approach. “Public policy considerations” must therefore necessarily form a big part of “policy considerations” as such.<sup>509</sup>

Although the considerations opposed to piercing the veil are as relevant today as in the past, there is undoubtedly a growing realisation that the policy considerations favouring piercing where tax is concerned, have started to weigh significantly more in recent years.<sup>510</sup> In the international tax context public policy has caused a shift in sympathy from the taxpayer to revenue services the world over.<sup>511</sup> South Africa will no doubt follow this trend if one has regard to the economic inequalities and the role of tax collection in the redistribution of wealth. The gradual change in the interpretation of fiscal statutes demonstrates this. This allows the courts to adopt a more lenient

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*nothings – the human cost of a British sugar giant avoiding taxes in southern Africa* are illustrative of this. See also the findings of an Oxfam report: OXFAM “Tax on the “private” billions now stashed away in havens enough to end extreme world poverty twice over” (22-05-2013) OXFAM <<http://www.oxfam.org/en/eu/pressroom/pressrelease/2013-05-22/tax-havens-private-billions-could-end-extreme-poverty-twice-over>> (accessed 05-06-2013).

<sup>509</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 117. Also see J Maughan “The uses of morality in tax” (18-12-2014) *Tax Journal* <<http://www.taxjournal.com/tj/articles/uses-morality-tax-17122014>> (accessed 18-12-2014). Also the Canadian Supreme Court judgment in *Gustavson Drilling (1964) Ltd v M.N.R.* [1977] 1 SCR 271 at 283: “... [I]n tax law it is imperative that legislation conform to changing social needs and government policy”. While it is noted that in the UK judgment in *VTB Capital plc v Nutritek International Corp* 2013 UKSC 5 124 quoted above, it is cautioned that “moral indignation” should not be used to trump established legal principle, it is submitted, on the strength of *Cape Pacific*, that moral indignation could well come into play as an influence on policy considerations which may be used to interpret and apply a legal rule, yet stop short of trumping it.

<sup>510</sup> A balancing approach is also required to counter the increased instances of abuse that will naturally occur through the greater ease with which companies, and the corporate veil, can now be created— see the text to ch 2 part 3 1 above.

<sup>511</sup> The BEPS project undertaken by the OECD in reaction to the tax “scandals” by Google, Starbucks and the like at the behest of the G20 is a prominent indicator of this. Refer to Organisation for Economic Co-Operation and Development *Action Plan on Base Erosion and Profit Shifting* (2013) OECD Publishing. Available at: <<http://dx.doi.org/10.1787/9789264202719-en>> (accessed July 2013).

interpretation of tax laws, resulting in taxpayers not being caught by the strict wording of a tax provision.<sup>512</sup> Our courts' interpretation and application of common law principles will probably follow suit:<sup>513</sup> They are constitutionally obliged to develop the common law in the interests of justice<sup>514</sup> and to do so in the spirit of the Constitution<sup>515</sup> and of the Bill of Rights.<sup>516</sup> In the words of Moseneke J in *S v Thebus*:

“Superior courts are protectors and expounders of the common law. The superior courts have always had an inherent power to refashion and develop the common law in order to reflect the changing social, moral and economic make-up of society. That power is now constitutionally authorised and must be exercised within the prescripts and ethos of the Constitution.”<sup>517</sup>

On the basis of this increased frowning upon tax avoidance, and specifically the utilisation of corporate structures for this purpose, the question is when an action perpetrated by a taxpayer will be regarded as being fraudulent, dishonest or improper enough to warrant piercing in a case where abuse is also present.

The submission is that the common law has since *Cape Pacific* been available to thwart abuse of corporate personality for tax reasons. Even if this is not the case, the Constitution requires the courts to develop the common law consonant with the policy considerations linked to public policy, the *boni mores* of society and reasonableness,<sup>518</sup> as well as the interests of justice<sup>519</sup> considered in an open and

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<sup>512</sup> See also the similarly evolving approach of the UK courts, from the earlier literal approach adopted in *IRC v Duke of Westminster* (1936) AC 1–19 and *Partington v Attorney-General* (1869) HL 100 to that in *WT Ramsay Ltd v IRC* (1982) AC 300 and *Furniss v Dawson* [1984] STC 153 (HL).

<sup>513</sup> As stated by De Koker & Williams *Silke on South African Income Tax* ch 25.1C there has, in the interpretation of tax acts, been a “subtle shift over a long period by the judiciary from the strict rule of interpretation attempting to establish the intention of the legislature, even in cases where the words appeared clear and unambiguous.” [own emphasis].

<sup>514</sup> S 173 of the Constitution.

<sup>515</sup> See the text to n 272 above.

<sup>516</sup> See the text to n 520 below.

<sup>517</sup> 2003 6 SA 505 (CC) 31.

<sup>518</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 117.

<sup>519</sup> S 173 of the Constitution.

democratic society.<sup>520</sup> These factors should weigh heavily against the considerations opposed to piercing when corporate structures are used mainly for tax purposes.<sup>521</sup>

In considering how piercing may be applied in the law of income tax, the question is whether this can be done within the *dictum* expressed in *Botha*:

*“Regsontwikkeling het begin toelaat dat bloot op grond van onderlinge afspraak te dien effekte (en met nakoming van sekere prosedures en formele vereistes) partye 'n onderlinge verhouding kan skep met betrekking tot bates en laste in die besonder, waarvolgens die posisie sal geld tussen hulle, maar ook teenoor derdepartye asof daar nog 'n persoon naas hulself bestaan. Ook ons regstelsel duld so 'n skepsel van individue en aanvaar dat daardie skepsel hanteer word op die basis dat hyself draer van regte en verpligtinge kan wees en as sulks in die handelsverkeer en regsverkeer kan deelneem. Oorsee, met die meerdere kompleksiteite en variasies van die Amerikaanse samelewing waarskynlik 'n faktor, het die oortuiging algaande meer aanvaarding gevind by Howe sowel as navorsers dat ontwikkeling van die erkenning van die maatskappy as 'n verdere persona in die reg plaasgevind het weens die behoefte daaraan in die verkeer, maar dat nadele kan ontstaan en onreg tot stand kan kom juis deur 'n aandrang op die erkenning van die afsonderlikheid van die regspersoon. Dit kom voor asof besef is dat om 'n volstrekteid te verleen aan die erkenning van die afsonderlikheid van die maatskappy soms inhou dat verder gegaan word as die doel en rede vir die erkenning van die bestaanbaarheid van 'n regspersoon; dat so 'n benadering die heer kan word van onreg in plaas daarvan dat erkenning van regspersoonlikheid bloot die verkeersbehoefte volgens billikheidsmaatstawwe dien; dat*

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<sup>520</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 118 where the majority judgment directs that the common law should be developed in line with the objective normative value system which the Bill of Rights embodies – see s 7(1) of the Constitution. In *S v Thebus* 2003 6 SA 505 (CC) para 28 Moseneke J said:

“It seems to me that the need to develop the common law under s 39(2) could arise ... even when a rule of the common law is not inconsistent with a specific constitutional provision but may fall short of its spirit, purport and objects. Then, the common law must be adapted so that it grows in harmony with the ‘objective normative value system’ found in the Constitution.”

*Cf Currie & De Waal The Bill of Rights Handbook 67 et seq.*

<sup>521</sup> This is not to argue that the Constitution prescribes a more relaxed approach to piercing as such. One should heed the warning of the Constitutional Court in *S v Zuma* 1995 2 SA 642 (CC) that, “[w]hile we must always be conscious of the values underlying the Constitution, ... it cannot be too strongly stressed that the Constitution does not mean whatever we may wish it to mean ... If the language used by the lawgiver is ignored in favour of a general resort to ‘values’ the result is not interpretation but divination”. Undoubtedly, the same principle also applies to the development of the common law.

*dit nie vir voldoening aan die behoeftes van die gemeenskap nodig is om 'n regs persoon so te benader dat totaal onaanvaarbare resultate ontstaan omdat partye toegelaat word om 'n fiktiewe persoon in die alledaagse verkeer te laat optree nie.*<sup>522</sup>

This is a strong endorsement of Benade's "*doelmatigheidsreël*".<sup>523</sup> When the achievement of certain tax results is no longer a consequence, but the *raison d'être* for using the corporate veil, the case for piercing clearly outweighs the policy considerations opposed thereto.<sup>524</sup> In such circumstances society pays too high a price for separate corporate personality and its concomitant advantages.<sup>525</sup> Piercing is then not only warranted, but indeed necessary.<sup>526</sup>

Benade is of the opinion that "[g]een dogmatiese konsep van die maatskappy word verkrag nie as dié geskeidenheid om geen gewigtiger rede nie as bloot ter wille van die billikheid buite rekening gelaat word."<sup>527</sup> Leaving aside whether fairness considerations are a sufficient basis upon which to pierce, the fact remains that the rule of separate corporate personality is not derogated from when piercing is applied in limited, predetermined circumstances. This is evident from a consideration of the actions of the legislature. Just as the legislature at times seeks to pierce the veil in specific instances,<sup>528</sup> which has done nothing to detract from the rule of separate corporate personality in other respects, so too our courts should be empowered to do so in cases of abuse. These instances include the use of the corporate veil for reasons beyond those contemplated by its statutory creators.

The overriding reason for the law's recognition of the separate legal personality of a company is the fostering of economic activity. Taxation by its very nature is a product

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<sup>522</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) 161.

<sup>523</sup> Benade (1967) *THRHR* 215.

<sup>524</sup> See the text to ch 3 part 3 3 2 2 above; *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 15; *Larkin* (1989) *SA Merc LJ* 295.

<sup>525</sup> See *Silke Tax Avoidance and Tax Reduction* 73.

<sup>526</sup> See the text to ch 4 part 1 1 1 below. A necessary exception would be those circumstances where a beneficial tax regime is introduced by the legislature to encourage certain taxpayer behaviour which would, *inter alia*, involve the taxpayer using the corporate veil to benefit from such a tax incentive (e.g. where a natural person incorporates a business to benefit from the small business corporation regime in s 12E of the Income Tax Act).

<sup>527</sup> Benade (1967) *THRHR* 227 ("No dogmatic concept of the company is lost if this separateness is ignored for no other reason than in the interest of fairness.")

<sup>528</sup> The controlled foreign company rules in the Income Tax Act is a pertinent example.

of economic activity and the question may be asked whether in a modern commercial society it has not become a purpose for which the corporate veil may be legitimately used. There is no evidence to be found in South African law of such a development.

Another developing issue is whether the shareholders of the company are still the only beneficiaries of the company. Or do other stakeholders also have a legitimate claim to benefit from the economic activity of the corporate entity? Deakin argues convincingly that the shareholder primacy model is no longer appropriate for modern corporate law, also due to its direct contribution to the global financial crises and its failing to address theoretical and practical problems underlying separate corporate existence. This became very apparent after the 2008 financial crisis for which the shareholder primacy model has been widely blamed, *inter alia* because a purely shareholder-centric approach discourages corporate longevity. It is therefore argued that a wider “stakeholder interest-based” approach should be adopted.<sup>529</sup> The law should in future specify when the various contributors of inputs into a company are allowed, under pre-set conditions, to draw on such resources.<sup>530</sup> According to Deakin society at large is necessarily one such stakeholder which contributes to the company. Society’s interests should therefore also be represented and be kept in mind in developing a model for the proper understanding of the corporate form.<sup>531</sup> It remains an evolving policy debate on how legal personality should be approached,<sup>532</sup> and one which applies also to issues such as how the company should be treated when being used for income tax purposes.

Any discussion on how the company is to be used, logically includes a discussion on how the company is not meant to be used, in other words when its use is

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<sup>529</sup> The stakeholder model was also used to a certain extent to inform the drafting of the Companies Act. It also describes both Government’s and the legislature’s approach to company law – see the text to n 766 below. See also the Institute of Directors Southern Africa *King IV Report on Corporate Governance for South Africa 2016*.

<sup>530</sup> Deakin (2012) *Queen’s Law Journal* 343 *et seq* and the other authors quoted there in support.

<sup>531</sup> See also C Stein & G Everingham *The New Companies Act Unlocked* (2011) 2 and 8 *et seq* in relation to the “enlightened shareholder value model” adopted by the Companies Act. Also see s 7(d) of the Companies Act.

<sup>532</sup> Deakin (2012) *Queen’s Law Journal* 343 *et seq*. See also the chapter by Deakin in *The Critical Corporation* under 2.2 (unpublished format used with permission of the author).

tantamount to abuse of the legal form.<sup>533</sup> Society contributes in much the same sense to natural persons and the expectation that individuals should contribute back to society by for example paying taxes is similar. I agree with this, but would add that the corporate form is meant to benefit society at large by, amongst others, contributing to the *fiscus*. If the law were to condone the corporate form being used mainly for tax purposes and thus only for the benefit of those controlling it for themselves and at the cost of others, the law would indirectly give credence to the outdated shareholder primacy model. If we were to acknowledge rather that it is contrary to policy considerations when the corporate form is used for purposes directly contrary to its legitimate purpose under the stakeholder interest model,<sup>534</sup> then our law could be developed to address this obvious social challenge. This is not to argue that shareholders should be treated on an equal footing with other stakeholders, but is merely a plea to recognise that other stakeholders also have a legitimate interest in the company and that it is, at least to a certain extent, a shared resource.<sup>535</sup>

Once our courts have confirmed, as it is argued here that they should, that the use of the company for tax purposes should be disallowed as it amounts to an abuse of the doctrine of separate corporate personality, it is no longer a question of degree. Degree no longer plays a role: where the corporate veil is being used primarily for tax purposes, piercing should be applied, irrespective of the amounts or circumstances involved. This is, of course, subject thereto that a court is satisfied that control exists and that the corporate veil has indeed been misused primarily for tax reasons. Just as

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<sup>533</sup> In this regard *Deakin* remarks in *The Critical Corporation* that “the question of how far the law should recognise the distinct identity of the corporation ought to be approached from a functional perspective, not a naturalistic one” and that such a functional approach lays bare the potential for abuse of the corporate form, amongst others, for tax purposes.

<sup>534</sup> Both Anderson (2009) *Melb UL Rev* 349-350 and *Glazer v Commission on Ethics for Public Employees* 758 refer correctly to the “privilege” of corporate personality. This correlates with the civil law “abuse of rights” doctrine and applies in the tax context too (Vandekerckhove *Piercing the Corporate Veil* 311). See too J Cassidy “Tainted elements or nugatory directive? The Role of the general anti-avoidance provisions (“GAAR”) in fiscal interpretation” (2012) 23 *Stell LR* 319 338.

<sup>535</sup> *Deakin* in *The Critical Corporation*. Also see Directors Southern Africa *King IV Report on Corporate Governance for South Africa 2016* 23 *et seq* where responsible corporate citizenry is encouraged.

there are no degrees of piercing, there should be no degrees of impermissible tax avoidance.

The courts have confirmed that the use of the corporate veil to circumvent restraint of trade agreements is an appropriate basis upon which to pierce the corporate veil.<sup>536</sup> In my view it should also be confirmed as a principle based in law that a tax benefit achieved by using the corporate veil is improper and contrary to policy considerations if that tax benefit was the main purpose of a transaction. The principle should be that in such circumstances the policy considerations in favour of piercing outweigh those considerations opposed thereto.<sup>537</sup> This must be clearly confirmed as a legal principle to avoid the uncertainty that may arise should lower courts be tempted to deviate from it on a factual basis; exactly the scenario against which the SCA cautioned in *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* (“*Fourway*”).<sup>538</sup>

## 5.2 A question of fact

Two questions of fact also need to be answered before a court can apply piercing for income tax purposes. The first entails a subjective enquiry into whether the corporate veil has been used for tax purposes and the second whether control through which the shareholder concerned can use the corporate veil objectively exists.

Both questions need to be interrogated on a case-by-case basis. The former involves a subjective enquiry. Therefore the test is largely dependent on the evidence put before a court to prove or disprove<sup>539</sup> the purpose with which a shareholder sought to apply the corporate veil. In practice this may present a significant evidentiary burden to bear, but a necessary one since it is a requirement for the taxpayer to have purposefully sought to achieve a tax benefit by using the corporate veil.<sup>540</sup> This presents a practical problem. In many cases only the *ipse dixit* of a taxpayer may be

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<sup>536</sup> See the text to n 252 above.

<sup>537</sup> An affirmatory conclusion was reached before in unreported cases 9593 & 9592.

<sup>538</sup> See the text to n 370 above.

<sup>539</sup> See the text to ch 3 part 5.2.3 above for a discussion of the burden of proof where the common law doctrine is applied by SARS as a remedy against impermissible tax avoidance.

<sup>540</sup> See the text to ch 3 part 5.1.1 above where the conclusion is reached that this tax purpose must also have been the main purpose of the taxpayer.

available as evidence. According to *ITC 1185*,<sup>541</sup> where no other evidence is placed before a court the oral evidence of a taxpayer would carry significant evidentiary weight. Such an approach would appropriately balance the burden of proof in the tax court, addressing these practical difficulties. While SARS is ordinarily at an advantage in tax cases due to the burden of proof placed on taxpayers,<sup>542</sup> it will in most cases require at least some objective evidence to counter a taxpayer's *ipse dixit*.

The second question involves an objective test of whether shareholder control actually exists. It is important to make some brief comments on deciding when control would be present.

It has been said<sup>543</sup> that where third party interests, such as minority shareholders, are negatively affected by piercing, that piercing should not be applied. Piercing in these circumstances would in effect lead to the minority shareholders' economic

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<sup>541</sup> *ITC 1185* [1972] 35 SATC 122 at 123: *"It is no difficult matter to say that an important factor is: what was the taxpayer's intention when he bought the property? It is often very difficult, however, to discover what his true intention was. It is necessary to bear in mind in that regard that the ipse dixit of the taxpayer as to his intent and purpose should not lightly be regarded as decisive. It is the function of the court to determine on an objective review of all the relevant facts and circumstances what the motive, purpose and intention of the taxpayer were. Not the least important of the facts will be the course of conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or participation in similar transactions. The facts in regard to those matters will form an important part of the material from which the court will draw its own inferences against the background of the general human and business probabilities. This is not to say that the court will give little or no weight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer's evidence under oath and that of his witnesses must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts."* (own emphasis) The aforementioned *dictum* was subsequently approved in *Malan v KBI* [1983] 45 SATC 59.

<sup>542</sup> See the text to ch 3 part 5 2 3 below.

<sup>543</sup> *Prest v Petrodel Resources Ltd* 2013 UKSC 34 22 *et seq.* Also see RA Stevens *The External Relations of Company Groups in South African Law: A Critical Comparative Analysis* LLD thesis, University of Stellenbosch (2011) 72; *cf Al-Kharafi & Sons for General Trading, General Contracting and Industrial Structures Wll v Pema NO & others* 2010 JOL 25851 (GSJ).

interest in the company also being diminished, even though their relationship with the company may be entirely legitimate. It is not necessary to comment on the validity of this argument here, since minority interests, or the interests of any other shareholder for that matter, will never be a relevant consideration in the case of piercing for tax purposes. It may, however, be a consideration where the veil is pierced, for example, in order to attribute the liability of a company to its shareholders. Where the calculation of the liability for tax is concerned though, the corporate veil is only disregarded to the extent that it is used, to unlawfully obtain some tax benefit. And it is then only pierced for that specific shareholder.<sup>544</sup> One should therefore be careful to generalise by requiring control to be present in all instances of piercing.<sup>545</sup> While this may be a necessary requirement where for example piercing is applied on a balance sheet level, this need not be the case where piercing is applied for tax purposes.<sup>546</sup> It is conceded that abuse would be more difficult to conceal in instances where a majority shareholding is present but even on a theoretical level this should not ignore the fact that minority shareholders are also able to abuse the corporate veil for improper purposes.

To illustrate this, consider the example where two shareholders own a South African company 50/50. Neither of the shareholders is exempt from dividends tax. Suppose shareholder A uses the company primarily to escape dividends tax. On application of piercing only 50% of the dividend received by the South African company should be treated as being exempt from dividends tax, with the remainder treated accruing directly to A. This portion should therefore be subject to the dividends tax for which A only would have been liable. Legally the entire dividend accrues to the company for all other purposes. For the purposes of calculating the dividends tax obligation the exemption afforded to the company should be limited to 50% of the dividend received

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<sup>544</sup> Refer the discussion in the text to ch 2 parts 2 3 and 6 1 above.

<sup>545</sup> Blackman et al *Commentary on the Companies Act* 4-133 See Anderson (2009) *Melb UL Rev* 348 for support that control is not necessarily a prerequisite for piercing to apply.

<sup>546</sup> Even if it were to be suggested that majority shareholder control should be a requirement for piercing to apply on an income statement level as well, a distinction is justified to provide for a different approach where matters relating to taxation are concerned (*Briggs v James Hardie & Co (Pty) Ltd* (1998) 15 NSWLR 549 579 and 580). Minority shareholders benefit as much from the corporate veil as the majority shareholder.

in the above example. The remainder should be treated as non-exempt and that tax should be only for the account of the shareholder using the corporate veil for escaping the tax obligation.<sup>547</sup>

The facts set out in Example 4 above lead to a similar conclusion.<sup>548</sup> Had only one of the trusts involved in that example transferred its assets to the company in order to benefit from a more beneficial tax rate (with the remaining two trusts doing so for unrelated commercial reasons), the conclusion is that a 33% minority interest held by that trust may nonetheless be susceptible to piercing, irrespective thereof that it amounts to a minority interest only.

### *5 2 1 Exercising control through groups*

The ability to use the corporate veil is linked to the ownership of a company's issued shares. This was mentioned above<sup>549</sup> as the determining factor in deciding whether a company is capable of being used for legitimate purposes or misused for illegitimate purposes. In the context of groups of companies the exercise of indirect control through other companies or direct control over companies with common control, such as fellow subsidiaries, becomes pertinent.

*De facto* control by virtue of a shareholding relationship is not on its own sufficient for a court to pierce in the tax context.<sup>550</sup> Such control needs to be exercised primarily for tax purposes. However, control of the corporate veil is still required, which control can only be established through a direct shareholding relationship, a substantial shareholder relationship<sup>551</sup> or an indirect shareholder relationship, (such as is typically present in a layered company group structure).<sup>552</sup>

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<sup>547</sup> See the text to n 197 above.

<sup>548</sup> See the text to ch 1 part 3 above.

<sup>549</sup> See the text to ch 3 part 3 3 2 3 above.

<sup>550</sup> Meskin et al *Henochsberg on the Companies Act*, discussion of s 19.

<sup>551</sup> Refer to the facts in *Cape Pacific* as an example.

<sup>552</sup> See the text to ch 3 part 3 3 2 3 above.

The term “group of companies” as discussed here refers to a collection of companies through which control<sup>553</sup> by way of shareholding<sup>554</sup> can be exercised through one or more shareholders, not unlike the definition given in section 1 of the Companies Act. There is in principle no reason why a company in which another company holds less than 100% of the voting rights, or even less than 50%, should be more difficult to pierce for tax purposes than a wholly owned company.<sup>555</sup>

For the purposes of this dissertation, piercing in the group context refers to those cases where piercing is applied between fellow subsidiaries of the same group, not where piercing is effected between company and shareholder. This is known as “horizontal piercing”. An example where this may be relevant for tax purposes can be found in the context of treaty shopping. For example, interest or royalty income flows through various companies in a group to benefit from beneficial reduced withholding tax rates in the applicable DTAs.

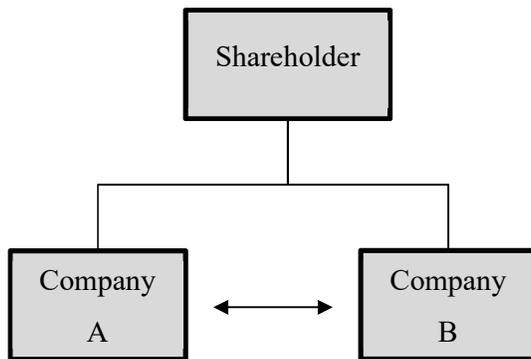
Since the principles discussed in this dissertation thus far all involve vertical piercing which would similarly apply to the holding/subsidiary relationship, only horizontal piercing is considered here as a potentially more complex matter to be dealt with, in order to establish whether different principles will apply thereto.

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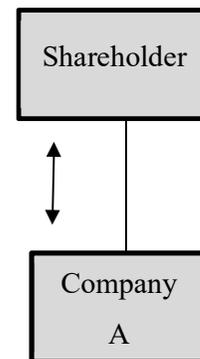
<sup>553</sup> As explained in the text to ch 3 part 3 3 2 3 above, the existence of control in the context of considering whether abuse of the corporate veil can be perpetrated, is not dependent on a shareholder’s control of a company, but rather on control of a company’s shares. In other words, a shareholder as owner of a “portion” of the corporate veil (figuratively speaking) is as capable of applying the corporate veil for his or her own abusive purpose as a majority shareholder would be (provided the company is employed in a manner allowing the abuse, which may be the case even if the majority shareholder’s purpose is entirely legitimate).

<sup>554</sup> By way of the exercise of voting rights attached to shares.

<sup>555</sup> *Contra Food Distributors Ltd v London Borough of Tower Hamlets* (1976) 3 All ER 462, and particularly the *dictum* by Lord Denning at 467 and Goff LJ at 68.



**Figure 1: Horizontal piercing**



**Figure 2: Conventional piercing**

Horizontal piercing requires the piercing principles to apply to two corporate veils. These veils include the corporate veil between Company A and the shareholder above and the aforementioned shareholder and Company B. The corporate veil exists only between a company and its shareholder(s). There is no corporate veil between subsidiaries.<sup>556</sup> This principle means that piercing can only be applied in a context where a common shareholder exists if **both** veils have been abused to a degree disallowed by the law. In the context of income tax specifically, the shareholder's purpose in using the corporate veil of both companies must have been primarily for tax purposes before a court would be willing to pierce in the group context.

This may appear to be a rather stringent test. However, had tax reasons been the predominant purpose for the shareholder to have its companies enter into a transaction with a fellow group company, that purpose would probably also be the reason for the other company to agree to enter that transaction.

<sup>556</sup> A good example of horizontal piercing is to be found in *ADT Security (Pty) Ltd v Botha* [2010] ZAWCHC 563. See also Cilliers & Luiz (1996) *THRHR* 524 and 525 on *Cape Pacific. Contra Metlika Trading Ltd v CSARS* [2012] JOL29511 (GNP) 13. See the text to ch 2 part 3 2 1 above: although this deals with the relationship between directors *vis-à-vis* their companies, the principle applies likewise to fellow subsidiaries. The corporate veil can only exist between a company and a shareholder. Also refer *DHN Food Distributors Ltd v London Borough of Tower Hamlets* (1976) 3 All ER 462 467 where it was held that piercing in a group context involves the two subsidiaries being deemed not to exist, and that the shareholder is the only person for the purposes of the finding.

The problem with analysing piercing in the group context in South Africa is that very few judgments have dealt with the question.<sup>557</sup> The findings of courts in other jurisdictions may however provide guidance, with good examples to be found in the English courts' judgments.<sup>558</sup>

The first authority dealing specifically with piercing within groups is *DHN Food Distributors*. The court allowed piercing in this case, since not doing so would have amounted to "a denial of justice".<sup>559</sup> The court preferred to view the structure as what it was in economic substance rather than what it was in legal form. It distanced itself from the "strict legalistic view" taken by the Lands Tribunal in that dispute.

In response the Court of Appeal in *Adams v Cape Industries plc* ("Adams") categorically stated that:

"... save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of *Salomon v A Salomon & Co Ltd* [1897] AC 22 merely because it considers that justice so requires. Our law, for better or for worse, recognizes the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to such separate legal entities."<sup>560</sup> [own emphasis]

Or as Goff LJ held in *Bank of Tokyo Ltd v Karoon*:

"Counsel suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged."<sup>561</sup> [own emphasis]

<sup>557</sup> This is not to say that piercing has not been applied in a group scenario in South Africa. See the judgments in *Gore* and *Cape Pacific* for examples hereof. The AD also confirmed the principle that a "holding company is a separate legal entity from its subsidiary": *The Ritz Hotel Ltd v Charles of The Ritz Ltd* 1988 3 SA 290 (A) at 43 of that judgment.

<sup>558</sup> The judgments which are discussed below have also been relied on by our own courts when considering piercing in the context of company groups: see the judgments referred to in n 557 above as examples.

<sup>559</sup> Shaw LJ in *DHN Food Distributors Ltd v London Borough of Tower Hamlets* (1976) 3 All ER 462 473.

<sup>560</sup> *Adams v Cape Industries plc* 1991 1 All ER 929 1019.

<sup>561</sup> [1986] 3 All ER 468 486 as quoted in *Adams*.

It is submitted that *DHN Food Distributors* cannot serve as good authority and it has been subject to much criticism since.<sup>562</sup> The problem is that courts are obliged to take a legalistic view. To depart from this approach will inevitably lead to legal uncertainty. The law demands that the separate legal personality of a company, one that is couched in fiction and in form, be recognised. To deviate from a strict application of this rule, except in the most exceptional of circumstances,<sup>563</sup> will lead to a curtailing of a rule which is a necessity for economic exchange as well as for the certainty of the persons in that environment that the form of their business will be recognised.

In the light of the well-founded criticism thereof in the *Adams* case, *DHN Food Distributors* should in my view not be regarded as authority for holding that piercing within groups (or within a “single economic unit” as was put to the court in *Adams*) should be subjected to an approach different from ordinary piercing principles.<sup>564</sup> There is no special dispensation when piercing is considered in a group context, and the separate existence of a company forming part of a group should be recognised to the same extent as that of any other company.<sup>565</sup> Although it was anticipated in 1982

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<sup>562</sup> Refer to *Adams v Cape Industries plc* 1991 1 All ER 929 above where the court also quoted with approval Lord Keith’s *dictum* in the House of Lords in *Woolfson* wherein that Court too distanced itself from the approach taken in *DHN*. *DHN* should also not be quoted out of context. As discussed in the text to ch 2 part 6 2 above, the case involved a situation where piercing was sought to be applied by the group for its own benefit, a rather unusual occurrence. It thus did not involve any abuse as such and which would by implication be present where piercing for tax purposes is concerned, which is what this dissertation is exclusively concerned with.

<sup>563</sup> Such as where a structure is set up with tax purposes primarily in mind.

<sup>564</sup> See specifically *Adams v Cape Industries plc* 1991 1 All ER 929 1026. *Contra Deputy Sherriff Harare v Trinpac Investments (Private) Ltd* [2012] JOL 28241 (ZH) where the *DHN* case is mentioned as the only authority for the extension of the exceptions to the general principle applicable to the piercing doctrine. Conspicuously, no mention is made of any of the English authorities criticising the *DHN* approach. I agree with Meskin et al *Henochsberg on the Companies Act* (at the discussion of s 19 of the Companies Act) that the conclusion reached in the *Deputy Sherriff* case cannot be supported.

<sup>565</sup> Refer to Cassim et al *Contemporary Company Law 53 et seq* and the authority quoted there. This approach has also been tacitly endorsed by our courts: see for example the *Metlika*, *Gore* and *Cape Pacific* cases referred to above. Also see *Williams* “Companies: Part I” in *LAWSA* 91; Meskin et al *Henochsberg on the Companies Act* at the discussion of s 19 of

in the case of *Ritz Hotel Ltd v Charles of The Ritz Ltd* (“Ritz”)<sup>566</sup> that the relaxed approach adopted in *DHN Food Distributors* may be followed in South Africa in future, nothing came of this.<sup>567</sup> Rather, the approach set out in *Adams*<sup>568</sup> should be adopted. This judgment was later than both *Ritz* and *DHN Food Distributors* and held that subsidiary companies are independent persons at law from one another and from their holding companies.

### 5 2 2 Piercing “one-man companies”

The question whether a different regime applies to so-called “one-man companies” is as old as the question whether a company is a distinct and separate legal *persona*.<sup>569</sup> The term “one-man company” as used here does not necessarily only refer to a company owned by a single natural person as shareholder, but rather to any company of which all the shares are owned by a single person, be it a natural or legal person.

The submission is that the principles regarding the ownership of companies within a group context apply in exactly the same way to one-man companies. As expressed by Lord Herschel in *Salomon*:

“I am unable to see how it can be lawful for three or four or six persons to form a company for the purpose of employing their capital in trading, with the benefit of limited liability, and not for one person to do so... It was said that in the present case the six shareholders other than the appellant were mere dummies, his nominees, and held their shares in trust for him. I will assume that this was so. In my opinion, it makes no difference.”<sup>570</sup>

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the Companies Act; Cassim et al *The Law of Business Structures* 70. Cf Stevens *The External Relations of Company Groups in South African Law* 72.

<sup>566</sup> 1982 2 All SA 292 (A). Also refer *Larkin* (1989) SA Merc LJ 279.

<sup>567</sup> Significantly too, none of the 3 SCA cases on piercing discussed in the text to ch 3 part 3 3 above even deals with the *DHN* case in the wake of *Adams*’ case. See also Cassim et al *Contemporary Company Law* 54 *et seq* and the authorities cited there.

<sup>568</sup> Approved by the AD in *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 2 All SA 11 (A) 25. *Adams v Cape Industries plc* 1991 1 All ER 929 1019 and quoted above.

<sup>569</sup> See *Salomon* where the matter was also considered.

<sup>570</sup> *Salomon v A Salomon & Co Ltd* 1897 AC 22 para 44 *et seq*.

And Lord Macnaghten:

“It has become the fashion to call companies of this class ‘one man companies’. That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy...”<sup>571</sup>

The conclusion from the above is as applicable in modern company law as it was in 1896: the mere fact that a company is 100% held by a person should not even be a factor to take into account when considering whether piercing should be applied or not. The separate legal personality of a “one-man company” deserves as much recognition and is as open or closed to piercing as a company with many shareholders or one belonging to a group.<sup>572</sup>

What distinguishes “one-man companies” from companies with more shareholders is that it is *practically* easier for the separate legal personality of such companies to be abused, given the absence of other shareholders to keep the one shareholder in check. The same applies in the group context.

Whether a company is a “one-man company” is therefore not a factor when deciding whether piercing would be justified or not. Rather, a “one-man company” will be easier to pierce simply because it will be easier to demonstrate that the corporate veil of such

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<sup>571</sup> Para 53. See also *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89 95 and 96.

<sup>572</sup> See Meskin et al *Henochnberg on the Companies Act* on s 19. In *RP Crees (Pvt) Ltd v Woodpecker Industries (Pvt) Ltd* [1975] 2 All SA 665 (R) 668 it was said:

“Thus, a company can be under complete control of and its activities entirely dictated by another person but that does not deprive it of its distinct legal personality. A person in captivity may be entirely subject to and his conduct completely dictated by his captor. Nevertheless he still retains an existence and is a separate entity from the person who has complete power over and direction of him.”

The decision of the court in *Gering v Gering* [1974] 1 All SA 65 (W) 69 and 70 can therefore not be supported. The position is the same under English law (*Faiza Ben Hashem v Shayif* 2008 EWHC 2380 (Fam) para 103), Canadian law (*Clarkson Co v Zhelka* [1967] 2 OR 565, 64 DLR (2d)) and US law (see Cheng (2010) *Mississippi Law Journal* 509).

a company is being abused. Nevertheless, this should not be seen as justification for treating the corporate veil of “one-man companies” as of a lesser substance or “density”<sup>573</sup> than that of other companies.<sup>574</sup>

### 5 2 3 *Burden of proof*

The corporate veil may be pierced where two questions of fact have been answered affirmatively. These questions are, firstly, whether the taxpayer was indeed in the position to use the corporate veil in question and, secondly, whether the taxpayer did so primarily for tax purposes. Whether this will constitute “improper conduct” in terms of prevailing policy considerations is a question of law, which is irrelevant in establishing who bears the onus. Questions of law are left to courts to answer once all the facts have been established in line with the burden of proof.<sup>575</sup>

Ordinarily the burden of proof in respect of the two questions of fact on which the legal question will be based is on the party alleging misuse of the corporate veil (in other words on the SARS).<sup>576</sup> The law of taxation, however, proves to be the exception to the rule and the statutory rule must trump the common law approach.<sup>577</sup> Section 102(1) of the Tax Administration Act provides:

“A taxpayer bears the burden of proving—

- (a) that an amount, transaction, event or item is exempt or otherwise not taxable;
- (b) that an amount or item is deductible or may be setoff;
- (c) the rate of tax applicable to a transaction, event, item or class of taxpayer;
- (d) that an amount qualifies as a reduction of tax payable;

<sup>573</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) 162.

<sup>574</sup> *Bark and another NNO v Boesch* serves as example. Also see the discussion of the *alter ego* doctrine in the text to ch 2 part 4 2 3 above.

<sup>575</sup> DT Zeffertt & AP Paizes *The South African Law of Evidence* 2 ed (2009) 45 *et seq*; *Mabaso v Felix* 1981 3 SA 865 (A) 874: “[T]he onus of proof relates to factual and not legal issues.”

<sup>576</sup> This has been the consistent approach of the courts in all reported judgments considering the piercing doctrine. It is also consistent with the position in the South African law of evidence in general (Zeffertt & Paizes *The South African Law of Evidence*) and as enunciated by the AD in *Pillay v Krishna* 1946 AD 946, adopting the position of Voet being that he who asserts must prove. See also the application of this principle in *CIR v Pick ‘n Pay Employee Share Purchase Trust* [1992] 2 All SA 245 (A) 255 *et seq*.

<sup>577</sup> Zeffertt & Paizes *The South African Law of Evidence* 46.

- (e) that a valuation is correct; or
- (f) whether a 'decision' that is subject to objection and appeal under a tax Act, is incorrect."

Typically, where piercing is to be applied tax will fall on a party other than the pierced company. In terms of the provisions of section 102(1)(a) the taxpayer will have to show that piercing should not be applied. It is difficult to conceive of a scenario where piercing is applied in the tax context that will not be subject to this provision. It covers the four examples identified in chapter 1 and the taxpayers there will in each instance have to bear the onus in terms of section 102(1).

The question arises whether the statutorily assigned burden of proof in section 102 also applies to common law remedies, or whether its application is limited to the anti-avoidance rules contained in the various tax acts. There is no indication in the wording of section 102 itself that the application of this provision is limited to the remedies created by a tax act. This is confirmed by the attitude of the courts in the past when they were confronted with the question of onus in cases where common law doctrines were being applied against taxpayers. The judgment in *CSARS v NWK Ltd* ("NWK"), dealing with the common law simulation doctrine, is instructive in this regard: the court held that the onus of proof rests on the taxpayer to refute SARS' assessment of the facts.<sup>578</sup> It follows that this principle will also extend to cases where SARS applies other common law remedies.

Section 102 above makes it clear that one is dealing here with the burden of proof in the ordinary sense, in other words with questions of fact.<sup>579</sup> Therefore, once SARS has issued an assessment, the taxpayer will be called upon to show on a balance of probabilities which facts contradict the basis on which the assessment has been issued to the taxpayer. Where piercing is concerned, these would have to be either that the taxpayer did not use the corporate veil in question or alternatively that the veil was not used primarily with a tax motive in mind.

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<sup>578</sup> *CSARS v NWK Ltd* [2010] 73 SATC 38 *et seq* dealing with the legislative predecessor of s 102(1) contained in the now repealed s 82 of the Income Tax Act. Also see *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* [1996] 58 SATC 229 240.

<sup>579</sup> *Mabaso v Felix* 1981 3 SA 865 (A).

On a practical level, it will in most cases be easy to establish whether the taxpayer was in fact able to use the company. It will mostly amount to whether the taxpayer was a shareholder of the company or not.<sup>580</sup> The more difficult factual question will in practice be whether the taxpayer intended using the company primarily for tax purposes.<sup>581</sup>

### 5.3 Application

Example 1<sup>582</sup> serves as an illustration of the application of the above principles: the individual that transfers the listed share portfolio to the wholly owned company through which the portfolio will be held going forward, effectively avoids the incidence of dividends tax.<sup>583</sup> Although there is the added benefit of having the shares secured in a separate corporate vehicle, this is clearly an ancillary benefit to the individual investor on a subjective level. People have always had the opportunity of structuring the listed share investments in this manner and had in the past not cared to do so. The restructuring now<sup>584</sup> is clearly because of the tax benefits only.<sup>585</sup>

In the international tax context of Example 3,<sup>586</sup> the individual would be able to reduce his tax liability permanently if the investment holding company referred to were to be incorporated and effectively managed in Mauritius by exploiting the reduced withholding tax rates in the South Africa/Mauritius DTA.<sup>587</sup> Mauritius does not levy a domestic dividend withholding tax.

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<sup>580</sup> Although this may be less simple to the extent that an in-substance shareholding relationship (see the text to n 340 above) is alleged.

<sup>581</sup> See the text to ch 3 part 5.2 above.

<sup>582</sup> See the text to ch 1 part 3 above.

<sup>583</sup> Companies tax resident in South Africa are exempt from dividends tax in terms of s 64F(1)(a) of the Income Tax Act. It should be noted that this is not a beneficial regime contrived by Parliament, but rather one to ensure that profits distributed through companies to the ultimate beneficial owner are not subject to double taxation. See the text to n 499 above.

<sup>584</sup> Which can be done without suffering any tax costs now in terms of s 42 of the Income Tax Act.

<sup>585</sup> Admittedly, in practice, evidentiary considerations may hamper proving the subjective element of the test.

<sup>586</sup> See the text to ch 1 part 3 above.

<sup>587</sup> Agreement between the Government of the Republic of South Africa and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (effective 28 May 2015).

It is evident that both the subjective and objective prerequisites of the common law piercing test are present: the individual is able to, and indeed does objectively, use the corporate personality of the company. He does so subjectively for tax purposes. The question therefore is firstly whether this is at the very least “improper” and secondly, whether the avoidance of tax when achieved as primary purpose can be considered “improper enough” to allow for piercing.

It has already been explained in parts 3 3 2 1 and 5 1 1 of this chapter above why the use of corporate personality for tax purposes should at the very least be considered improper. Because the individual’s commercial or other considerations in the example above are of secondary importance to him and his main purpose was to commit the said impropriety, policy considerations warrant piercing of the corporate veil.

## **6 Conclusion**

Chapter 2 has shown that piercing should be regarded as a separate remedy potentially available to SARS in the South African tax context. This chapter has concluded that where the main purpose to avoid tax through use of the corporate veil is present, the question of whether the remedy can only be used as a last resort becomes irrelevant. So too does the question whether other shareholders with no tax purpose are part of the structure: the veil is just as translucent for minority shareholders where impermissible tax avoidance is concerned as it is for majority shareholders.

The availability of the remedy depends entirely on the remaining criteria set out in *Cape Pacific*. Firstly, whether the purposeful use of the corporate veil primarily for tax purposes can be described as “improper.” Secondly whether such impropriety would on a balancing of policy considerations be enough to warrant piercing. Recent UK precedent largely supports this approach by applying the “evasion principle” which South African courts too should in my view adopt in developing the common law.

The conclusion drawn above is that piercing should be available as remedy against impermissible tax avoidance. Not only should the intentional avoidance of tax through the use of the corporate veil be treated as amounting to an evasion of otherwise legal obligations if done mainly for those reasons, but policy considerations favouring such an approach should be recognised even when weighed against considerations opposed to piercing.

That is not to say that tax avoidance is necessarily improper. However, where Parliament has created a fiction which is then used in a manner contrary to its intended purpose, indeed in such a way that it actively counters the efficacy of other statutes passed into law (for example the Income Tax Act), such misuse is clearly improper and policy considerations require such impropriety to not be allowed.

It remains to be considered in chapter 4 how, if at all, this common law test interacts with section 20(9) of the Companies Act.

## CHAPTER 4: PIERCING IN TERMS OF THE COMPANIES ACT – SECTION 20(9)

### 1 Introduction

The Companies Act of 2008 brought with it a number of provisions not previously contained in the Repealed Companies Act. One of these provisions is section 20(9) which provides a legislative mechanism with which South African courts may apply the piercing doctrine. Section 20(9) states:

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

- (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and
- (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).”

Much speculation and little clarity exist on how section 20(9) generally, and the phrase “unconscionable abuse” specifically, interact with the existing body of law. The foremost element of uncertainty arises from the fact that the corporate veil may already be pierced in terms of the common law.<sup>588</sup> The question is: how should the common law and the new legislative remedy interact? Should the common law inform the content of section 20(9) or is section 20(9) incompatible with the common law position that it will then have supplanted? Section 65 of the Close Corporations Act and the judgments dealing with that provision are also indirectly relevant. Due to the obvious similarities between section 20(9) of the Companies Act and section 65 of the Close Corporations Act, it is conceivable that the South African courts will follow the same approach in interpreting section 20(9) as they have with section 65.<sup>589</sup> It remains to be

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<sup>588</sup> Discussed in ch 3 above.

<sup>589</sup> Even though *Ex Parte Gore* suggests otherwise. See the text to ch 4 part 1 1 2 2 below.

considered whether the subtle differences in wording between the two statutory provisions may have been intentional.

The South African courts have thus far considered section 20(9) only on two occasions, firstly in *Ex Parte Gore* and shortly thereafter only briefly in *Van Zyl NO v Kaye NO* (“*Van Zyl v Kaye*”).<sup>590+591</sup> The latter judgment did no more than confirm the earlier judgment in *Ex Parte Gore*.<sup>592</sup> *Ex Parte Gore* is therefore the appropriate point of departure to consider how section 20(9) should be approached, especially regarding the interaction between the common law doctrine and the remedy in section 20(9).

Even though *Ex Parte Gore* set the basis for how the common law doctrine and section 20(9) should interact, that judgment did not carry out a detailed analysis of the content of the key phrase “unconscionable abuse”. An interpretative approach such as that prescribed by the SCA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (“*Natal Joint Municipal Pension Fund*”)<sup>593</sup> is therefore carried out in this chapter after a critical analysis of *Ex Parte Gore* in order to ascertain what section 20(9) says. The proposed content of section 20(9) is then compared to the common law piercing doctrine and applied in the context of the law of taxation.

## 1 1 *Ex Parte Gore*

In *Ex Parte Gore* the liquidators of a number of companies applied for the corporate veils of those companies to be pierced. The companies involved were all subsidiaries of a single holding company. The court was asked to pierce the corporate veils to allow the liquidators to treat the assets of these companies as being that of the holding company for satisfying the claims brought by various creditors. In granting the application in terms of section 20(9) Binns-Ward J declared that the separate juristic personalities of the companies concerned were unconscionably abused. The

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<sup>590</sup> *Van Zyl NO v Kaye NO* 2014 4 SA 452 (WCC).

<sup>591</sup> The facts in *Van Zyl v Kaye* did not involve the piercing of the corporate veil in detail, but rather focused on an application to disregard the so-called “vener” of a trust. The judgment was delivered by the same judge in the same court as that in *Ex Parte Gore* and is dated a little more than a year later than the earlier judgment.

<sup>592</sup> On whether s 20(9) should be considered as being supplemental to the common law rather than substitutive. *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 466 *et seq.*

<sup>593</sup> 2012 4 SA 593 (SCA) 18 *et seq.*

companies were therefore to be regarded as a single entity for the purposes of satisfying the creditor claims in question.

The significant finding in *Ex Parte Gore* was that section 20(9) should be considered as being supplemental to the common law, rather than substitutive,<sup>594</sup> since the Companies Act does not expressly provide that section 20(9) replaces the common law doctrine.<sup>595</sup> This finding suggests that the essence of the common law piercing doctrine has been retained in section 20(9), but that piercing in terms of the statutory provision may be granted more readily compared to the common law doctrine.

*Ex Parte Gore* offers two reasons why section 20(9) piercing should be approached with less circumspection than is the case under the common law. Significantly, one of these reasons is not that the court considered the common law remedy to be a remedy of last resort,<sup>596</sup> whereas section 20(9) was not. Rather, *Ex Parte Gore* confirms that the common law remedy, like section 20(9), is potentially available even where an alternative remedy is also present.<sup>597</sup> The first reason is doctrinal in nature and the second is based on a literal interpretation of section 20(9).

#### *1 1 1 Revisiting considerations opposed to piercing – the separation of powers doctrine*

It is instructive that the court uses the word “supplemental” to describe the relationship between section 20(9) and the common law.<sup>598</sup> It suggests that the remedy in section 20(9) does not restrict the application of the common law doctrine in any way. The less “drastic” or “exceptional” statutory provision can therefore only serve to increase the cases where piercing may be applied.<sup>599</sup> It further shows that the common law remedy co-exists with section 20(9).<sup>600</sup>

Considering the content of the common law doctrine, the only manner in which that doctrine in its current state can be applied in a less drastic manner is through a

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<sup>594</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34.

<sup>595</sup> 31.

<sup>596</sup> See the text to chapter 3 part 2 above.

<sup>597</sup> See n 38 to that judgment.

<sup>598</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34.

<sup>599</sup> 33.

<sup>600</sup> 34.

divergence of approach to either or both of the two questions of law which that doctrine involves. These two questions of law are (a) the meaning of improper conduct<sup>601</sup> and (b) whether a considerations-based approach<sup>602</sup> would dictate that piercing be applied in a specific instance or not. Of the two only the latter can conceivably have been affected by the introduction of section 20(9).<sup>603</sup> Nothing suggests that section 20(9) can be interpreted as introducing more grounds for impropriety<sup>604</sup> than under the common law.<sup>605</sup> *Ex Parte Gore* must therefore be understood to suggest either that section 20(9) introduced further policy considerations in favour of piercing, to have detracted from those considerations opposed to piercing, or a combination of the two

In my view section 20(9) eliminated a key consideration that previously would have caused piercing to be applied with circumspection: the introduction of the statutory piercing remedy removed the risk of a court breaching the separation of powers doctrine.<sup>606</sup>

The corporate veil of the company form is itself introduced by statute.<sup>607</sup> The disregarding of a statutorily designed instrument by an application of the common law by its very nature amounts to a drastic intervention by the judiciary.<sup>608</sup> Incorporating the doctrine into legislation was a significant yet natural development that should be understood in the context of the rule of law, the doctrine of separation of powers and the interplay between the common law and statutory law. Previously the common law piercing doctrine could be seen as the judiciary “overriding” statutory law in the form of the Companies Act. The courts were therefore reluctant to use the remedy for fear of trumping valid legislative directives of Parliament.<sup>609</sup> In this sense, the common law remedy certainly required exceptional circumstances to justify its application to any

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<sup>601</sup> See the text to ch 3 part 5 1 1 above.

<sup>602</sup> See the text to ch 3 part 5 1 2 above.

<sup>603</sup> See the text to ch 3 part 3 3 2 2 above.

<sup>604</sup> See text to ch 4 parts 2 2 to 2 4 below.

<sup>605</sup> See the text to ch 3 part 3 3 2 1 above.

<sup>606</sup> The effect of the separation of powers doctrine in acting as a disincentive to piercing in terms of the common law was identified as a consideration in the text to ch 3 part 3 3 2 2 above.

<sup>607</sup> See n 45 above.

<sup>608</sup> See n 278 above.

<sup>609</sup> See *Prest v Petrodel Resources Ltd* 2013 UKSC 34 83.

given set of facts. In order to apply the doctrine, there had to be clear indications that the legislature did not intend that the corporate personality should be abused in such a manner.

The position is different now, if only by virtue of the fact that the remedy has been legislated. Piercing no longer involves the judiciary revoking a privilege created by statute. Rather, the legislature itself now clearly grants authority to the judiciary to do so. The legislature has acted and has clearly set out the circumstances in which courts should act.

Through the removal of this risk South African courts are now actively empowered to pierce the corporate veil whenever the facts of a particular case justify them to do so.<sup>610</sup>

*Ex Parte Gore* is therefore correct when it regards section 20(9) as presenting a less drastic remedy compared to the common law piercing doctrine. While the policy considerations in favour of piercing remain the same for section 20(9) as for the common law, the main consideration against piercing has now been removed.

### 1 1 2 “Gross” versus “unconscionable”

The second reason advanced in *Ex Parte Gore* in support of section 20(9) presenting a less “drastic” or “exceptional” remedy compared to the common law doctrine is one based on the literal interpretative view expressed by Binns-Ward J. *Ex Parte Gore* reaches its conclusion on the basis that section 20(9) refers to an “unconscionable abuse” rather than the “more extreme”<sup>611</sup> phrase “gross abuse”.<sup>612</sup> The implication is accordingly that section 65 of the Close Corporations Act involves more restrictive requirements than section 20(9). *Ex Parte Gore* mentions no authority for this conclusion and in my view it is not correct.<sup>613</sup> It is both ironic and contradictory that *Ex Parte Gore* relies elsewhere on the judgment of *Airport Cold Storage* which involved

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<sup>610</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34.

<sup>611</sup> 34.

<sup>612</sup> Which phrase is used in the piercing provision in s 65 of the Close Corporations Act.

<sup>613</sup> For the reasons set out in the text to part 1 1 2 2 of this chapter below it is suggested that a contextual interpretative approach, which is considered more appropriate in the current instance, shows the opposite, namely that “gross abuse” in the Close Corporations Act and “unconscionable abuse” in the Companies Act should be given the same meaning.

section 65 of the Close Corporations Act,<sup>614</sup> to illustrate when piercing in terms of section 20(9) would be justified and where the common law would have failed to present an adequate remedy. If *Ex Parte Gore*'s literal interpretation were to be accepted, piercing in terms of the common law, section 65 of the Close Corporations Act and section 20(9) of the Companies Act would each involve a different standard of proof for piercing.

The literal meaning of "unconscionable" in section 20(9) is considered below, followed by an analysis whether "gross abuse" in section 65 of the Close Corporations Act carries a different meaning compared to that in section 20(9) of the Companies Act.

#### 1 1 2 1 The literal interpretative approach in *Ex Parte Gore*

It is suggested that a literal interpretative approach to give content to "unconscionable abuse" is inappropriate, primarily due to the problematic phrasing involved. Where *Ex Parte Gore* favours a literal interpretation of "unconscionable abuse" solely by differentiating between "gross" and "unconscionable" abuse, such a conclusion seems insufficient.<sup>615</sup>

"Unconscionable" apparently suggests that a limited form of abuse of the corporate veil, if such a notion exists, is condoned.<sup>616</sup> Clearly the words "unconscionable abuse"

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<sup>614</sup> At 33 Binns-Ward J refers to *Airport Cold Storage* where the "scant regard for the separate legal personalities of the individual corporate entities" would constitute both a "gross abuse" as contemplated in s 65 as well as an "unconscionable abuse".

<sup>615</sup> I illustrate the limited assistance of a literal interpretation in the current context in part 2 2 of this chapter below by conducting a more thorough literal analysis there compared to the cursory literal analysis which formed the basis of the conclusion reached in *Ex Parte Gore*.

<sup>616</sup> Williams "Companies: Part I" in *LAWSA* 93; Strydom & Du Plessis (1997) *TSAR* 415 *et seq.* See also Domanski's criticism of this "unduly restrictive" approach in Domanski (1986) *SALJ* 235. It must be presumed that "unconscionable" was added to the provision for good reason. On the presumption that statutes do not contain purposeless provisions: Du Plessis "Statute law and interpretation" in *LAWSA* 342; C Botha *Statutory interpretation – An introduction for students* (2012) 133; LC Steyn *Die Uitleg van Wette* 5 ed (1981) 119 *et seq.*; J Silke "The Interpretation of Fiscal Legislation – Canons of Construction, Recent Judicial Comments and New Approaches" (1995) *Acta Juridica* 153 *et seq.* It is arguable that the approach is comparable to the common law distinction between "negligence" and "gross

are intended to restrict the application of section 20(9) in some manner. It is obvious that the provision cannot be applied where juristic personality is used for legitimate purposes. However, where a shareholder departs from the legal or reasonable use of juristic personality,<sup>617</sup> the question then arises when such abuse can be described as being “unconscionable”.

“Unconscionable” can be defined as “not right or reasonable”,<sup>618</sup> “unscrupulous”<sup>619</sup> or “exorbitant”.<sup>620</sup> In comparison “gross” can be said to be “(especially of wrongdoing) very obvious and unacceptable”,<sup>621</sup> “heinous” or “bad”<sup>622</sup> or even “culpable”.<sup>623</sup> While dictionary definitions are relevant when interpreting a particular statutory phrase,<sup>624</sup> the dictionary meaning of “unconscionable” unfortunately seems unhelpful in determining the scope of application of section 20(9).<sup>625</sup>

It is unclear how the above can be said to suggest a less extreme connotation compared to “gross abuse” as used in the Close Corporations Act.

1 1 2 2        The purpose and context of section 65 of the Close Corporations Act Cassim et al<sup>626</sup> are of the view that section 20(9) should be interpreted in the same manner as section 65 of the Close Corporations Act. The reason for this is obvious when comparing the almost identical wording of the two provisions. Section 65 reads:

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negligence” – see Schoeman (2012) *De Rebus. Cf* Cassim et al *Contemporary Company Law* 62 and Domanski (1986) *SALJ* 235.

<sup>617</sup> See definition of “abuse” in Garner *Black’s Law Dictionary*.

<sup>618</sup> Soanes & Stevenson *Oxford Dictionary of English*.

<sup>619</sup> Garner *Black’s Law Dictionary*.

<sup>620</sup> G Davidson *Roget’s Thesaurus* (2004).

<sup>621</sup> Soanes & Stevenson *Oxford Dictionary of English*.

<sup>622</sup> Davidson *Roget’s Thesaurus*.

<sup>623</sup> D Greenberg *Stroud’s Judicial Dictionary of Words and Phrases* (2012), referencing “gross negligence”.

<sup>624</sup> *National Screenprint (Pty) Ltd v Minister of Finance* 1978 3 SA 501 (C) at 507A-H. The SCA held in the cases cited above that the dictionary meaning of words should be used with caution as interpretative aid: it should rather be used as guidance or a framework within which the purpose and context of a phrase may be sought.

<sup>625</sup> S 40 of the Consumer Protection Act 68 of 2009 (“CPA”) contains a list of factual circumstances when conduct would amount to “unconscionable conduct”. Given the different context in which “unconscionable” is used in that Act, it is doubtful whether any meaningful help for the purposes of s 20(9) may be gleaned from the CPA’s wording.

<sup>626</sup> Cassim et al *Contemporary Company Law* 57.

“Whenever a Court on application by an interested person, or in any proceedings in which a corporation is involved, finds that the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate entity, the Court may declare that the corporation is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the corporation, or of such member or members thereof, or of such other person or persons, as are specified in the declaration, and the Court may give such further order or orders as it may deem fit in order to give effect to such declaration.”

The main difference between section 65 and section 20(9) is that the corporate veil of a company may be pierced where there has been an “**unconscionable** abuse” of its corporate personality. In comparison the Close Corporations Act’s piercing provision applies where a “**gross** abuse” of the corporate personality of a close corporation is present, which according to *Ex Parte Gore* carries a more extreme connotation.

At the outset the vagueness of both the terms “unconscionable” and “gross” is notable. Apart from indicating that more than mere “abuse” is necessary in both legislative provisions,<sup>627</sup> there is no other clear difference between “gross” and “unconscionable”. Both provisions are aimed at achieving the same purpose, albeit for different types of juristic *persona*. The context and purpose of section 65 is therefore the same as that of section 20(9). An interpretation that the two words have distinctly different meaning therefore relies solely on a literal approach, which, as shown above, must be considered inconclusive.<sup>628</sup>

Reliance on such a literal interpretive approach<sup>629</sup> has diminished in recent years. “[R]ather than attempting to draw inferences as to the drafter’s intention from an uncertain premise...”,<sup>630</sup> an interpretation which gives certainty and clarity must be

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<sup>627</sup> See also the text to ch 4 part 1 1 2 1 above and part 2 2 below.

<sup>628</sup> See the text to ch 4 part 1 1 2 1 above.

<sup>629</sup> See the text to ch 4 part 2 1 below.

<sup>630</sup> *Standard General Insurance Co Ltd v Commissioner for Customs and Excise* 2005 2 SA 166 (SCA) 25.

preferred.<sup>631</sup> A literal interpretation in the current instance presents such an uncertain premise. A contextual and purposive interpretation on the other hand suggests that sections 65 and 20(9) share a similar meaning of the phrases “unconscionable abuse” and “gross abuse”.<sup>632</sup>

In the present instance the presumption that the same (or substantially the same)<sup>633</sup> words used in the same statute have the same meaning is obviously not applicable. However, there is some authority that substantially the same wording used in different statutes dealing with the same topic may carry some interpretative weight.<sup>634</sup> Context is vital when applying this “presumption”.<sup>635</sup> A similar context is obviously present in sections 20(9) and 65: the purpose of both remedies is to guard against an abuse of corporate personality. The context therefore strongly supports application of the presumption in this case. Even if this is not done, practical considerations dictate that the two provisions be given a similar meaning. A contrary view would give rise to illogical results: the corporate personality of a close corporation would be more or less penetrable than the corporate personality of a company. There is no legal authority for this notion.<sup>636</sup>

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<sup>631</sup> In the absence of evidence of a deliberate change of expression the presumption that a change in language shows to a different meaning cannot be applied: EA Kellaway *Principles of legal interpretation – Statutes, Contracts & Wills* (1995) 365 *et seq.*

<sup>632</sup> Also see J Roodt “The consequences of the “unconscionable abuse of the company’s juristic personality” (undated) *bbrief.co.za* <<http://www.bbrief.co.za/resources/articles/new-companies-act-2008>> (accessed 11-09-2012).

<sup>633</sup> Du Plessis “Statute law and interpretation” in *LAWSA* 347.

<sup>634</sup> Kellaway *Principles of legal interpretation* 364, referring to *Zimmerman v Grossman* [1971] 1 All ER 363 369.

<sup>635</sup> Silke (1995) *Acta Juridica* 138 *et seq.*; Kellaway *Principles of legal interpretation* 364; *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) 18 *et seq.*

<sup>636</sup> Cassim “Piercing the veil under s 20(9) of the Companies Act 71 of 2008: A new direction” (2014) 26 *SA Merc LJ* 307 318. See also Strydom & Du Plessis (1997) *TSAR* 420 and Cassim *et al Contemporary Company Law* 57. The preamble to the Companies Act also clearly expresses the intention of the Companies Act to harmonise the treatment of companies and close corporations. It is further significant that the approach in both *Airport Cold Storage* and *Die Dros* was to use the common law approach as applied to companies in the interpretation of s 65, in other words to apply the approach to piercing for companies also to close corporations. See also Meskin PM, Galgut B & Kunst JA *Henochsberg on the Close Corporations Act* (2010) n 65.1 where the view is expressed that a court’s jurisdiction to pierce

Final authority for the argument that section 20(9) should be interpreted to have the same threshold requirement as section 65 (which in turn is interpreted as being the legislative equivalent of the historic common law test)<sup>637</sup> is the SCA's comparative approach in *Ebrahim* when comparing section 64 of the Close Corporations Act to section 424 of the Repealed Companies Act. Here the Court held that “[t]he case law on one provision ... illuminates the other.”<sup>638</sup> For section 64 to apply, the “business of a corporation ... [must be] ... carried on recklessly, with gross negligence or with intent to defraud ...”. In comparison, the Repealed Companies Act in section 424 requires the business of a company to be carried on “recklessly or with intent to defraud ...”. Here the SCA read nothing into the fact that the Close Corporations Act, introduced some years after the Repealed Companies Act, had a differently worded section 64 compared to section 424 of the Repealed Companies Act. Despite the different wording the two were considered the same in substance and to apply with the same threshold requirement, albeit in different contexts.<sup>639</sup> There is no reason why there should be a different approach in approaching the application of section 20(9) *vis-à-vis* section 65.<sup>640</sup>

### 1 1 3 Conclusion on Ex Parte Gore

While the conclusion in *Ex Parte Gore* that section 20(9) is supplemental to the common law must be agreed with, it is suggested that only the first reason advanced for the remedy in section 20(9) being less drastic than the common law remedy is valid. Section 20(9) removed a key obstacle to piercing, viz the separation of powers

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in terms of s 65 is equivalent to that under the common law and further that s 65 has subsumed the common law piercing doctrine where close corporations are concerned.

<sup>637</sup> See n 268 above.

<sup>638</sup> *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 13.

<sup>639</sup> Also see *L & P Plant Hire BK v Bosch* 2002 2 SA 662 (SCA) 39.

<sup>640</sup> Strydom & Du Plessis (1997) *TSAR* 420. A possible explanation why the term “unconscionable” was preferred over “gross” in s 20(9) is that the term “unconscionable” was already known in the context of piercing as applied for companies. It is worth noting that “unconscionable” is not a new term in the context of piercing. The term has its origin in *Botha* where Flemming J referred to an “*onduldbare onreg*”, which was subsequently translated by Nel J in the *Cape Pacific a quo* judgment to “*unconscionable injustice*”. See n 733 below. See also the text to ch 4 part 2 4 2 2 below.

doctrine. The literal comparison between section 20(9) and section 65 also offered in *Ex Parte Gore* as a second reason for reaching this conclusion does not seem tenable.

## 2 “Unconscionable abuse” – a statutory interpretive exercise

### 2 1 Introduction

It remains to be considered in what other respect, if any, section 20(9) creates a remedy different from that offered by the common law. Once this has been established, the possible application of section 20(9) in a tax context will be considered.

Section 19 breathes life into the company and provides it with juristic personality. Without it companies would not have existed.<sup>641</sup> Yet, “... their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted.”<sup>642</sup> Until the adoption of the present Companies Act such curtailing or withdrawal of the legal existence of companies had no equal in legislation compared to the remedy that existed in respect of close corporations.<sup>643</sup>

The interpretation of the phrase “unconscionable abuse” is central to the application of section 20(9). It provides the key to the future application of the piercing doctrine in South Africa since it is also bound to affect the common law approach. The phrase has connections to some older cases forming part of the common law<sup>644</sup> as well as cases involving the Close Corporations Act.<sup>645</sup>

Cassim et al rightly identify the vagueness and uncertainty of the meaning of the phrase as the “most troublesome aspect of section 20(9)”.<sup>646</sup> The enquiry into the content of section 20(9) requires a detailed exercise in statutory interpretation, something that *Ex Parte Gore* did not engage in.

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<sup>641</sup> *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 15:

“Although juristic persons are recognised by the Bill of Rights – they may be bound by its provisions and may even receive its benefits – it is an apposite truism that close corporations and companies are imbued with identity only by virtue of statute.”

<sup>642</sup> *Ebrahim* above at para 15.

<sup>643</sup> S 65 of the Close Corporations Act.

<sup>644</sup> See the text to ch 4 part 2 3 5 below.

<sup>645</sup> See the text to ch 4 parts 1 1 2 2 above and 2 3 4 below.

<sup>646</sup> Cassim et al *Contemporary Company Law* 60.

While the point of departure for statutory interpretation remains the words of the particular provision,<sup>647</sup> the position in South African law is no longer a question of simply attaching the ordinary or literal meaning of words to a specific provision.<sup>648</sup> Nevertheless, it is also not possible to disregard the clear, ordinary meaning of words used in a statute and only to have regard to the context and purpose of the provision. Rather, the meaning of the words used must be analysed by considering the purpose and context in equal measure. One cannot ascertain a meaning by way of a literal approach and then merely test this against the purpose and context within which the words are used. Context and purpose together are paramount.

However, interpreting a provision can never be separated from the wording of a statute itself. Content must be given to the words used to the extent that the definition of the words used permits it, but drawn from the context and purpose within which they are used, rather than with reference to a dictionary meaning.

*CSARS v Bosch*<sup>649</sup> summed up this unitary approach of considering context and purpose in the first instance (and not only in instances of ambiguity),<sup>650</sup> as follows:

“The words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material.”<sup>651</sup>

This approach is followed below to ascribe a meaning to the phrase “unconscionable abuse”. It has already been shown that a literal interpretation of the phrase provides little assistance.<sup>652</sup>

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<sup>647</sup> Confirmed in *City of Tshwane v Marius Blom & GC Germishuizen Inc* 2014 1 SA 341 (SCA) para 15 and *Bothma Batho Transport v S Bothma & Seun Transport* 2014 2 SA 494 (SCA) para 12.

<sup>648</sup> The so-called “golden rule” of statutory interpretation, as discussed by DV Cowen “The interpretation of statutes and the concept of “the intention of the legislature”” (1980) 43 *THRHR* 374. See also *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) para 18 *et seq.*

<sup>649</sup> *Commissioner for the South African Revenue Service v Bosch* 2015 2 SA 174 (SCA).

<sup>650</sup> CA Emslie “Income Tax – Deduction of Research and Development Expenditure in terms of Section 11D of the Income Tax Act” (2015) 64 *The Taxpayer* 93.

<sup>651</sup> At para 9.

<sup>652</sup> See the text to ch 4 part 1 1 2 above.

The context of the phrase in section 20(9) presents a wide range of factors to consider: the provision's appearance in the Companies Act; the Constitutional context; the context within the existing common law framework and the context within the body of law concerning piercing in terms of section 65 of the Close Corporations Act.

The interpretive value to be placed on "background material" must, however, also be used with circumspection. This material will therefore be considered last to determine whether or not it confirms the interpretation offered in this part.<sup>653</sup>

## 2.2 Purposive and literal interpretative approach

It is clear from the wording of section 20(9) that its purpose is to provide a sanction against the misuse of corporate personality. The extent of the abuse that must be present before invoking the section 20(9) sanction is, however, unclear. While the purpose of the provision is obvious, the difficult questions are when such abuse arises and when an abuse can be said to be "unconscionable".

Section 7(a) of the Companies Act may be appropriately regarded as prescribing a purposive approach for the interpretation of the Companies Act as a whole, including section 20(9).<sup>654</sup> However, all that section 7(a) does is to bring the purposive interpretation of section 20(9) within the context of a constitutionally-based interpretation, which is dealt with in a contextual interpretive approach.<sup>655</sup> Whilst the purpose of section 20(9) is clear, its scope of application needs to be determined by way of a contextual enquiry.

A critical analysis of the cursory literal interpretative analysis by Binns-Ward J in *Ex Parte Gore* was done above.<sup>656</sup> That analysis showed that a literal interpretation of the meaning of "unconscionable" is of limited value when only comparing it to the phrase used in section 65 of the Close Corporations Act.

It must be accepted that the only logical manner in which to interpret "unconscionable abuse" would be to accept that the separate existence of a company

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<sup>653</sup> Du Plessis "Statute law and interpretation" in *LAWSA* 374.

<sup>654</sup> See J Katzew "Crossing the divide between the business of the corporation and the imperatives of human rights – the impact of section 7 of the Companies Act 71 of 2008" (2011) 128 *SALJ* 689.

<sup>655</sup> See the text to ch 4 part 2.3.3 below.

<sup>656</sup> See the text to ch 4 part 1.1.2.1 above.

may be used for various purposes. This variety of purpose may even extend to circumstances not foreseen or intended by the Companies Act, but which may still be permissible.<sup>657</sup> If this is not the case, the adjective “unconscionable” in section 20(9) would be unnecessary. The logical conclusion is that the corporate veil may not be used for purposes unforeseen by the Companies Act or to the detriment of others. It is therefore possible to use corporate personality for purposes that would have been disallowed, had it not been that those purposes would in those circumstances achieve an ancillary goal. In instances of limited abuse the use of corporate personality is condoned where it achieves an entirely legitimate primary purpose. Using the separate corporate personality of a company for such unforeseen purposes may rightly be described as a misuse or abuse, since it entails the use of the corporate veil for purposes for which the Companies Act did not intend it. Seen in this light “unconscionable” denotes more than the use of the corporate veil for an unintended purpose. It envisages the abuse of the corporate veil primarily for unintended purposes which will simultaneously disadvantage another.<sup>658</sup> In this sense the misuse can be described as “exorbitant”, “unreasonable” and “unscrupulous”.<sup>659</sup> This accords with the common law approach which states that the corporate veil cannot simply be pierced when it is considered just to do so.<sup>660</sup> Disadvantage on its own is insufficient. What “unconscionable abuse” in the literal sense does suggest, and which accords with the common law approach, is that the corporate veil may be pierced when used primarily for purposes unintended by the Companies Act which are also prejudicial to third parties.

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<sup>657</sup> See *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 16 where one of the uses of a close corporation was described, in the context of piercing, as being “contrived but permissible”.

<sup>658</sup> Similar to the common law approach in *Hülse-Reutter* where the court was only willing to pierce in the presence of a person being “unfairly prejudiced” (being but one of the requirements listed) as a result of the corporate veil being used by someone else. See text to ch 3 part 2 above. *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34: “The provision brings about that a remedy can be provided whenever the illegitimate use of the concept of juristic personality adversely affects a third party ...” Cf Cassim et al *Contemporary Company Law* 60.

<sup>659</sup> See the text to n 618 to 620 above.

<sup>660</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552.

Separate corporate personality can serve more than one purpose.<sup>661</sup> At various times the value of the various benefits to a shareholder of separate corporate personality could differ. It is therefore seems that the insertion of the word “unconscionable” was necessary to ensure that the corporate veil is not pierced in circumstances where it is used partly for purposes other than it was intended for,<sup>662</sup> but which are nonetheless acceptable in the context of a legitimate primary purpose.<sup>663</sup> This strongly suggests that an “**unconscionable** abuse” can only be present if the primary purpose of the use amounts to an abuse.

If it is accepted that the corporate veil was not intended to provide tax benefits,<sup>664</sup> the mere fact that such benefits had been obtained would per definition amount to an abuse of corporate personality. To automatically consider such abuse as unconscionable though, would be absurd. Where the corporate veil is used for legitimate purposes, and a tax benefit arises as a secondary benefit, the ensuing tax benefit is a legal consequence of a legitimate transaction, rather than the motive for the transaction itself. In such instances using the corporate veil objectively to achieve a secondary purpose that the corporate personality doctrine was not designed for cannot be said to be “unconscionable”.

“Unconscionable” therefore involves a subjective test of the purpose or intention with which the shareholder in question uses the corporate veil. However, as is clear from both the literal definition of the word as well as the comparable phrase found in the Afrikaans version of the Companies Act,<sup>665</sup> the phrase also has traits of an objective test. It is therefore necessary to compare the actions of the shareholder with society’s likely view of those actions. This means a value determination of what society would regard as being “unreasonable”, “excessive”, or “*gewetenloos*”.<sup>666</sup> The

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<sup>661</sup> See the text to ch 2 parts 2 2 and 2 3 above.

<sup>662</sup> For example, if an otherwise unintended purpose is but a secondary advantage envisaged by the shareholders.

<sup>663</sup> This accords with the judgment in *CIR v Golden Dumps (Pty) Ltd* [1993] 55 SATC 198 by the AD that the firm rule is that every word in a statutory provision must be considered and ascribed some meaning; there is a strong presumption against the notion that the legislature would have included words in a statute *per incuriam*.

<sup>664</sup> Which is the conclusion in ch 4 part 4 below.

<sup>665</sup> “*gewetenlose misbruik*”.

<sup>666</sup> See the text to n 659 and 665 above.

approach is similar to, for example, the test to determine “gross negligence” through the application of the “reasonable person” criterion.<sup>667</sup> That being said, although it is an objective determination whether or not an action would be considered “unconscionable”, the test ultimately applied is a subjective one: was what is seen as objectively “unconscionable” actually intended?<sup>668</sup> This is shown by the various cases dealing with the common law piercing doctrine:<sup>669</sup> did the shareholder intend to abuse? This necessarily includes an enquiry into whether the abuse of the corporate personality is so severe that the reasonable person will be unable to reconcile him- or herself with the shareholder’s subjective purpose for abusing the corporate form. Whether such abuse was severe enough is thus subject to objective considerations.

Although a literal interpretive approach is not without value,<sup>670</sup> the above conclusions are by no means final and confirm that the use of a literal interpretation only by the court in *Ex Parte Gore* was inappropriate. As is evident from the discussion above the very nature of the word “unconscionable” leads to potentially divergent meanings.

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<sup>667</sup> *Malan* discussed by Strydom & Du Plessis (1997) *TSAR* 415 in the context of close corporations. As concluded in the text to ch 4 part 1 1 2 2 above, the approaches under the Companies Act and the Close Corporations Act should be aligned.

<sup>668</sup> As was argued in ch 3 above (see especially part 3 3 2 1 thereof) the subjective intention for using the corporate veil is of significant importance in the tax avoidance context: the doctrine, whether in terms of the common law or s 20(9), can by implication only apply where the tax purpose was at least the primary purpose with which the veil is used by the taxpayer in question.

<sup>669</sup> This dissertation concludes that s 20(9) is essentially an embodiment of the common law piercing doctrine: see the text to ch 4 part 2 5 below.

<sup>670</sup> It is interesting to note the divergent views taken on the literal meaning of the term, further confirming that a literal enquiry is of limited use here. Where Ewing and Kleitman for example consider the phrase on a literal analysis to introduce a narrower piercing test compared to the common law (C Ewing & Y Kleitman “Piercing the corporate veil” (2011) *Without prejudice* 8-9). *Ex Parte Gore* regards the legislative provision as providing for a wider basis on which courts would be entitled to pierce.

## 2 3 Contextual approach

### 2 3 1 Introduction

As mentioned above, a contextual interpretive approach to section 20(9), specifically the phrase “unconscionable abuse”, holds the key to the meaning of this provision. This context includes the common law position on the piercing doctrine as developed thus far, the similarly worded section 65 of the Close Corporations Act and section 20(9)’s context in the Companies Act. All of this must be seen in the broader constitutional context. This follows from the judgment of Schreiner JA in *Jaga v Dönges, NO and another; Bhana v Dönges, NO and another*,<sup>671</sup> which the SCA recently referred to with approval:

“Certainly no less important than the oft repeated statement that the words and expressions used in a statute must be interpreted according to their ordinary meaning is the statement that they must be interpreted in the light of their context... ‘[T]he context’, as here used, is not limited to the language of the rest of the statute regarded as throwing light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and, within limits, its background.”<sup>672</sup>

In the various contexts within which section 20(9) is to be interpreted, various presumptions of statutory interpretation find potential application. These presumptions, although not sufficient on their own to give a definitive meaning to section 20(9), provide great assistance, particularly in a contextual approach.

They are briefly discussed below before applying them in the various contexts identified earlier.

### 2 3 2 The role of presumptions in statutory interpretation

The presumptions of statutory interpretation that could be used as interpretive tools in giving meaning to section 20(9) include the presumption that statute law does not alter existing law more than necessary (but also that statutes do not contain purposeless or nugatory provisions) that words used by the legislature in more than one statute should bear the same meaning and that statute law promotes public interest.

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<sup>671</sup> 1950 4 SA 653 (A).

<sup>672</sup> See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) 421.

Regarding section 20(9) the following issues are pertinent:

- to what extent does the presumption relating to public interest affect the contents of section 20(9) when considering the provision in the context of the present constitutional dispensation?<sup>673</sup>
- does the presumption that similar wording has the same meaning if used in a similar statutory context have any influence on the comparison of section 65 of the Close Corporations Act with section 20(9) of the Companies Act?<sup>674</sup> and
- is the presumption dealing with the alteration of law applicable when considering section 20(9) in the context of the common law, keeping in mind that statutes are also presumed not to contain nugatory provisions?<sup>675</sup>

In this regard the presumptions do seem to have some role to play in a contextual interpretative exercise.<sup>676</sup>

The role that these presumptions play in our modern constitutionalist era has admittedly been questioned.<sup>677</sup> However, in the recent Constitutional Court judgment in *South African Reserve Bank v Shuttleworth* (“*Shuttleworth*”)<sup>678</sup> the relevance of presumptions in the constitutional era received explicit acknowledgment.<sup>679</sup>

Although there is a consensus that the presumptions can at most only assist in a limited fashion, the dominant view is that they do provide a guide where uncertainty

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<sup>673</sup> See the text to part 2 3 3 of this chapter below.

<sup>674</sup> See the text to ch 4 parts 1 1 2 2 above and 2 3 4 below.

<sup>675</sup> See ch 4 part 2 3 5 below.

<sup>676</sup> See too the view of Du Plessis “Statute law and interpretation” in *LAWSA* 333 that a literalist-cum-intentionalist approach to statutory interpretation would ordinarily seek to discount the operation of the presumptions entirely. Here one is dealing with something different, viz a contextual approach only. Also see *Cowen* (1980) *THRHR* 391 *et seq* who argues for a much more prominent role for the presumptions in our law.

<sup>677</sup> Du Plessis “Statute law and interpretation” in *LAWSA* 333.

<sup>678</sup> 2015 5 SA 146 (CC).

<sup>679</sup> 116 *et seq* where Froneman J based an argument solely on the presumption against sub-delegation. See also the judgment of Ngcobo J in *Veldman v Director of Public Prosecutions* 2007 3 SA 210 (CC) para 67, dealing with the presumption against retrospectivity.

exists. It is evident from the analysis which follows<sup>680</sup> that this remains the case for section 20(9), irrespective of whether the relevant canons of statutory interpretation have all been applied.<sup>681</sup>

The presumptions identified above have a clear role to play in a contextual approach to interpretation.

### 2 3 3 *Context within the Companies Act and the constitutional framework*

In considering “unconscionable abuse” “[t]he phrase must ‘take its colour, like a chameleon, from its settings and surrounds in the Act’”.<sup>682</sup> It is therefore necessary to look at the remainder of section 20<sup>683</sup> to determine whether anything useful may be gleaned therefrom on the contents of section 20(9) or any of the other provisions contained in the same part, chapter, or the remainder of the Companies Act.

When conducting such an analysis, the uncomfortable setting within which the subsection finds itself is striking. It does not neatly fit into the theme of section 20, which deals with the validity of company actions, as opposed to the dealings of shareholders using a company. The same uncomfortable setting was present for section 163(4) of the Companies Act. That section previously contained an almost identical version of the section 20(9) piercing provision before the Companies Amendment Act 3 of 2011<sup>684</sup> moved it to section 20(9) of the Companies Act.

Section 20 addresses the “Validity of company actions”, while section 163 provides for the “Relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company”. The subsequent moving of the piercing provision under the

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<sup>680</sup> See the text to parts 2 3 3 to 2 3 5 below.

<sup>681</sup> *Botha v Van Niekerk* 1983 4 All SA 157 (W) para 44; Du Plessis “Statute law and interpretation” in *LAWSA* 333; GE Devenish “*African Christian Democratic Party v Electoral Commission*: The new methodology and theory of statutory interpretation in South Africa” (2006) 123 *SALJ* 399-408 402; A Singh “A re-evaluation of the common law presumptions of interpretation in the light of the Constitution” (2012) 75 *THRHR* 99 *et seq.* See also Cowen (1980) *THRHR* 391; HS Celliers “Die betekenis van vermoedens by wetsuitleg” (1962) 79 *SALJ* 195.

<sup>682</sup> *Standard General Insurance Co Ltd v Commissioner for Customs and Excise* 2005 2 SA 166 (SCA) para 25, quoting with approval from the *dictum* in *De Beers Marine (Pty) Ltd v Commissioner for SARS* 2002 3 All SA 181 (A).

<sup>683</sup> With the heading “*Validity of company actions*”.

<sup>684</sup> Effective on 1 May 2011, the same date that the Companies Act became effective.

Companies Act appears to have done nothing to alter the content of section 20(9) and was merely brought about to facilitate an easier flow to the reading of the Act. The uniqueness of the remedy granted by section 20(9) is such that it may have been better placed as a separate section in the Companies Act altogether, as is the case for its legislated comparative in section 65 of the Close Corporations Act. While this does not detract from the force of the provision, it also does not shed any light on its potential content.

The obvious conclusion is that very little can be deduced from the physical space that the provision occupies in the Companies Act. It is necessary to consider the Act holistically and to consider section 20(9) within the context and ambit of what the Companies Act seeks to achieve. In this regard, section 5(1) of the Companies Act determines that the Act:

“(1) ... must be interpreted and applied in a manner that gives effect to the purposes set out in section 7.”<sup>685</sup>

Section 7 prescribes that the Companies Act has as its purpose the promotion of compliance with the Bill of Rights in the application of company law.<sup>686</sup> This echoes the sentiments of section 8(1) of the Constitution that the Bill of Rights applies to all law. It also purports to provide a predictable environment for the efficient regulation of companies.<sup>687</sup> Where piercing in the common law context is concerned, the need for legal certainty and the piercing doctrine itself are potentially in conflict with one another. As a result of section 7 this conflict also exists in the context of the Companies Act: the value-based considerations of the Bill of Rights on the one hand compared to the need for legal certainty on the other, the latter being especially relevant in a commercial context. The similarity to the common law position is further extended as section 7 calls for a balancing approach where the rights and obligations of shareholders are concerned, as is the case in the common law context.<sup>688</sup> Notably

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<sup>685</sup> See also *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 32 which subscribes to an approach whereby ss 5 and 7 are consulted to assist in interpreting s 20(9).

<sup>686</sup> S 7(a) of the Companies Act.

<sup>687</sup> S 7(l).

<sup>688</sup> See the text to ch 3 part 3 3 2 2 above.

though, section 7 does not imply that potential tax benefits afforded to companies are a purpose at which the incorporation of companies under the Companies Act is aimed.

The Bill of Rights does not address the corporate veil nor the state's ability to tax directly. In this regard one should therefore be careful not to push the constitutional argument too far where it is but of limited and indirect application.<sup>689</sup> However, as was argued in part 3 3 1 2 the Bill of Rights must necessarily play a role in interpreting section 20(9) of the Companies Act, in particular the meaning of "unconscionable abuse". Section 39(2) of the Constitution requires this.<sup>690</sup> The judgment in *Paulsen*<sup>691</sup> shows that even in the absence of a specific provision of the Bill of Rights having direct application, the Bill of Rights still has an important role to play in the interpretation of statutes or the common law.<sup>692</sup>

This is especially relevant where matters of policy come into play. The very substance of the corporate veil is greatly dependent on the policy considerations surrounding its application.<sup>693</sup>

In this context, as has been argued is the case at common law,<sup>694</sup> the values and spirit of the Constitution cannot be said to support the use of a company for tax purposes. The Bill of Rights has clear transformational aspirations<sup>695</sup> with a focus on and clear theme of social justice.<sup>696</sup> The *Shuttleworth* judgment makes it clear that the levying of tax is an expression of democratic will.<sup>697</sup> The levying of tax therefore becomes a constitutional matter and one subject to democratic values. This does not

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<sup>689</sup> See the text to n 521 above and the comments in *Zuma* above.

<sup>690</sup> Du Plessis "Statute law and interpretation" in *LAWSA* 327.

<sup>691</sup> *Paulsen v Slipknot Investments 777 (Pty) Ltd* 2015 3 SA 479 (CC) 117.

<sup>692</sup> See also *Cool Ideas 1186 CC v Hubbard* 2014 4 SA 474 CC para 28, 484F-485A.

<sup>693</sup> A teleological interpretation is therefore warranted: see Botha *Statutory interpretation* 143 *et seq*; Du Plessis "Statute law and interpretation" in *LAWSA* 365 *et seq*.

<sup>694</sup> See the text to ch 3 part 5 1 2 above.

<sup>695</sup> *South African Reserve Bank v Shuttleworth* 2015 5 SA 146 (CC) 87.

<sup>696</sup> See specifically ss 25(2) and (4)(b) of the Constitution.

<sup>697</sup> 2015 5 SA 146 (CC) para 42:

"[T]he power to tax residents is an incident of, and subservient to, representative democracy. The manner and the extent to which national taxes are raised ... must yield to the democratic will as expressed in law. It is the people, through their duly elected representatives, who decide on the taxes that residents must bear."

conflict with the principle enunciated in *Conhage*:

“Within the bounds of any anti-avoidance provisions in the relevant legislation, a taxpayer may minimise his tax liability by arranging his affairs in a suitable manner. If e.g. the same commercial result can be achieved in different ways, he may enter into the type of transaction which does not attract tax or attracts less tax.”<sup>698</sup>

A taxpayer’s ability to minimise his tax liability must also be exercised within the bounds of accepted constitutional norms in the Bill of Rights. Like other legislative instruments tax statutes embody the democratic will of the voting public. If the arranging of a taxpayer’s affairs involves using a company in a transaction only to frustrate the effect of a tax statute such abuse should tip the balance of considerations<sup>699</sup> in favour of piercing, irrespective of other considerations.

Taxation is one of the methods with which to promote social cohesion by distributing wealth. It is a tool through which Government can exercise legislative power to achieve some desirable social objective. It must be recognised that taxation is more than an instrument through which the state procures income to enable it to govern. Taxation is often used to achieve a secondary allocative, distributive or stabilising purpose through which to achieve certain social and economic objectives, objectives often mandated by the Constitution and the Bill of Rights itself.<sup>700</sup>

Although by no means conclusive, a constitutional approach to the intentional avoidance of tax through using the corporate veil must weigh heavily when compared to considerations opposed to piercing. The presumption that statute law promotes the public interest, linked to section 39 of the Constitution, underscores this.<sup>701</sup>

Section 158 of the Companies Act supports the constitutional approach discussed here. It encourages courts to adopt a wider rather than a narrow interpretive approach when interpreting the Act.<sup>702</sup> The courts are mandated to develop the common law and to promote, *inter alia*, the purposes of the Act. In this context section 7(b)(iii), (d)

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<sup>698</sup> [1999] 61 SATC 391 1.

<sup>699</sup> 1. As referred to by Domanski.

<sup>700</sup> J Murphy “The Constitutional Review of Taxation” (1995) *Acta Juridica* 89-122.

<sup>701</sup> Du Plessis “Statute law and interpretation” in *LAWSA* 336; Steyn *Die Uitleg van Wette* 124 *et seq.*

<sup>702</sup> Devenish (2006) *SALJ* 401.

and (e) are relevant indicators of the social purpose that the company should seek to achieve. It is this purpose and the social contract between society and the company, in terms of which companies both directly and indirectly are meant to benefit society,<sup>703</sup> which shareholders abuse if the separate existence of the company is used primarily for tax purposes.

Section 20(9) would therefore deem it more than a mere “ordinary” abuse of legal personality of a company if that separate personality is used for tax purposes. This conclusion is based on a consideration of section 7(a) of the Companies Act specifically, together with policy considerations and the values which section 39 of the Constitution aims to promote. Admittedly, it is by no means clear from either the constitutional approach or the Companies Act alone that any identified instance of abuse should be considered “unconscionable”. The constitutional approach only provides further context within which a court in exercising its discretion to pierce must consider public policy.<sup>704</sup> It falls short though of giving an unambiguous meaning to the phrase “unconscionable abuse”. The meaning of this phrase becomes much clearer when one considers section 65 of the Close Corporations Act as well as the common law context.

#### *2 3 4 Context within the legal framework of section 65 of the Close Corporations Act*

Contrary to the suggestion in *Ex Parte Gore*,<sup>705</sup> any interpretation of “unconscionable abuse” as used in the Companies Act should in my view keep the approach to the phrase “gross abuse” in the Close Corporations Act in mind.

The view has been advanced throughout this dissertation that the common law piercing test necessarily contains a subjective requirement.<sup>706</sup> In other words, the veil can only be pierced if the shareholder intentionally abused the separate corporate personality of the company.<sup>707</sup> This is in line with the cases dealing with section 65 of

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<sup>703</sup> Katzew (2011) SALJ 692 *et seq.*

<sup>704</sup> See the text to ch 4 part 3 2 below.

<sup>705</sup> See the text to part 1 1 2 2 of this chapter above.

<sup>706</sup> See the text to ch 2 part 4 2 3 and ch 3 parts 3 3 2 1 and 3 3 2 4 above.

<sup>707</sup> Flemming J did not use the term “*onduldbare onreg*” above in the subjective sense. Now though, through the translation which the term has undergone before being legislated, both the English (“*unconscionable abuse*”) version of the Companies Act and the Afrikaans

the Close Corporations Act which strongly suggests that the common law remedy and section 65 are aligned in this respect. In *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis*<sup>708</sup> Hattingh R determined that the relevant member's actions were done “*met een doel voor oë*”.<sup>709</sup> In the *a quo* judgment in *Airport Cold Storage Griesel J* held that the members “chose” to ignore the separate corporate personality of the relevant close corporation when it suited them.<sup>710</sup> In *Mncube v District Seven Property Investments CC*<sup>711</sup> it was determined that abuse of the corporate veil would involve it being used for a “nefarious purpose”. Admittedly, in *Haygro Catering BK v Van der Merwe*<sup>712</sup> the

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(“*gewetenlose misbruik*” translated back to Afrikaans from “*unconscionable abuse*”) translation suggest, on a literal interpretation at least, that a subjective approach should be followed, if only at least in part but a requirement nonetheless. With reference to the origins of the term, one may be tempted to suggest that, given the origin of the term in the judgment of Flemming J (and regarded as being “too rigid” in *Cape Pacific*), that the choice of the phrase “unconscionable abuse” in s 20(9) may be an expression by the legislature that the piercing test should be applied in this rigid sense. Such an argument will however be incorrect – see n 36 of *Ex Parte Gore*. The phrase “unconscionable injustice” has been used in an entirely different context by the courts than is the case now for the phrase used in s 20(9): the former relates to the consequence of certain conduct, whereas s 20(9) would refer to the conduct giving rise to the remedy (as opposed to the consequence thereof).

<sup>708</sup> 1998 1 SA 971 (O).

<sup>709</sup> 985 and 986.

<sup>710</sup> 2008 2 SA 303 (C) para 78. The facts of the case were briefly that a father and son were the respondents facing applications in terms of ss 63, 64 or 65 of the Close Corporations Act (all of these provisions effectively amounting to piercing in varying circumstances). In terms thereof an application was brought to have the two individuals held personally liable for the debts of a close corporation. The application was successful, based on s 65. On appeal to the SCA the appeal was rejected and the *a quo* judgment upheld, but based on s 64. The list of objective factors mentioned in the *a quo* judgment in support of the application for piercing in terms of s 65 may cast doubt on whether the subjective intention was decisive in arriving at the court's conclusion that piercing was an appropriate remedy in that instance. Even though the judgment was upheld on appeal to the SCA in *Ebrahim*, it is then significant, that the order was maintained, though in terms of s 64 and no longer s 65. Since the order of the court *a quo* was left undisturbed by the SCA, the court may have felt disinclined to address whether the piercing remedy may have been more appropriate in terms of s 64. A similar example of the most appropriate piercing provision perhaps not being utilised, is to be found in *Haygro Catering BK v Van der Merwe* 1996 4 SA 1063 (C): see the text to n 713 below.

<sup>711</sup> [2006] JOL 17381 (D) 15.

<sup>712</sup> *Haygro Catering BK v Van der Merwe* 1996 4 SA 1063 (C).

court appears to have considered only objective factors in applying section 65. The reliance on objective factors in this judgment has, however, been questioned, particularly whether section 65 was the appropriate provision in terms of which to effectively pierce the corporate veil.<sup>713</sup> Considering that both the section 65 remedy and the common law doctrine<sup>714</sup> clearly involve a subjective test and further that the phrase used in section 20(9) has its roots in the common law and a clear connection with section 65, it is suggested that the same approach must be taken in respect of section 20(9). “Unconscionable” must therefore be determined with reference to the subjective intent with which the abuse is exercised.

A further important observation from a study of the reported cases dealing with the piercing of close corporations is that section 65 appears to have, at least in practice, usurped the role of the common law.<sup>715</sup> In none of these reported cases have the courts sought to apply the common law remedy as alternative to the remedy in section 65 of the Close Corporations Act. Since the Close Corporations Act has a legislated piercing remedy in place which mirrors the common law doctrine’s content,<sup>716</sup> it means that practically section 65 would be the preferred method to pierce the corporate veil of a close corporation. While the common law doctrine may continue to exist in theory in the close corporation context, it does so together with the remedy in section 65.

A natural conclusion is that the same approach should be applied to the relationship of section 20(9) of the Companies Act and the common law remedy: the former is largely the legislated replica of the latter.<sup>717</sup> As was the case for close corporations,

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<sup>713</sup> Meskin et al *Henocheberg on the Close Corporations Act* n 65.4 where the view is expressed that the corporate veil should rather here have been pierced in terms of s 63(a) or alternatively 64, and that the application of s 65 here may have been inappropriate. See also Strydom & Du Plessis (1997) *TSAR* 419.

<sup>714</sup> See the text to ch 3 part 3 3 2 1 above.

<sup>715</sup> See also Strydom & Du Plessis (1997) *TSAR* 417 (and 420) who agree with this approach where the interaction between s 65 and the common law was at stake, as well as *Botha v Van Niekerk* 1983 4 All SA 157 (W) 164 referred to there as authority for the view taken.

<sup>716</sup> See text to n 715 above. See also *Airport Cold Storage* at para 24.

<sup>717</sup> Other than potentially that the one remedy having wider or narrower application than the other (which it is maintained is not the case), no other divergent principles exist between the two remedies. It follows that, if s 20(9) would apply to broader set of facts, the common law remedy would be rendered powerless, as it can never remedy any situation where s 20(9) would not also apply. If it were argued that s 20(9) has narrowed the scope of piercing,

the enactment of a statutory piercing doctrine of general application should not be regarded as an indication of an intentional departure from the position that pre-existed under the common law.<sup>718</sup> Section 20(9) was not intended to substitute the common law doctrine. It should rather be regarded as the legislated equivalent of that remedy, supplementing it yet without changing the substantive requirements thereof.<sup>719</sup> For South African common law purposes though, even though the common law and section 20(9) piercing remedies will co-exist, the practical effect is bound to be that the common law remedy will practically no longer serve much of a purpose, simply since the two remedies are in substance the same.<sup>720</sup> *Ex Parte Gore* illustrates this well: a piercing application was brought in terms of the common law, alternatively in terms of section 20(9). By granting relief in terms of section 20(9), and not in terms of the relief requested in first instance, the court effectively found the two remedies to be substantially the same.

The wording of section 20(9) suggests that the piercing remedy in this provision will not be rigid, but will be developed in the same way, as the common law remedy.<sup>721</sup> The vagueness of the literal interpretation of the abstract phrase “unconscionable abuse” will enable the courts to develop the piercing doctrine continuously within the context of ever-changing policy considerations.<sup>722</sup> Where it had previously been done in order to develop the common law, it will in future happen as part of a statutory interpretive process to contextualise this “open-ended concept”.<sup>723</sup>

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compelling arguments would exist that this was done purposefully and in line with the presumption that statutes do not contain purposeless or nugatory provisions – legislation trumps the common law (Botha *Statutory interpretation* 43). Also see Kellaway *Principles of legal interpretation* 360 *et seq.*

<sup>718</sup> See *Airport Cold Storage* where the court uses the common law principles developed thus far to inform the contents of “gross abuse”.

<sup>719</sup> See *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34; Nel (2014) *Obiter* 575; Smith (2016) *JJS* 71.

<sup>720</sup> See the one exception noted in ch 4 part 3 4 below as well as those instances where s 20(9) will be supplemental to the common law remedy (see the text to ch 4 part 3 5 2 below).

<sup>721</sup> See the text to ch 4 par 2 3 5 below.

<sup>722</sup> Ch 4 part 3 2 below.

<sup>723</sup> *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 2 SA 303 (C) para 24.

One has to conclude therefore that the two tests contained in section 20(9) of the Companies Act and section 65 of the Close Corporations Act have the same meaning.<sup>724</sup> This means that section 20(9) involves a subjective enquiry into the intention with which the separate corporate personality of the company is being abused, as is the case in section 65. This is an important conclusion in a tax avoidance context.<sup>725</sup>

It is interesting to note Larkin's prophetic words in 1989 that section 65 of the Close Corporations Act could very well act as the forerunner for a legislated equivalent in the Companies Act at some stage in the future.<sup>726</sup> He was also clear in his correct analysis that section 65 replaced the common law piercing doctrine where close corporations are concerned. The time has indeed now arrived where the statutory provision in section 20(9) has practically usurped much of the common law piercing doctrine,<sup>727</sup> but without replacing it. Legislating the remedy may have its advantages, but as Larkin rightly pointed out, the risk is that it may bring along an element of rigidity.<sup>728</sup> For a common law doctrine such as piercing, rigidity is bound to render the provision archaic over time if it is unable to adapt with the ever-changing nature of society's commercial needs. This will be the challenge for our courts: to continue developing the doctrine even in its legislated form in order to maintain the doctrine's relevance. The provision in its current form fortunately provides enough manoeuvring space for the courts to develop the doctrine.<sup>729</sup>

Rigidity, according to Larkin, is bound to set in if section 20(9) is interpreted in an overly technical manner. This demands a pragmatic approach to the interpretation of section 20(9), requiring it to be interpreted as having the same meaning as section 65

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<sup>724</sup> See also ch 4 part 2 4 2 2 below: the drafting history of s 20(9) betrays that the provision was meant to have the same effect as s 65 of the Close Corporations Act. *Contra Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 34 where Binns-Ward J *obiter* comments that the test in the Close Corporations Act has a more "extreme connotation" to it compared to the test in s 20(9).

<sup>725</sup> See the text to ch 4 part 4 below.

<sup>726</sup> *Larkin* (1989) SA Merc LJ 280.

<sup>727</sup> See also the text to ch 4 part 2 5 below; *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 32.

<sup>728</sup> See also Cassim et al *The Law of Business Structures* 71.

<sup>729</sup> See the text to ch 4 part 3 2 below.

(in the context of companies as opposed to close corporations). As has been shown, section 20(9) is to be regarded as the equivalent of the pre-Companies Act common law doctrine.<sup>730</sup> This does not signal the demise of the piercing doctrine.<sup>731</sup> Rather, it continues to exist substantially unchanged,<sup>732</sup> but its practical use is bound to be extremely limited in future.

### 2 3 5 Context within the common law

“Unconscionable”, as appearing in the Companies Act, seems to have been borrowed from the common law judgments on the piercing of companies. It is thus a familiar term in the piercing context,<sup>733</sup> even though the contents thereof have developed over time.

South African courts have thus far only considered section 20(9) in detail once, and that was in *Ex Parte Gore*.<sup>734</sup> The conclusion reached in this dissertation regarding the interplay between the common law and section 20(9) is confirmed in that case.<sup>735</sup> It was concluded there that the common law test was not replaced, but rather that section 20(9) applies concurrently with it and operates in a supplemental fashion.

The fact that the relief granted in *Ex Parte Gore* was in terms of the alternative relief requested under section 20(9) gives context to Binns-Ward J’s *dictum* that section 20(9) is “supplemental to the common law, rather than substitutive”. This may seem to contradict the afore-mentioned *dictum*, but it shows that section 20(9) is not meant to vary the common law doctrine by replacing it with a new and different test. It keeps the common law remedy intact. Seen in this light, the question whether the common

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<sup>730</sup> See also the conclusions at ch 4 part 2 4 2 2 below where this conclusion is supported by the drafting history of s 20(9).

<sup>731</sup> See the text to ch 4 part 2 4 below. It remains the only remedy in terms of which a court can pierce a foreign incorporated company.

<sup>732</sup> See the text to ch 4 parts 2 2 to 2 5 below.

<sup>733</sup> Refer the discussion in ch 4 parts 1 1 2 2 and 2 3 4 above on the translation by Nel J in *Cape Pacific a quo* of Flemming J’s “*onduldbare onreg*” in *Botha v Van Niekerk* 1983 4 All SA 157 (W) to “unconscionable injustice”.

<sup>734</sup> See the text to parts 4 1 1 and 4 1 2 above.

<sup>735</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) paras 31, 32 and 34 and discussed in the text to ch 4 part 1 1 above.

law piercing doctrine still exists becomes largely academic if the requirements and outcome of both remedies are similar.<sup>736</sup>

Although *Ex Parte Gore* is the only example of a direct consideration of section 20(9), the SCA has also expressed itself *obiter* on the matter. In *WT v KT* the court compared the divergent approaches that may underlie “looking behind the veneer of a trust” and “piercing the corporate veil”. The court concluded:

“By analogous reasoning, unconscionable abuse of the trust form through fraud, dishonesty or an improper purpose will justify looking behind the trust form.”<sup>737</sup> [own emphasis]

It is significant that the SCA used this specific wording.<sup>738</sup> Applying it to a company, piercing of the corporate veil will be justified where an unconscionable abuse of it is perpetrated by means of fraud, dishonesty or with an improper purpose.

It confirms that piercing can only be justified where an unconscionable abuse is present, that is abuse which has arisen through fraud, dishonesty or improper purpose.<sup>739</sup> Although the discussion of the common law piercing doctrine in chapter 3 has shown that there are many more considerations linked to the doctrine than merely determining when an act will qualify as “fraud, dishonesty or other improper conduct”,<sup>740</sup> this statement clearly indicates that the SCA would regard section 20(9)

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<sup>736</sup> *Contra* Cassim et al *Contemporary Company Law* 58, published though before the judgment in *Ex Parte Gore*. See also Claassen *Dictionary of Legal Words and Phrases* at “Interested Person” that s 20(9) has broadened the common law remedy.

<sup>737</sup> *WT v KT* 2015 3 SA 574 (SCA) para 31.

<sup>738</sup> Smith (2016) *JJS* 75.

<sup>739</sup> In the company law context this is an obvious reference to the test proposed by the same court in *Cape Pacific*. The approach is consistent with that proposed by Steyn *Die Uitleg van Wette* 100 where he explains the rule with reference to Donellus *De Jure Civili* 1 15 8 and Glück *Pandecten*, 1: 390:

“Regsterme in ‘n wet gebruik, put hul inhoud uit die gemene reg waaruit hul afkomstig is, en indien ‘n woord of uitdrukking in ‘n wet ‘n onduidelike, maar in die gemene reg ‘n duidelike betekenis het, word die gemeenregtelike betekenis daaraan toegeskryf.”

<sup>740</sup> The role of policy considerations in determining whether the remedy is only available as a final one is discussed in part 3 3 2 2 of this chapter below.

as inextricably linked to the common law test enunciated in *Cape Pacific*.<sup>741</sup> It confirms that the *Cape Pacific* test is still valid and currently the test to be applied in terms of section 20(9).

The “unconscionable abuse” test in terms of section 20(9) is – as was the case with for the common law test<sup>742</sup> – necessarily a subjective one. The SCA emphasised this in *WT v KT*, referring not to “improper **conduct**” as was done in *Cape Pacific*, but rather to an “improper **purpose**”. This is a clear endorsement that the subjective intent or purpose of a shareholder abusing the corporate veil is a necessary factor to enable a court to pierce in terms of section 20(9). It is unfortunate that Binns-Ward J in *Ex Parte Gore* appeared to be willing to pierce the veil only based on objective criteria.<sup>743</sup> The approach is not correct and the reference to *Ebrahim’s* case as justification is misplaced. In *Ebrahim* the SCA dealt exclusively with the provisions of section 64 of the Close Corporations Act and not section 65 as the *a quo* judgment had. The SCA’s judgment strongly suggests that the court purposefully preferred to apply section 64 given the objective considerations at play, rather than section 65 on which the *a quo* judgment relied.<sup>744</sup> It is submitted that any piercing according to section 65 of the Close Corporations Act,<sup>745</sup> section 20(9) of the Companies Act<sup>746</sup> or the common law<sup>747</sup> necessarily involves a subjective enquiry.

The conclusion is therefore that the threshold requirement for piercing in terms of the common law is also the test applied to piercing in terms of section 20(9). At common law, once fraud, dishonesty or an improper purpose is shown to be present, policy and other considerations come into play. This too is the case with section 20(9),

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<sup>741</sup> See the text to ch 3 part 3 3 2 1 above. *Contra Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 33 which suggests that there are many more bases on which to pierce in terms of s 20(9) when compared to the traditional common law approach.

<sup>742</sup> See the text to ch 3 part 3 3 2 1 above.

<sup>743</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 33. The willingness to pierce on objective criteria alone is based on the principles of the *alter ego* doctrine cautioned against in the text to ch 2 part 4 2 3 above. It is suggested that objective criteria are not enough for piercing to be applied, subjective criteria also need to be involved.

<sup>744</sup> See the text to n 710 above.

<sup>745</sup> See the text to part 2 3 4 above.

<sup>746</sup> See the text to part 2 3 3 above.

<sup>747</sup> See the text to ch 2 part 4 2 3 and ch 3 parts 3 3 2 1 and 3 3 2 4 above.

which provides that a court “may”<sup>748</sup> pierce the veil in instances of unconscionable abuse.<sup>749</sup>

It remains to refer briefly to the presumptions of statutory interpretation. Two presumptions are of particular relevance in this regard. They are the presumption that the legislature does not intend to vary existing law more than is necessary and that legislation does not contain nugatory or futile provisions.

Applied to section 20(9) it appears at first sight as though these two presumptions may be in conflict with each other. On the one hand there is the presumption that section 20(9) is nothing but the legislated equivalent of the common law position. On the other hand the second presumption would have it that the introduction of section 20(9) must have changed the scope of the common law doctrine. Nevertheless, it is possible for the two to be reconciled.

Section 20(9) is essentially the statutory version of the common law doctrine, both in its current application as well as in its ability to evolve in line with changing policy considerations. The presumption that the legislature does not intend to vary the law more than is necessary<sup>750</sup> fits in well with this view. A clear departure from the prevailing position is required to avoid the application of the presumption. No such clear departure is present in section 20(9) and the piercing remedy in section 20(9) must therefore be interpreted in line with the existing common law remedy.<sup>751</sup>

However, honouring the presumption that a statutory provision does not impose more change than is necessary, does not mean that the provisions of section 20(9) can be regarded as nugatory. Particularly in view of the uncertainty in which the remedy is shrouded (and recent doubt in some jurisdictions even about its

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<sup>748</sup> As opposed to “must”.

<sup>749</sup> See 4 3 2 below.

<sup>750</sup> Which exists to promote legal certainty and esteem for the common law.

<sup>751</sup> Steyn *Die Uitleg van Wette 97 et seq*, quoting exhaustively from the old Dutch authorities. “*Die bedoeling om die gemenereg te verbeter moet, soos P Voet sê, blyk uit ‘n uitdruklike bepaling, of ipso facto, dit wil sê uit dwingende veronderstellings uit die wet self afgelei word.*” See also the various other authorities and case law discussed there as further authority. Also see Botha *Statutory interpretation* 78; Du Plessis “Statute law and interpretation” in *LAWSA* 340; Kellaway *Principles of legal interpretation* 335 and 357 *et seq*; Silke (1995) *Acta Juridica* 134 *et seq*.

existence),<sup>752</sup> it is to be welcomed that the South African legislature has expressed itself in favour of the remedy. Section 20(9)'s clarification of ancillary matters (such as whether the piercing remedy is a remedy of last resort)<sup>753</sup> also counters the argument that interpreting section 20(9) in line with the existing common law renders it effectively purposeless. The presumption that statutory law is not purposeless or nugatory must be regarded as having been rebutted in this case.<sup>754</sup>

It follows that the common law presumptions support the argument that “unconscionable abuse” in section 20(9) should be interpreted in line with the pre-existing common law threshold requirement, viz the presence of fraud, dishonesty or an improper purpose.

#### 2.4 Background material

It remains to consider whether the conclusion in the previous paragraph will also be justified if one has regard to the “relevant background material”.<sup>755</sup>

Du Plessis considers background material to have a confirmatory function at most and that it should be used with circumspection.<sup>756</sup> In the present context this is uncontentious since a contextual interpretative approach already points to the meaning that should be attached to “unconscionable abuse”.<sup>757</sup>

The Constitutional Court<sup>758</sup> decided in *Minister of Health v New Clicks SA (Pty)*

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<sup>752</sup> See for example the UK Supreme Court judgment in *Prest v Petrodel Resources Ltd* 2013 UKSC 34.

<sup>753</sup> See the text to ch 3 part 2 below.

<sup>754</sup> Du Plessis “Statute law and interpretation” in *LAWSA* 342; Botha *Statutory interpretation* 133; Steyn *Die Uitleg van Wette* 119.

<sup>755</sup> See *Commissioner for the South African Revenue Service v Bosch* 2015 2 SA 174 (SCA) para 9; *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) 18 and *Jaga v Dönges, NO and another; Bhana v Dönges, NO and another* 1950 4 SA 653 (A) 421 (referred to with approval in *Natal Joint Municipal Pension Fund*).

<sup>756</sup> Du Plessis “Statute law and interpretation” in *LAWSA* 374.

<sup>757</sup> See the text to ch 4 part 2 3 above.

<sup>758</sup> After leaving the question open in *S v Makwanyane* 1995 3 SA 391 (CC) para 19. It was decided there at para 18 that undisputed, clear and relevant background material (even if not a report of a judicial commission of enquiry) may be useful as interpretive aid in constitutional matters.

*Ltd*<sup>759</sup> that background material may be used to inform the interpretation of non-constitutional statutory provisions too.<sup>760</sup> The SCA in *Krok v CSARS*<sup>761</sup> applied this view. In *Krok* it was said that the approach to statutory interpretation in South Africa is akin to that set out in articles 31 and 32 of the Vienna Convention on the Law of Treaties. Article 32 makes it clear that the preliminary work in preparation of a treaty – which is in essence a statutory instrument – may be considered to confirm an interpretation through the application of the prescribed unitary interpretative method.<sup>762</sup> This method is also used in this dissertation in relation to section 20(9) of the Companies Act.<sup>763</sup> The question is whether the background material to the Companies Act, section 20(9) in particular, supports the conclusion that the common law piercing doctrine gives meaning to “unconscionable abuse”.

#### 2 4 1 *Background to the adoption of the Companies Act: the context of section 20(9)*

The Companies Act of 2008 was not meant to radically change all aspects of South African company law. This is clear from the policy document on corporate law reform released by the Department of Trade and Industry (“DTI”) in 2004.<sup>764</sup> The Companies Act in its current form which in many places retained the principles contained in the Repealed Companies Act of 1973, supports this. Where a direct departure from the previous dispensation is not apparent, the common law remains. This also applies to the piercing doctrine. There is no evidence of any direct policy decision on whichever level to purposefully alter the pre-existing common law in this area.

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<sup>759</sup> 2006 2 SA 311 (CC) paras 200 and 201.

<sup>760</sup> See *Mansingh v General Council of the Bar* 2014 1 BCLR 85 (CC) paras 26 to 28 and the reference there to *Natal Joint Municipal Pension Fund*; Kellaway *Principles of legal interpretation* 276.

<sup>761</sup> 2015 6 SA 317 (SCA) para 27. See also the extensive background material relied upon by the court in *Pienaar Bothers (Pty) Ltd v CSARS* HC case no 87760/2014 of 29-05-2014 para 33 to assist with a contextual statutory interpretative exercise.

<sup>762</sup> See the *dictum* in *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 quoted in *Bothma Batho Transport v S Bothma & Seun Transport* 2014 2 SA 494 (SCA) para 12.

<sup>763</sup> Steyn *Die Uitleg van Wette* 134 no longer reflects the current position in South African law.

<sup>764</sup> *South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004 3.3 (27).

This is not true of indirect impacts. Olson<sup>765</sup> points to the emergence of the stakeholder model as part of the present Companies Act and how this model is playing a bigger part in the interpretation of the Companies Act of 2008.<sup>766</sup>

This should also inform the manner in which section 20(9) should be approached, especially in the context of tax avoidance. Whereas shareholders may in the past have been able to argue that – in keeping with the shareholder model – the company is a creature created for their use and profit maximisation only (which would be promoted by paying less tax), this is no longer the case. If it is accepted that the use of a company mainly for tax purposes amounts at a minimum to the abuse of legal personality,<sup>767</sup> such abuse in terms of the stakeholder model clearly leans more, rather than less, to being “unconscionable”.

Seen in this context, section 20(9) provides a remedy of potentially wider application in the tax context compared to the common law developed when the Repealed Companies Act was still in effect.<sup>768</sup> This is not to say that piercing should now be applied liberally. Such an approach will detract from the purpose that the company as legal person is meant to serve. Although the stakeholder model changes the understanding of the company form, the Companies Act as a whole in principle still subscribes to the shareholder primacy model. The influence of the stakeholder model

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<sup>765</sup> Olson “South Africa moves to a global model of corporate governance but with important national variations” (2010) *Acta Juridica* 219 220 *et seq.* Olson was a member of the international team engaged as part of the company law reform process.

<sup>766</sup> Also see s 7 of the Companies Act which contains clear evidence hereof. S 20(9) itself, as well as ss 165(2)(c) and (d), further serve as examples. The requirement in s 72(4) for bigger companies to have a social and ethics committee is a further example of a nuanced inclination towards the stakeholder model as opposed to the strict shareholder model. Olson (2010) *Acta Juridica* 222 also refers to Elkington’s “triple bottom line” approach, adopted by the King II and III reports on corporate governance and expressly subscribed to by Government (*South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004 3.2.3). It is clear from these Guidelines that a definitive policy shift towards the stakeholder model was intended. The *King IV Report on Corporate Governance for South Africa 2016 23 et seq* not only considers it necessary that a company’s tax strategy and policy should be in line with wider stakeholder considerations, but also that specifically tax strategy and policy should be the responsibility of the governing body and audit committee of a company.

<sup>767</sup> See the text to ch 4 part 2 2 above.

<sup>768</sup> Ch 3.

does shift policy considerations in a direction in which the intentional avoidance of tax can increasingly be regarded “unconscionable” and a justifiable ground on which a court may apply section 20(9).

## 2 4 2 Background to the adoption of section 20(9): its purpose

### 2 4 2 1 International influence

When looking at the law reform process that culminated in the Companies Act of 2008, the role of international corporate law advisors is striking. This points to the possibility that the wording of section 20(9) too may have its origin in foreign company law. The international involvement comprised mainly legal experts from Canada, the UK and the USA.<sup>769</sup> The significant American influence in the drafting of the Act is foreshadowed in the DTI policy document which contains extensive referencing to the USA experience.<sup>770</sup> The significant foreign influence in the drafting process is also shown by the fact that the chief drafter of the Companies Act, Mr Phillip Knight, was from Canada.<sup>771</sup>

It is therefore necessary to investigate whether company legislation from particularly the USA, Canada and the UK contain comparable provisions to our section 20(9) and, if so, how these are applied in their country of origin.

The USA does not have a federal corporate law system and laws governing companies fall under the jurisdiction of each state. Apart from the approach adopted by states generally, it is necessary also to consider the company law in the State of Delaware specifically, which does not use of the Model Business Corporation Act.<sup>772</sup>

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<sup>769</sup> TH Mongalo “An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008” (2010) *Acta Juridica* xiii reports that the initial round table discussions held on 11 July 2003, and which formally marked the launch of the company law reform process, included several participants from the USA and the UK. This group was to expand further in the coming years to include other international experts, notably from Canada. These individuals would make up the international reference team which, together with the local reference team, advised the drafting team.

<sup>770</sup> *South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004.

<sup>771</sup> *Mongalo* (2010) *Acta Juridica* xv.

<sup>772</sup> (Revised 2010) (“Model Business Corporation Act”), which states generally apply.

Not only is the State of Delaware the most popular jurisdiction in the USA for incorporating companies, but it is also relevant due to its perceived status as a tax haven.<sup>773</sup>

The general position regarding limited liability in the USA is set out in section 6.22(b) of the Model Business Corporation Act which provides that:

“Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.”

Although broad piercing provisions do exist in Delaware, none of them goes as far as section 20(9) and none can be applied to counter abuse for tax purposes.<sup>774</sup>

For example, while section 325 of the State of Delaware’s General Corporation Law<sup>775</sup> envisages piercing, it stops short of providing any grounds, notably tax related grounds, upon which the corporate veil may be pierced:

- “(a) When the officers, directors or stockholders of any corporation shall be liable by the provisions of this chapter to pay the debts of the corporation, or any part thereof, any person to whom they are liable may have an action, at law or in equity, against any 1 or more of them, and the complaint shall state the claim against the corporation, and the ground on which the plaintiff expects to charge the defendants personally.
- (b) No suit shall be brought against any officer, director or stockholder for any debt of a corporation of which such person is an officer, director or stockholder, until judgment be obtained therefor against the corporation and execution thereon returned unsatisfied.”

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<sup>773</sup> See JG Gravelle “Tax Havens: International Tax Avoidance and Evasion” (23-01-2013) *Congressional Research Service* <<http://www.fas.org/sgp/crs/misc/R40623.pdf>> (accessed 12-06-2013).

<sup>774</sup> While some states also provide for so-called “pass-through entities” for tax purposes (S Corporations in North Carolina and Delaware being examples), these hybrid entities are not considered in this research: CCH *State tax Guide – all states* vol 1 (2010, updated 2013) (Loose leaf publication).

<sup>775</sup> (Revised 2013) Title 8, Ch 1, revised 2013.

In the context of a so-called “professional corporation” section 608 of the same Act<sup>776</sup> limits the grounds for piercing to acts carried out in the exercise of the profession:

“Any officer, employee, agent or shareholder of a professional corporation shall remain personally and fully liable and accountable for any negligent, wrongful acts, or misconduct committed by such person, or by any person under such person's direct supervision and control, while rendering professional services on behalf of the professional corporation to the person for whom such professional services were being rendered.”

In Canada, the Canadian Business Corporations Act of 1985<sup>777</sup> contains a potentially wide-ranging provision aimed at providing relief for acts that are “oppressive or unfairly prejudicial”:<sup>778</sup>

“If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates

- (a) any act or omission of the corporation or any of its affiliates effects a result,
- (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
- (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.”

It is unclear though whether this provision would allow for piercing as a relief as such, let alone piercing being applied to counter the intentional avoidance of tax as contemplated in this dissertation.<sup>779</sup> It in any case seems to be related to our section 163 rather than section 20(9).

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<sup>776</sup> Title 8, Ch 6.

<sup>777</sup> R.S.C., 1985, c. C-44.

<sup>778</sup> S 241(2) of the Canadian Business Corporations Act.

<sup>779</sup> No similar provision is contained in the Corporations Act, R.S.C., 1970, c. C-32.

A further relevant provision is article 317 of the Civil Code of Québec:

“The juridical personality of a legal person may not be invoked against a person in good faith so as to dissemble fraud, abuse of right or contravention of a rule of public order.”<sup>780</sup>

As is the case with section 241(2) of the Canadian Business Corporation Act, article 317 of the Civil Code of Québec too is not as far-reaching as the provisions of our section 20(9).

A corresponding provision to section 20(9) could also not be found in the UK Companies Act of 2006.<sup>781</sup>

Although the foreign legislation studied to a lesser or greater extent does contain focused piercing provisions, none of them is of such a potentially sweeping nature as section 20(9). And since the term “unconscionable abuse” could not be traced to any foreign statutes, the South African provision seems to be of local origin. Foreign company law therefore provides little assistance in the interpretation of section 20(9), save for the indirect role which it played in the development of the common law piercing doctrine<sup>782</sup> that in turn shaped the approach to section 20(9).<sup>783</sup>

#### 2 4 2 2 History of the drafting of section 20(9)

The domestic roots of section 20(9) and how it was introduced into the Companies Act of 2008 remain to be considered.

Although it has been established that “background material” may be used as a help to statutory interpretation<sup>784</sup> the use of extrinsic evidence of the drafting process in the form of parliamentary debates and reports is particularly controversial. It is suggested such evidence is to be applied with particular circumspection and with limited for referring thereto: not to ascribe a meaning to “unconscionable abuse” as such, but

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<sup>780</sup> CQLR c C-1991.

<sup>781</sup> 2006 C 46.

<sup>782</sup> S 5(2) of the Companies Act providing that “[t]o the extent appropriate, a court interpreting or applying [the Companies Act] may consider foreign company law”, does not have a direct bearing on the interpretation of s 20(9).

<sup>783</sup> See the text to ch 4 part 2 3 5 above.

<sup>784</sup> See the text to ch 4 part 2 4 above.

rather to give context to this phrase. Put differently, the parliamentary drafting process is considered not in order to pin a specific part of such deliberations to a phrase. It rather informs the broader context of the provision to determine whether it supports or derogates from the conclusions reached thus far.

Neither the memorandum on the objects of the Companies Bill 2008<sup>785</sup> nor the memorandum on the objects of the Companies Amendment Bill of 2010<sup>786</sup> addresses the provision, first introduced as section 163(4) and later moved almost *verbatim* and renumbered as section 20(9).<sup>787</sup>

Although by no means conclusive, the limited attention that the provision received throughout the drafting process suggests that the provision was not considered a deviation from the existing legal position at the time. If this had been the case, one would have expected an explanation in the supplementary material to the Companies Act and Companies Amendment Act.

Section 163(4) further did not form part of the Draft Companies Bill 2007<sup>788</sup> or of the Bill<sup>789</sup> introduced to Parliament's Portfolio Committee on Trade and Industry on 25 June 2008. As appears from the minutes of the Portfolio Committee's final meeting on the Bill held on 28 August 2008,<sup>790+791</sup> section 163(4) was only introduced there at that very late stage and as part of the proposed amendments by the DTI.

The deliberations of that Portfolio Committee meeting were the only discussions forming part of the parliamentary process on what was then section 163(4). No minutes of meetings indicate that the provision was discussed at any other Portfolio

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<sup>785</sup> B61-D 2008.

<sup>786</sup> B40-B 2010.

<sup>787</sup> See the Companies Amendment Act. S 20 addresses the "Validity of company actions" whilst s 163 provides for the "Relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company". The subsequent moving of the piercing provision does not in any way detract from that provision's validity or potential application and appears to have been merely brought about as an attempt at a more logical grouping of the provisions of the Companies Act.

<sup>788</sup> Presented on 10 May 2007 during a workshop by the Department of Trade and Industry to the Trade and Industry Portfolio Committee.

<sup>789</sup> Certified as at 18 June 2008 without being introduced.

<sup>790</sup> Companies Bill [B61-2008].

<sup>791</sup> Which Bill was finalised without any further changes or debates on s 163(4), passed by Parliament subsequently and signed into law on 8 April 2009.

Committee meeting or that it was the subject of debate in either the National Assembly or the National Council of Provinces. It is therefore important to take note of the only limited discussion and rather crude analysis of the provision at the deliberations at that final Committee meeting held on 28 August 2008 as recorded in its minutes:

“Clause 63

Mr Sibanda<sup>792</sup> read out the proposed amendment to the clause. He explained that this provision would ensure that no person could use the company as a shield.

In response to questions, chiefly from Mr Labuschagne,<sup>793</sup> Mr Dwinger<sup>794</sup> gave as examples of what was intended, companies not paying their creditors and their directors relying on the limited liability provision to escape paying the creditors personally.

Mr Netshitenzhe<sup>795</sup> explained that this was in line with a recent court decision regarding a close corporation where the members of the defaulting close corporation had been held personally liable for the debts of the close corporation.<sup>796</sup> [own emphasis]

The above can certainly not be considered a technical analysis of what is now section 20(9). It further betrays very little of the reasoning behind the introduction of the legislative piercing provision. The reference to “a recent court decision” is, however, insightful.

The court decision referred to can only be that in *Airport Cold Storage*. This should not be used as a means to interpret section 20(9) though. *Airport Cold Storage* which correctly interpreted section 65 as being in line with the common law approach, was mentioned only as an example of the potential effect of a general piercing provision. The minutes show that the judgment was not referred to as guidance on how section 20(9) should be approached.<sup>797</sup>

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<sup>792</sup> DTI Chief Director: Policy and Regulations, Consumer and Corporate Regulation Division.

<sup>793</sup> Democratic Alliance member.

<sup>794</sup> Manager: Legal Services: CIPRO.

<sup>795</sup> DTI Director: Compliance Law and Policy, Consumer & Corporate Regulation Division.

<sup>796</sup> Parliamentary Monitoring Group <<https://pmg.org.za/print/report/20080828-companies-bill-adoption>> (accessed 26-09-2014).

<sup>797</sup> The judgment was subsequently upheld on appeal, albeit for very different reasons. See the text to ch 3 part 3 3 2 1 and ch 4 parts 1 1 2 2 and 2 3 5 above.

Perhaps more pertinent, the reference to *Airport Cold Storage* is possibly the best indication yet that the provision was meant to operate in the same manner as its legislative counterpart, section 65 of the Close Corporations Act. This supports the conclusion reached above,<sup>798</sup> viz that no distinction should be made between the tests of “gross abuse” and “unconscionable abuse” as prescribed in the Close Corporations Act and the Companies Act respectively. And since section 65 of the Close Corporations Act is to be interpreted in line with the common law piercing test, the same approach should be applied to section 20(9). This again supports the earlier conclusion that the common law test and that to be applied for the purposes of section 20(9) are the same.<sup>799</sup>

## 2.5 Conclusion

Having applied the holistic approach of statutory interpretation to section 20(9), in particular to the phrase “unconscionable abuse” as used in that provision, it is concluded that no particular inference can be drawn from a literal and purposive approach other than that the provision is aimed at preventing the abuse of corporate personality.

It has already been stated<sup>800</sup> that using the corporate personality of a company to achieve a tax benefit can be described as an abuse.<sup>801</sup> Whether such an abuse goes far enough to become unconscionable, can only be established by considering the contexts of the provision. These contexts include the common law<sup>802</sup> as well as the largely similar provision to be found in section 65 of the Close Corporations Act<sup>803</sup> (especially when considered in conjunction with the process involved in creating the statutory remedy),<sup>804</sup> together with the presumptions of statutory interpretation.<sup>805</sup>

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<sup>798</sup> See the text to ch 4 part 1 1 2 2 above.

<sup>799</sup> See the text to ch 4 part 1 1 2 2 above.

<sup>800</sup> See the text to ch 3 part 5 1 1 above.

<sup>801</sup> See also part 2 of this chapter below in relation to what would constitute an abuse of corporate personality in the context of s 20(9) specifically.

<sup>802</sup> See the text to ch 4 part 2 3 5 above, and particularly the SCA judgment in *WT v KT* 2015 3 SA 574 (SCA) linking the common law to s 20(9).

<sup>803</sup> See the text to part ch 4 2 3 4 above.

<sup>804</sup> See the text to ch 4 part 2 4 2 above.

<sup>805</sup> See the text to ch 4 part 2 3 2 above.

These all support the conclusion that section 20(9) aims to provide a statutory equivalent to the common law doctrine as it existed before, with the same ability to evolve and develop. It follows that “unconscionable abuse” in section 20(9) should be understood in the same light as *Cape Pacific’s* common law test of “fraud, dishonesty or other improper conduct”.

The previous criteria entitling a court to pierce therefore remain relevant. These criteria are now no longer applicable only to the common law piercing doctrine, but also to piercing in terms of section 20(9).<sup>806</sup> Section 20(9) embodies the common law doctrine: it does not provide for a wider or stricter approach,<sup>807</sup> although the constitutional framework considered together with the Companies Act as a whole<sup>808</sup> suggests that policy considerations in favour of piercing, especially where tax considerations are involved, may weigh heavier going forward.<sup>809</sup>

It remains to consider how section 20(9) interacts with the pre-existing common law position.

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<sup>806</sup> See the text to ch 4 part 2 3 5 above; *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 32, *Cf Botha v Van Niekerk* 1983 4 All SA 157 (W) 157:

*“Sulke bepalings, langs wisselende lyne, dui nie aan wat die bestek van die gemeenregtelike benadering tot assimilasië tussen aandeelhouer en maatskappy moet wees nie, behalwe dat dit meermale sal blyk dat wetgewende maatstawwe omtrent die persoonlike aanspreeklikheid wat in 'n bepaalde situasie ontstaan 'n voldoende aanduiding gee dat 'n Hof nie daarnaas uit hoofde van gemeenregtelike oorwegings vir dieselfde situasie tog ook aanspreeklikheid kan erken volgens ander maatstawwe nie.”* [own emphasis]

<sup>807</sup> Other therefore that the remedy is no longer only available as a last resort (see ch 4 part 3 3 below); compare with the common law position set out in ch 3 part 2 above. If there was uncertainty previously, this was removed through the introduction of s 20(9) which makes no mention of the existence of alternative remedies as a consideration when applying s 20(9).

<sup>808</sup> See the text to ch 4 part 2 3 3 above.

<sup>809</sup> See the text to ch 4 part 3 2 below.

### 3 Relationship between the broader section 20(9) and the common law piercing doctrine

#### 3 1 Introduction

The effect of the common law piercing doctrine on section 20(9)'s interpretation cannot be ignored. The conclusion above was that the content of the word "unconscionable" in section 20(9) is the same as that of the "fraud, dishonesty or other improper purpose" test applied for common law purposes.<sup>810</sup> There is no reason why "abuse" as used in the common law context,<sup>811</sup> such as in *Cape Pacific*, should carry any different meaning from where it is used in a legislative provision such as the Companies Act.

#### 3 2 Policy considerations in favour of and considerations opposed to piercing

"Unconscionable abuse" does not comprise the entire piercing provision in section 20(9), although it is a key component thereof. A key element of the common law doctrine is the role played by policy considerations.<sup>812</sup>

Yet section 20(9) appears to ignore policy considerations altogether. Does this mean that they have become irrelevant for the purposes of section 20(9)? If this is the case, a court would be entitled to pierce the corporate veil even where only a limited form of abuse is present.

In the absence of a clear indication to this effect, policy as a determining factor of when abuse is serious enough to warrant piercing should not be discarded. Judicial discretion has always been a key component<sup>813</sup> of the piercing doctrine. It is still true that our courts do not have a general discretion to pierce<sup>814</sup> but there can be no doubt that some discretion may be exercised.<sup>815</sup>

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<sup>810</sup> *WT v KT* 2015 3 SA 574 (SCA) para 31.

<sup>811</sup> See the text to ch 3 parts 3 3 2 3 and 5 2 above.

<sup>812</sup> See the text to ch 3 part 3 3 2 2 above.

<sup>813</sup> See the text to ch 3 part 3 3 2 2 above.

<sup>814</sup> See the text to n 417 above.

<sup>815</sup> See the text to n 819 below. See also *ADT Security (Pty) Ltd v Botha* [2010] ZAWCHC 563 para 18 as authority therefor that courts are entitled to adopt a flexible approach to piercing.

The fact that section 65 of the Close Corporations Act has been interpreted as akin to the common law piercing doctrine, effectively reading policy considerations into that legislative provision, supports this conclusion.<sup>816</sup>

It is further important that section 20(9) provides that a court “may” (as opposed to a clear directive that a court “must”) apply piercing.<sup>817</sup> This leaves room for a court to consider other factors such as policy considerations<sup>818</sup> and then to exercise its discretion<sup>819</sup> whether it would be appropriate to pierce or not to remedy the particular instance of abuse.

To apply piercing under section 20(9) without the discretion to take policy considerations into account would amount to a drastic departure from the common law doctrine which was not the intention with the introduction of the Companies Act.<sup>820</sup> A departure of this nature would have such a great effect on legal certainty and the manner in which corporate personality is understood that it would require clear legislative intent to this effect. “Abuse” is a wide concept. If policy considerations were not taken into account, any instance where a company is used to achieve a purpose other than that for which corporate personality was intended would be open to piercing.<sup>821</sup> A different approach under section 20(9) whereby policy considerations are ignored would not only erode legal certainty in relation to corporate legal personality, but would disallow many of the accepted uses of the company form. Policy considerations must therefore continue to enjoy recognition in the application of section 20(9) in the same manner as at common law.

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<sup>816</sup> See the text to parts 1 1 2 2 and 2 3 5 above.

<sup>817</sup> Cf s 65 of the Close Corporations Act.

<sup>818</sup> See ch 3 part 3 3 2 2 and part 2 3 3 above.

<sup>819</sup> *Haygro Catering BK v Van der Merwe* 1996 4 SA 1063 (C) 1070; *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 6 SA 585 (SCA) para 26; *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 552 and *Hülse-Reutter v Götde* 2001 4 SA 1336 (SCA) 20; Schoeman (2012) *De Rebus*.

<sup>820</sup> See the text to ch 4 part 2 4 1 above.

<sup>821</sup> See the text to ch 3 part 3 3 2 3 above.

### 3 3 Not a remedy of last resort

The conclusion earlier in this dissertation was that piercing in terms of the common law is not a remedy of last resort as has been claimed.<sup>822</sup> Piercing will be appropriate if it has been determined that no effective remedy exists against the company, even though other remedies against the company's shareholders may be available.<sup>823</sup>

Section 20(9) now removes any doubt that piercing need not only be applied as a remedy of last instance.<sup>824</sup>

There appears to be little justification for the legislated remedy in section 20(9) not to be applied if alternative remedies may exist.<sup>825</sup> If the Companies Act does not require it, then such a requirement, even if it did exist in common law,<sup>826</sup> has become redundant.<sup>827</sup> The common law cannot limit the application of a remedy created by statute where that statute does not provide for such a limitation.

When one considers the equivalent piercing provision in section 65 of the Close Corporations Act, there are no cases where the courts sought to limit the application of section 65 to a remedy of last resort.

### 3 4 Application to foreign companies

Particularly relevant in the context of profit shifting as an example of impermissible tax avoidance is the question whether section 20(9) can also be used to pierce the corporate veil of companies not incorporated under South African law.

Section 20(9) applies to any "company", which definition in section 1 does not include foreign companies.<sup>828</sup> Therefore section 20(9) cannot be available as remedy

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<sup>822</sup> See the text to ch 3 part 2 above.

<sup>823</sup> Which is unlikely to ever apply as a restriction in the tax context.

<sup>824</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 29; D Subramanien "Unconscionable abuse" - section 20(9) of the Companies Act 71 of 2008, *Ex Parte Gore NNO* 2013 (3) SA 382 (WCC)" (2014) 35 *Obiter* 150 159.

<sup>825</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) 34.

<sup>826</sup> The conclusion in ch 3 part 2 above was that no such bar ever existed.

<sup>827</sup> Cassim et al *Contemporary Company Law* 58; Cassim (2014) *SA Merc LJ* 320.

<sup>828</sup> See the text to n 834 below.

in the case of a company not incorporated in South Africa.<sup>829</sup> Foreign companies will be the one area where common law piercing can remain relevant.

This gives rise to two questions, namely whether it was previously possible to pierce foreign companies in terms of South African common law and whether it was the intention of the Companies Act to ensure that foreign companies cannot be pierced under its section 20(9).

Piercing of foreign companies appears to have been possible at common law.<sup>830</sup> Such an approach appears logical: although the legal personality of the foreign company was created in terms of South African law, it is still recognised by South African law.<sup>831</sup> Likewise, it would be unthinkable in the modern-day commercial environment for the South African legal system not to recognise the legal personality of foreign companies. It follows that foreign companies too could, if their legal personality was used to perpetrate fraud, dishonesty or some other improper purpose, be pierced by a South African court. Just as legal personality (irrespective of nationality) is a principle accepted by South African common law, so too is the piercing doctrine, and for the common law in general it does not matter where that corporate

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<sup>829</sup> S 20(9) may apply to “domesticated companies” (which are included in the definition of a “company”), but this will not always be applicable to companies involved in cross-border avoidance structures.

<sup>830</sup> One would have expected a contrary comment to this extent in any of the judgments in *Banco de Mozambique*, *Hülse-Reutter* or *The Shipping Corporation of India Ltd* had this not been the case. In all three cases the court considered whether applying piercing would be appropriate, which it would have been unable to do had it not been satisfied that it had the jurisdiction to pierce the corporate veil of the foreign companies involved. Specifically, paragraph 24 of the latter judgement is significant where the court went as far as to state that a South African court will apply South African law when called upon to pierce the corporate veil of a foreign incorporated company. See also *VTB* where the UK Supreme Court was willing to pierce the veil of Russian companies. Though doubt was expressed there (at 131) about the correct forum in which to do so, the court did apply piercing there. The conclusion there was that there may be no single choice of law rule to govern piercing matters. Where matters relating to tax are concerned though, I would consider it appropriate that the matter be considered in the country whose tax is allegedly being escaped.

<sup>831</sup> See definition of “juristic person” in s 1. Also see text to n 836 below.

personality was created. The only question that is relevant is whether a court would have jurisdiction to hear a matter,<sup>832</sup> which is an entirely different question.<sup>833</sup>

There are two possible explanations why section 20(9) does not apply to foreign companies. It may be an intentional lacuna to ensure that foreign incorporated companies can no longer be pierced by South African courts (which amounts to a drastic deviation from the pre-Companies Act era). Alternatively, it should be accepted that the Companies Act is meant to regulate South African companies only and thus cannot authorise the piercing of a company that it has no authority over.<sup>834</sup>

The latter approach must be accepted. An overhaul of company law involving that foreign companies can no longer be pierced would have necessitated an express statement to that effect.<sup>835</sup> The legal personality of the foreign company was previously and still is recognised in South Africa by our common law and not by the Companies Act.<sup>836</sup> The foreign company thus operates within the bounds of the common law and within that legal context, which includes the piercing doctrine.

The piercing doctrine aims to address abuse of the corporate legal personality. Just as piercing may be applied irrespective of the original reason for a company's incorporation, so it should be irrelevant where that corporate legal person has been incorporated in considering whether piercing should be applied or not. The South

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<sup>832</sup> *Banco de Mozambique; The Shipping Corporation of India Ltd v Evidomon Corporation* 1994 2 All SA 11 (A).

<sup>833</sup> In the tax context ss 107 and 117 of the Tax Administration Act suggest that a South African forum will have jurisdiction to consider piercing cases.

<sup>834</sup> S 20(9) applies to a "company". That word is defined in s 1 of the Companies Act to exclude a "foreign company" from its ambit. In support of this interpretation it is significant that s 95 deems it necessary to include a "foreign company" in the definition of "company" for the purposes of chapter 4 of the Companies Act.

<sup>835</sup> An interpretation that would suggest that the effect of s 20(9) is that foreign companies can no longer be pierced would be contrary to the presumption that statutory law does not intend to change the existing legal position more than is necessary (see the text to ch 4 part 2 3 5 above).

<sup>836</sup> Even though the Companies Act classifies a foreign company as a "juristic person", this in itself does not endow it with legal personality: a "trust" is also defined as a "juristic person" for the purposes of the Companies Act, even though it is settled in South African law that it does not have legal personality (E Cameron, MJ de Waal, B Wunsh, P Solomon & E Kahn *Honoré's South African Law of Trusts* 5 ed (2002) 67 *et seq*).

African common law recognises the corporate legal personality of a foreign company. The place of incorporation of a company should not exempt a legal person from scrutiny and regulation.

This is the one instance where the common law piercing doctrine has not been rendered practically redundant and will continue to play a role to counter the abuse of legal personality of foreign origin. Other than confirming that the piercing of foreign companies will happen in terms of the common law doctrine and not section 20(9), nothing substantial turns on this. If anything, it reinforces the conclusion that the piercing remedies in section 20(9) and the common law must be seen as equal and existing concurrently. If this is not done, the absurd result will be that the corporate legal personality of foreign companies and of South African companies will be approached differently without any justification.

The conclusion is therefore that piercing in terms of the common law doctrine still presents the appropriate remedy to counter the intentional avoidance of tax in the facts set out in Example 3 above,<sup>837</sup> whereas section 20(9) will not be available to address the use of the Mauritian company in that example.

### 3 5 Ancillary matters

There are further ancillary matters which are dealt with briefly below.

#### 3 5 1 *Where the common law remedy correlates with section 20(9)*

Section 20(9) confirms the common law principle that a company need not have been founded in deceit for piercing to be applied.<sup>838</sup> Rather, it needs to be considered what the company is used for and not why it was created. Section 20(9) is quite clear that either “any use of the company”, or alternatively “the incorporation of the company”, may present an instance of unconscionable abuse.

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<sup>837</sup> See the text to ch 1 part 3 above.

<sup>838</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 2 All SA 543 (A) 553; *Cassim (SA Merc LJ)* 310.

As is the position in common law, section 20(9) provides for the piercing of companies in relation to shareholders in substance,<sup>839</sup> that is persons substantially acting in shareholder capacity, as opposed to mere shareholders in form.<sup>840</sup>

Also unchanged from the common law position is that foreign law can still play an important role in interpreting and developing the piercing doctrine under the Companies Act.<sup>841</sup>

Section 20(9) is also written in general terms which do not specifically address the position of one-man companies or company groups. There appears to be no room to argue that the common law approach to these entities has been altered in any material way.<sup>842</sup>

Finally, the legislated remedy, as was the case with the common law remedy,<sup>843</sup> operates in a limited fashion only. Piercing only disregards the corporate veil to the extent necessary to counter the identified instance of abuse thereof. All other rights and obligations created by the corporate veil remain unaffected and unaltered. This is clear from both section 20(9) and section 218(1) of the Companies Act. Section 20(9) is specific in its application in this regard. It provides that a company may be disregarded as a separate juristic person as relates only to “any right, obligation or liability of the company or of a shareholder of the company” as opposed to **all** such rights, obligations or liabilities. In a similar vein section 218(1) directs that all agreements (and by implication existing rights and obligations) remain intact unless specifically affected by an order of court. It is made clear that a declaration by a court in terms of section 20(9) only reaches as far as the order itself, without tainting the remainder of the rights and obligations of the company unrelated to the piercing order.

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<sup>839</sup> Persons able to exert effective shareholder control over a company, even though in form that person does not actually hold any shares in the company under consideration.

<sup>840</sup> See n 340 above.

<sup>841</sup> S 5(2); see the text to ch 3 part 4 above.

<sup>842</sup> See the text to ch 3 parts 5 2 1 and 5 2 2 above.

<sup>843</sup> Ch 2 part 6 1 above.

### 3 5 2 *Ancillary matters where section 20(9) is supplemental to the common law doctrine*

Earlier in this dissertation<sup>844</sup> examples of reverse piercing, or where piercing was applied for the benefit of the shareholder, were given. Although it is doubtful whether the judgments mentioned were decided correctly,<sup>845</sup> the possibility to apply the piercing doctrine in such a manner appears to have been effectively removed by section 20(9). It is difficult to imagine any example whereby a court, in terms of the discretion afforded to it, would grant relief to a shareholder who had proven also that he or she had abused the corporate veil him- or herself.<sup>846</sup> The doctrine of estoppel would also militate against such relief being granted.

In the strict sense this may not be a departure from the common law doctrine as such, but to the extent that examples of reverse piercing appear to exist, section 20(9) clarifies that this is no longer possible.

What is of greater importance and a clear divergence from the common law remedy is that piercing in terms of section 20(9) is no longer a drastic or exceptional remedy,<sup>847</sup> notwithstanding the fact that the remedy has been left largely unchanged in its legislated form.<sup>848</sup> There is no further reason why the remedy should be approached with deference and judicial restraint, even if such a reason may have existed at common law.

As a result our courts are empowered to apply piercing. The Companies Act now foresees that piercing may be applied where the requirements are met, which include situations where the corporate veil is abused with an improper purpose in mind and

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<sup>844</sup> Ch 2 part 6 2 above.

<sup>845</sup> It is difficult to consider how reverse piercing could strictly meet the requirements of the common law piercing doctrine, since it is inconceivable that an applicant-shareholder could successfully prove that it had itself perpetrated an abuse whereby it should benefit itself.

<sup>846</sup> An apparent exception would be where minority shareholders seek to have the corporate veil pierced due to the abuse thereof by a majority shareholder. This would, however, not constitute reverse piercing, but piercing in the ordinary sense.

<sup>847</sup> See the text to ch 4 part 1 1 above; *Knoop NO and Others v Birkenstock Properties (Pty) Ltd* FSHC case no 7095/2008 of 4 June 2009 para 23; *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA) 23; *Amlin (SA) (Pty) Ltd v Van Kooij* 2008 2 SA 558 (C) para 23.

<sup>848</sup> The provision itself gives no indication that judicial restraint should be exercised in applying the remedy. See also *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 34.

policy considerations in favour of piercing outweighs those considerations opposed thereto. Once this test has been passed, there is no reason why the courts should not apply the remedy available in section 20(9). This will be the case where the corporate veil is used mainly for a tax purpose.

#### **4 Application of section 20(9) for purposes of the law of taxation**

##### **4 1 Overview**

Any interested person may bring an application in terms of section 20(9). Therefore, where the merits warrant it, the SARS Commissioner may also bring such an application.<sup>849</sup>

Section 20(9) has the potential to be successfully applied as a remedy by SARS to counter the use of the corporate veil primarily for tax purposes.<sup>850</sup> Section 5(4) of the Companies Act directs that the provisions of that Act and the Income Tax Act should be applied concurrently, with the Companies Act's provisions, including section 20(9), prevailing in the case of inconsistencies.

From the various targeted interventions in the Income Tax Act<sup>851</sup> it is clear that the corporate veil is capable of being abused in such a manner. Using the corporate veil mainly for tax purposes constitutes an improper purpose in terms of the common law piercing test. Improper purpose means that an abuse of the corporate veil by shareholders has occurred if they used corporate personality to that end.<sup>852</sup>

On the basis that the common law threshold test is the same in the now legislated piercing remedy,<sup>853</sup> using the corporate veil for tax purposes can therefore be described as unconscionable abuse.

However, the matter does not end there and policy considerations such as when the court “may” pierce the corporate veil in terms of section 20(9), then come into

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<sup>849</sup> See also s 218(2) of the Companies Act.

<sup>850</sup> PwC “Piercing the corporate veil: section 20(9) of the Companies Act 2008” (2013) *PwC South Africa Synopsis Tax Today*; Lewis & Malcolm “Notion of ‘piercing the corporate veil’ extended” (31-03-2013) *TaxManSA.co.za*.

<sup>851</sup> See n 244 above. Also see confirmation to this effect in *Botha v Van Niekerk* 1983 4 All SA 157 (W) 164.

<sup>852</sup> See the text to ch 3 parts 3 3 2 1, 3 3 2 3 and 5 1 1 above.

<sup>853</sup> See the text to ch 4 parts 2 5, 3 1 and 3 2 above.

play.<sup>854</sup> Certainly, the same policy considerations in favour of piercing for tax purposes already identified<sup>855</sup> remain as relevant for the purposes of section 20(9) as was the case in common law. The policy considerations favouring piercing for tax purposes appear, if anything, to have increased in recent years.<sup>856</sup>

When balancing the considerations against piercing with the increasing considerations in favour thereof, the conclusion that the legislated remedy should embolden courts to apply the remedy<sup>857</sup> becomes even stronger, especially in the tax context.

The policy considerations in favour of piercing were extensively dealt with earlier<sup>858</sup> and were also considered as part of the discussion of the Companies Act's drafting process.<sup>859</sup> As mentioned in *Ex Parte Gore* these policy considerations should now also include the moral and economic effect that piercing would have.<sup>860</sup> This is relevant in the tax context in the form of questions surrounding tax morality and the ability of the state to fund its operations for the public benefit.

Considering the conclusion regarding the separation of powers,<sup>861</sup> the question may be asked what further considerations opposed to piercing exist?

The effect that piercing may have on other shareholders has already been identified as irrelevant in the tax context, given the remedy's limited and focussed effect.<sup>862</sup> In a similar vein, the creditors of the company will be left unaffected as the tax consequences would fall on the shareholder if the company is pierced, and not on the company. In the normal course of business it should be a risk which creditors have to accept regarding debtors since the latter may incur tax liabilities affecting the credit risk linked to the debtor involved. Since piercing is also possible through application

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<sup>854</sup> See the text to part 3 2 of this chapter above.

<sup>855</sup> See the text to ch 3 part 5 1 2 above.

<sup>856</sup> See the text to ch 3 part 5 1 2 above.

<sup>857</sup> See the text to ch 4 part 3 5 2 above.

<sup>858</sup> See the text to ch 3 part 5 1 2 above.

<sup>859</sup> See the text to ch 4 part 2 4 1 above. See also the DTI policy paper, *South African Company Law for the 21<sup>st</sup> Century: Guidelines for Corporate Law Reform* GN 1183 in GG 26493 of 23-06-2004. S 7 of the Companies Act now embodies these principles.

<sup>860</sup> *Ex Parte Gore NO and Others* 2013 2 All SA 437 (WCC) para 29.

<sup>861</sup> See the text to ch 4 part 1 1 1 above.

<sup>862</sup> See the text to ch 2 part 4 2 3 above and the example there.

of the Income Tax Act, the possibility of detriment being caused to creditors of shareholders in a tax context appears to be acceptable from a policy perspective.

The only other potential objection to piercing in the tax context would be legal uncertainty. However, the limited effect of the piercing remedy and the fact that piercing for tax purposes will not affect either the shareholders or creditors of the company involved largely negate this consideration. The question is also: legal certainty for whom? The only other party that may wish to depend on the need for legal certainty as a consideration opposed to piercing would be the offending shareholder him- or herself. Where the legal certainty of the taxpayer is impacted by such shareholder's intent which has already been classified as unconscionable, the latter should prevail. The tax avoider's uncertainty about the success or not of his avoidance scheme cannot be a consideration against piercing. Legal certainty for the shareholder in such a case must therefore be a secondary consideration.

Barring any other considerations opposed to piercing in the tax context, the conclusion is that significant policy considerations exist in favour of piercing for tax purposes, whereas considerations opposed thereto are few. In an era where legal personality is so much more accessible,<sup>863</sup> it is to be expected that instances of abuse thereof will be more prevalent. The same applies in the tax context and instances where corporate personality is used for tax purposes are bound to increase too. It is therefore necessary to approach the remedies contained in the Companies Act (such as section 20(9)) more liberally.

Such an approach would also accord with the presumption that a remedial statute must be construed generously.<sup>864</sup> This is apposite in an era where a purposive interpretation of statutes is increasingly required, especially in the tax context.<sup>865</sup>

Section 20(9) should not be regarded in a different light. When applied in a tax context, it becomes an anti-avoidance provision and should be construed accordingly. Regard should then not only be had to the purpose of the remedy in section 20(9), but also to the purpose of section 19(1) which provides for the corporate veil. In the tax context this provision too should be regarded from a purposive point of view. When

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<sup>863</sup> See the text to ch 2 part 3 1 above.

<sup>864</sup> Du Plessis "Statute law and interpretation" in *LAWSA* 345.

<sup>865</sup> See the text to ch 3 parts 5 1 2 and part 2 1 above.

the conclusion is reached that the purpose of the separate legal personality of a company is not to create a tax advantage,<sup>866</sup> the use of the corporate veil primarily for this purpose must surely fail the test set in section 20(9).

Piercing of the corporate veil is intended to serve as remedy where separate corporate personality is used to sidestep an anticipated contractual or other legal obligation.<sup>867</sup> Where that obligation arises because of a taxation statute the remedy is no less applicable.<sup>868</sup>

#### 4.2 Burden of proof

Section 20(9) applies irrespective of whether an interested person brings an application in terms of that provision for the section to apply or not. Section 20(9) enables a court to apply this section merely because a company is involved in the proceedings before it.

Section 20(9) is silent on the burden of proof.<sup>869</sup> As is the case with the common law piercing remedy, one is left with no alternative but to allocate the burden of proof to the taxpayer in terms of section 102(1) of the Tax Administration Act. For the purposes of section 20(9) the taxpayer will be required to disprove the questions of fact by showing either that the taxpayer was not capable of using the corporate veil or that the corporate veil was not used primarily for tax purposes.<sup>870</sup>

### 5 Conclusion

Through a careful analysis of legal interpretation one can conclude that the common law piercing remedy is largely similar to the remedy now contained in section 20(9). This conclusion is reached by considering the limited assistance of the literal and purposive interpretative approach. Of more value is the contextual approach, supported by the relevant background material on section 20(9) and the Companies Act as a whole.

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<sup>866</sup> See the text to ch 3 part 5 1 2 above.

<sup>867</sup> Strydom & Du Plessis (1997) *TSAR* 403.

<sup>868</sup> See n 496 above.

<sup>869</sup> S 221 of the Companies Act is equally unhelpful in this regard.

<sup>870</sup> See the text to ch 3 part 5 2 3 above and the discussion there on the application of s 102(1)(a) of the Tax Administration Act where common law remedies are involved.

The analysis of the common law position, the Close Corporations Act and the parliamentary drafting process revealed the clear link between the common law and section 20(9), especially regarding the threshold requirements of fraud, dishonesty or improper conduct now embodied in the phrase “unconscionable abuse”. The Constitution, the Companies Act and the drafting process behind the latter create a context for wider application of the piercing remedy than had previously existed, especially through the influence of policy considerations in favour of piercing, introduced through the word “may” in section 20(9).

While stopping short of replacing the common law piercing doctrine, section 20(9) has usurped the role of the common law piercing doctrine in most practical situations, save where foreign companies are concerned. Since piercing of the corporate veil of a company can now also be achieved through legislated means, one can expect to see our courts henceforth apply the remedy with less deference. By implication one of the major considerations opposed to piercing has fallen away: the common law is now no longer used to override legislation, but legislation itself now limits the use of corporate personality.<sup>871</sup> This should embolden the judiciary to apply the remedy with less circumspection should an unconscionable abuse be present, having regard to the relevant policy considerations.

Admittedly, an argument may be made, if the aforementioned were true, that many more cases of close corporations being pierced in terms of section 65 of the Close Corporations Act should have occurred. No reported judgments could however be found where South African courts have refused to pierce the corporate veil of a close corporation other than for reasons linked to failure to discharge the burden of proof.

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<sup>871</sup> Section 19 of the Companies Act creates the companies separate legal personality (see ch 2 part 2 3 above). While there is no direct equivalent of section 19 of the Companies Act in the Repealed Companies Act, the latter also made provision for perpetual existence (section 65(1)) and dealt with limited liability (sections 66 and 85(3)). It can therefore be said that the consequences legal personality of a company was also previously created *ex lege*. There is also support for the notion that South African courts considered legal personality of companies to have been created by statute (as opposed to merely being regulated thereby). This is evident from the comment in Hülse-Reutter that justice considerations alone are not enough to warrant piercing. That judgment adds that judicial judgment must be used when considering piercing, but also a policy judgment. When considering whose policy should be judged, the answer must that of Parliament. It is clear further that Parliament too regarded the company as a “person”, as appears from that definition in the Interpretation Act, 33 of 1957.

Neither could empirical evidence be found to suggest that companies and close corporations have been pierced a comparative number of times since introduction of the Close Corporations Act. The absence of piercing cases in the close corporation context may therefore rather be due thereto that such potentially qualifying matters are not brought to court due to a lack of awareness on the part of legal practitioners of the existence of the potential remedy.

Where the corporate veil is used primarily for tax purposes the conclusion is that this can be considered an unconscionable abuse as contemplated in section 20(9) as the corporate veil is used to avoid what would otherwise have been a legitimate statutory obligation to pay tax. It was also argued that very few considerations, if any, would exist against piercing being applied in such an instance. In addition there are the very clear policy considerations in favour of piercing which are as relevant for section 20(9) as they were at common law.

Weighing up these considerations, the conclusion in this dissertation is that piercing would be justified in instances where the corporate veil is used primarily for the subjective purpose of avoiding the incidence of tax.

## CHAPTER 5: THE EFFICACY OF THE INCOME TAX ACT'S GENERAL ANTI-AVOIDANCE RULES TO ADDRESS THE USE OF THE CORPORATE VEIL FOR INCOME TAX PURPOSES

### 1 Piercing provisions of the Income Tax Act

As stated earlier, the corporate veil can be used to achieve tax benefits.<sup>872</sup> To address this problem, certain focused piercing provisions were included in the Income Tax Act,<sup>873</sup> often taking the form of specific anti-avoidance rules. The fact that these specific anti-avoidance provisions exist, indicates a general disapproval, at a policy level, of the corporate veil's use in this manner.

The introduction of the so-called "passive holding company" regime in 2008<sup>874</sup> serves as an example of how these specific anti-avoidance provisions counter the abuse of the corporate veil for tax purposes. With the introduction of dividends tax in 2012, National Treasury identified the risk that individuals could delay the liability for dividends tax by holding passive share investments through a company.<sup>875</sup> Section 9E, which was introduced to tax dividends received by "passive holding companies", was repealed with effect from 21 October 2008.<sup>876</sup> Thus, the structure achieving an avoidance of dividends tax was never addressed.

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<sup>872</sup> See the text to ch 1 part 3 above.

<sup>873</sup> See n 244 above for examples hereof.

<sup>874</sup> Introduced by s 14 of the Revenue Laws Amendment Act 60 of 2008.

<sup>875</sup> See Example 1 in ch 1 part 3 above. In terms of s 64F of the Income Tax Act, South African companies to which dividends are declared are exempt from the dividends tax. Example 1 (ch 1 part 3 above) illustrates this exact risk practically.

<sup>876</sup> S 15 of the Taxation Laws Amendment Act 22 of 2012. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012 at 52 somewhat unsatisfactorily claims that the risk has been mostly addressed by the increased dividends tax rate. No mention is made in the Explanatory Memorandum, or any other document released by National Treasury or SARS, of the continued potential for delay in levying dividends tax, which tax benefit as a result remains available to South African taxpayers.

The fact that the identified instance of abuse has not been attended to does not mean that the risk no longer exists. It remains one of the clearest examples of how taxpayers can use the corporate veil to mitigate or delay tax consequences.

Section 20(9) of the Companies Act has therefore been identified in this dissertation as a potential remedy that SARS could apply to address instances of abuse such as the above.<sup>877</sup> This chapter considers whether the GAARs contained in the Income Tax Act<sup>878</sup> can be applied with comparable efficacy.<sup>879</sup>

## 2 Overview of general anti-avoidance rules

South African courts have, to date, not pronounced on the GAARs in their current form.<sup>880</sup> Nor have their provisions been amended in any material manner since coming into effect on 2 November 2006. In the absence of any judicial guidance on how these provisions should be approached, the content of the GAARs remains unsettled.<sup>881</sup>

In terms of the now repealed section 103(1) the Commissioner could previously only apply the GAAR in that section's sanctions if four requirements were all present, namely:

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<sup>877</sup> See ch 4 above.

<sup>878</sup> Ss 80A to 80L of the Income Tax Act.

<sup>879</sup> *ITC 1501* [1989] 53 SATC 314 326 provides an example of when the GAARs could be applied in a manner that would amount to piercing. See also Glaser *Piercing the corporate veil* 39.

<sup>880</sup> The "new" GAARs in ss 80A to 80L replaced its legislative predecessor, s 103(1) of the Income Tax Act, with effect from 2 November 2006.

<sup>881</sup> In this chapter, the Canadian GAARs will mostly be referred to for comparative purposes, since the South African GAARs were, at least in part, based on its Canadian counterpart. Furthermore, the Canadian courts have pronounced on the provisions of the relevant GAARs and these cases may provide guidance to South Africa. Australia's GAARs do not contain an abnormality requirement and therefore differs substantially from the South African one. The USA does not have any federal GAARs and the position in the UK has not been the subject of any case law yet.

1. a transaction, operation or scheme (“scheme”) must have been entered into;
2. the scheme must give rise to a tax benefit;
3. the tax benefit must have been the sole or main purpose of the scheme; and
4. the scheme must have been entered into or carried out by means of, or in a manner which would not normally be employed, or must have created rights and obligations which would not have been created between persons dealing at arm’s length.<sup>882</sup>

These four essential requirements (for the GAAR in section 103(1) to apply) still reflect in the “new” GAARs contained in the Income Tax Act.<sup>883</sup>

Since this dissertation considers when piercing can be applied to address the deliberate use of a company for tax related reasons, one can accept that in such instances the first three of the four requirements of the GAARs listed above, all of which involve questions of fact, would always be met. In such circumstances an arrangement<sup>884</sup> would have been entered into involving a company, resulting

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<sup>882</sup> *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* [1971] 33 SATC 113 116 and 117; see also *Ovenstone v Secretary for Inland Revenue* [1980] 42 SATC 55 66; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 5.

<sup>883</sup> S 80A of the Income Tax Act.

<sup>884</sup> S 80A refers specifically to an “arrangement”. The term is so widely defined that it encompasses virtually all commercial activity: “... any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property”. See also EB Broomberg “Then and now – II: The first three prerequisites” (2007) 21 *Tax Planning*.

in a tax benefit with the sole or main purpose<sup>885</sup> of achieving that tax benefit.<sup>886</sup>

Consequently the only requirement that still requires consideration, is the fourth requirement, “normality”. In other words, can the use of a company for tax purposes be considered abnormal as contemplated in the GAARs?

### 3 Normality requirement

#### 3.1 Identifying the “arrangement” to which the abnormality requirement must apply

It is important to identify the arrangement to which the GAARs is applied. Piercing in terms of the corporate law doctrine may present the *fiscus* with a remedy at the moment that the company is incorporated. It is argued in this chapter that no such remedy will exist in terms of the GAARs at that stage. This is because companies achieve a tax benefit for their shareholders by way of a two-stepped process: firstly, by a transfer of assets to the company, and secondly, by the company utilising those assets to generate income. This latter step will result in income tax consequences that are more beneficial than would have been the case, had the income been derived by the shareholders directly. It is argued in

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<sup>885</sup> Although it is not yet settled whether the “sole or main purpose” requirement in s 80A involves a subjective or an objective test, strong arguments exist that the former is accurate (P Dachs “Anti Tax-Avoidance Provision – Is the purpose test subjective or objective?” (2013) 62 *The Taxpayer* 183-185; L van Schalkwyk & B Geldenhuys “The nature of the purpose requirement of an impermissible tax avoidance arrangement” (2010) 35 *JJS* 71-92; *ITC 1888* [2016] 79 SATC 23 72). *Contra* De Koker & Williams *Silke on South African Income Tax* ch 19.35 and SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 20 et seq*. This dissertation considers scenarios where the corporate veil is used with the subjective intent to achieve a tax benefit. Considering the arguments in favour of a subjective approach to be followed, together with the presumption of purpose against the taxpayer provided for in s 80G, the analysis continues on the basis that the “sole or main purpose” requirement will have been met where a company is used to achieve a tax benefit.

<sup>886</sup> See the specific anti-avoidance provisions referred to in the text to part 1 of this chapter above as examples of how a tax benefit could conceivably be created by use of the corporate veil.

this chapter that the GAARs can usually only be invoked in respect of the first step, namely on transfer of an asset to a company. Generally speaking, this is the only one of the two steps driven by a tax motive. Moreover, when income is later generated for the company by using the transferred asset, it is unlikely that the company's utilisation of the asset will be driven by tax reasons.

It is submitted that the "tax benefit" requirement<sup>887</sup> is met for both steps. However, after obtaining the assets, the company would generally hold and utilise its newly acquired assets for a commercial, non-tax purpose and will utilise these in order to generate commercial benefits for itself. It follows that the act of transferring an asset to the company (step one) should be scrutinised to detect elements that may potentially be abnormal in terms of the GAARs. The transactions subsequently giving rise to income through utilisation of the asset (step two) should not be examined because they lack a tax purpose. However, where the two steps form part of a "unitary scheme", both steps will have to be investigated.

Although most recently applied in *ITC 1862*,<sup>888</sup> the "unitary steps doctrine" was developed in the judgment of *CIR v Meyerowitz* ("*Meyerowitz*")<sup>889</sup> and further explored in *Louw*.<sup>890</sup> All these cases rely in essence on the English case of *Crossland (Inspector of Taxes) v Hawkins* ("*Crossland*").<sup>891</sup> The legal principles enunciated in these cases are that an "impermissible avoidance arrangement" may be wider than any one transaction<sup>892</sup> and that the eventual arrangement

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<sup>887</sup> S 1 of the Income Tax Act presents a wide definition of a "tax benefit" which would include the postponement or the reduction of tax for the shareholder by virtue of transferring an asset to a company, even if the tax benefit for the shareholder will only materialise at a much later stage. Also see Smith (2016) *JJS* 89 which requires a wide meaning to be ascribed to the defined term.

<sup>888</sup> *ITC 1862* [2012] 75 SATC 34 para 50.

<sup>889</sup> *CIR v Meyerowitz* 1963 3 SA 863 (AD) para 867.

<sup>890</sup> *CIR v Louw* [1983] 45 SATC 113 paras 135 and 136.

<sup>891</sup> *Crossland (Inspector of Taxes) v Hawkins* [1961] 2 All ER 812 and as referred to in *Meyerowitz*.

<sup>892</sup> *CIR v Meyerowitz* 1963 3 SA 863 (AD) referring to the *a quo* judgment.

need not be contemplated at the outset,<sup>893</sup> although *Louw* strongly suggests that the ultimate step must at least have been foreseen as a possibility from the start.<sup>894</sup> *Crossland* is clear though that a unitary scheme consists of all steps aimed at achieving an identified ultimate object.

These judgments indicate that transactions are bound together in a single “unitary scheme” if they are entered into with a common tax motivated purpose. In other words, those steps necessary to achieve the desired tax benefit must be entered into purposefully to achieve that tax benefit. In the absence of a unitary scheme, different transactions are not steps in a larger arrangement.<sup>895</sup>

*Crossland*, a case not dealing with GAARs as such, held that the steps of a larger arrangement would constitute a single arrangement or scheme, if the steps were all aimed at that same “ultimate object”, in that case the avoidance of surtax.<sup>896</sup> The same approach was adopted in *Meyerowitz*<sup>897</sup> and *ITC 1862*, although not with express reference to *Crossland* in the latter.

In *Louw*, the AD had to consider whether the GAARs could be applied to an alleged scheme of transactions where an existing engineering practice was transferred to a company. Profits were subsequently extracted from the company in the form of interest-free loans.<sup>898</sup> Although the terms of the loans were found

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<sup>893</sup> *Crossland (Inspector of Taxes) v Hawkins* [1961] 2 All ER 812 para 817 and *ITC 1862* [2012] 75 SATC 34 para 50.

<sup>894</sup> *CIR v Louw* [1983] 45 SATC 113 para 135.

<sup>895</sup> Although the definition of “arrangement” in s 80L includes all steps to “any transaction, operation, scheme, agreement or understanding”, whether these separate arrangements or steps can be said to form part of a single, larger arrangement to which s 80A will apply, is dependent on whether the steps would form part of a unitary scheme. This principle does not detract from the fact that the provisions of s 80A may be applied to any step considered in isolation. See s 80H. What the “unitary steps doctrine” does seek to achieve, is to ensure that only steps with a sufficient degree of unity may be considered together as an arrangement to determine whether that arrangement would also be an “impermissible avoidance arrangement”.

<sup>896</sup> *Crossland (Inspector of Taxes) v Hawkins* [1961] 2 All ER 812 para 817.

<sup>897</sup> *CIR v Meyerowitz* 1963 3 SA 863 (AD) para 873.

<sup>898</sup> The incorporation of a business (in other words the transfer of the underlying assets to a company) constitutes an “arrangement” (*CIR v Louw* [1983] 45 SATC 113 136;

to have the effect of avoiding tax, the incorporation of the business and the extraction of profits by way of subsequent loan accounts, were held not to constitute a unitary scheme.

There are three reasons for this finding that are important for purposes of the current analysis. Firstly, the granting of the loans was not a necessary step to bring about the tax benefits already achieved through incorporation of the business.<sup>899</sup> Secondly, and in keeping with *Crossland*, incorporation of the business and the subsequent granting of loans did not share the same ultimate objective.<sup>900</sup> Thirdly, a period of approximately five years lapsed between the incorporation transaction and the granting of the loans. This time period indicated to the court that the loan transaction was an independent transaction. The relatively short period within which the transactions in *Crossland* were entered into, seems to have influenced the court in finding that the transactions were linked.

In both *Meyerowitz* and *Crossland*, the taxpayers were unsuccessful. In both these cases, the relevant schemes were found to include the first step, where the

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*Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* [1971] 33 SATC 113 118). If it were argued that the setting up of the company itself was effected with a tax benefit in mind, it would be important to illustrate that the applicable tax benefit achieved subsequently and through use of the corporate veil was already foreseen at incorporation; in other words it would be required to illustrate that the tax benefit was a part of the incorporation scheme implemented (see *CIR v Louw* [1983] 45 SATC 113 134 and 135; *ITC 1862* [2012] 75 SATC 34 para 50 *et seq*). See the text to part 3 3 2 of this chapter below. An already incorporated business however also uses the separate legal personality of a company to achieve a tax benefit for its shareholders, even if only devised after incorporation and by virtue of agreements entered into by the company subsequently. (The directors' loans in question in *Louw* being a case in point.) In these instances the same principle would apply for the GAARs as was the case for the common law (see the text to ch 3 parts 3 3 2 and 4 1 above) and s 20(9) of the Companies Act (the text to ch 4 part 3 5 1 above), being that the anti-avoidance provision can apply even if the abuse was not foreseen at incorporation, yet on condition that the benefit achieved is causally linked to the use of the separate legal personality of the company.

<sup>899</sup> *CIR v Louw* [1983] 45 SATC 113 para 135.

<sup>900</sup> Para 135.

relevant assets were transferred from the taxpayer to a separate corporate structure, as well as the second step, namely the subsequent earning of income by the companies through the use of those resources. In both these cases, the evidence before the court indicated that the parties were aware of all the steps forming part of the arrangement and actively participated in certain vital parts thereof to achieve its purpose of obtaining a tax benefit.<sup>901</sup>

However, in *Louw* the AD did not regard the incorporation of the business (step one), and the subsequent trading activities of the company (step two) as part of the same arrangement.

Based on the facts in *Louw*, the court concluded that the transactions involved were not “part and parcel of a single scheme”.<sup>902</sup> It is submitted that the facts in *Louw* objectively indicate the lack of a common purpose to avoid tax on the part of the company, whereas the courts in *Crossland* and *Meyerowitz* came to the opposite conclusion.

The inference from these cases is that the necessary unity will exist only where the steps have all been entered into with a common purpose to avoid tax. The facts of each case will play a crucial role to determine whether the transactions were entered into with the same purpose. It is submitted that it may be difficult, in practice, to prove that two or more transactions form part of a unitary scheme, that is a single “arrangement” for purposes of the GAARs.

Turning to Examples 1 to 4, the question whether steps one and two in those examples form a unitary scheme depends on the facts of the case. For example, if the transferor in Example 1 was aware of the second step, the company was incorporated with the expectation that it would distribute its profits to the transferor (now shareholder), such a distribution took place within a reasonably short time period and it is proven on the evidence that the company’s purpose was to aid in the avoidance of tax, a unitary scheme will exist. If, on the other hand, an independent board of directors are appointed after the company’s incorporation, the shares in its share portfolio are changed and a relatively long period of time

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<sup>901</sup> *Crossland (Inspector of Taxes) v Hawkins* [1961] 2 All ER 812 819; *CIR v Meyerowitz* 1963 3 SA 863 (AD) para 872-873.

<sup>902</sup> *CIR v Louw* [1983] 45 SATC 113 para 135.

passes before the profits are extracted, it may well be that no unitary scheme exists.

The basis for the argument that no unitary scheme exists for Examples 1 to 4 is that one cannot think the separate personality of the company away when applying the GAARs to determine whether a common purpose to avoid tax exists. The transferor is not a “party” in the strict sense to the subsequent transactions entered into by the company in step two. Furthermore, in step two, the purpose of the company in entering into these transactions would ordinarily be to advance its own commercial interests. The transferor (now shareholder) need not even give instructions to the company to enter into the subsequent transactions: the company does so because the transactions are in its own interests. Thus, the company does not have the same purpose as the transferor and, in consequence, the necessary joint ultimate objective is missing.<sup>903</sup>

As a result, if no unitary scheme exists, only step one in Examples 1 to 4 may potentially be susceptible to the GAARs. Whether those arrangements may be considered “abnormal” is considered below.

### 3.2 Normality in terms of the previous section 103(1)

Under the previous version of the GAAR, an enquiry into the presence or absence of the “normality” requirement in section 103(1)(b) was conducted by:

“... having, regard to the circumstances under which the transaction, operation or scheme was entered into or carried out

- (i) was entered into or carried out -
  - (aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and
  - (bb) in the case of any other transaction, operation or scheme, being a transaction, operation or scheme not falling within the provisions of item (aa) by means or in a manner which would not normally be employed in

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<sup>903</sup> Although s 80F may be applicable in the current instance, it cannot apply to give rise to a different result to create a unitary scheme. Its operation is limited to establishing whether a tax benefit is present, which is uncontentious, and to determine whether an arrangement has commercial substance (see ch 5 part 3.3.3 below).

the entering into or carrying out of a transaction operation or scheme of the nature of the transaction, operation or scheme in question; or  
 (ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question ...”

Therefore, a transaction, operation or scheme could only be considered abnormal if either of the following two indicators was present:

1. the means or manner would not normally have been applied in the specific context (being business or otherwise); or
2. the transaction, operation or scheme in question has given rise to rights or obligations that would not normally be created between persons dealing at arm's length.

In *Hicklin v Secretary for Inland Revenue* (“*Hicklin*”),<sup>904</sup> the SCA summarised the test for abnormality as follows:

“For ‘dealing at arm's length’ is a useful and often easily determinable premise from which to start the inquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself. Indeed, in the Afrikaans text the corresponding phrase is ‘die uiterste voorwaardes beding’. Hence, in an at arm's length agreement the rights and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by [section 103(1)(b)](ii). And the means or manner employed in entering into it or carrying it out are also more likely to be normal than abnormal in the sense envisaged by para (i).”<sup>905</sup>

In terms of *Hicklin*, the enquiry for normality in terms of section 103(1) starts with the arm's length test. Only once it has been established that a transaction is entered into on an arm's length basis, should it be considered whether the transaction gave rise to normal rights and obligations and was entered into within normal means or in a normal manner. Two tests, namely whether normal rights

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<sup>904</sup> [1979] 41 SATC 179.

<sup>905</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195.

and obligations are created by an arrangement on the one hand, and whether these were created by way of normal means or in a normal manner on the other, remain important in terms of the current GAARs. Transactions creating normal rights and obligations may potentially be carried out by abnormal means or in an abnormal manner and *vice versa*. In other words, a transaction must give rise to normal rights and obligations and be carried out by normal means and in a normal manner, for it to be “normal” in terms of the previous GAAR in section 103(1). From a taxpayer’s perspective, it is not enough for an arrangement to be “normal” in terms of any one of the indicators listed in the GAARs, but rather that it is normal, measured against all of the potential indicators for abnormality.

Broomberg<sup>906</sup> considers it unlikely that the courts’ general approach to the current GAARs will differ significantly from its approach to section 103(1). The basis for Broomberg’s conclusion stems from a comparison of the wording of section 103(1) to that of section 80A, specifically in respect of the normality test. The normality test in section 80A shows many similarities when compared to its predecessor in section 103(1). However, the indicators for normality in section 80A have been increased from two to four. Two of these four bear several striking similarities and contain only a slightly redrafted version of the earlier two potential indicators for abnormality.<sup>907</sup>

In the absence of any case law dealing with sections 80A to 80L of the Income Tax Act, it is necessary to start with an analysis of the case law decided in terms of section 103(1) and to determine whether the case law relating to the abnormality requirement still apply to the current GAARs.<sup>908</sup> The abnormality requirement of the current GAARs may potentially find application where the corporate veil is used for tax purposes. Such an application is considered below.<sup>909</sup>

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<sup>906</sup> Broomberg (2007) *Tax Planning*.

<sup>907</sup> The two new indicators are discussed in the text to parts 3 3 3 and 3 3 4 of this chapter below.

<sup>908</sup> De Koker & Williams *Silke on South African Income Tax* ch 19.4.

<sup>909</sup> See the text to parts 3 3 1 and 3 3 2 of this chapter below.

### 3.3 Normality in terms of section 80A

In terms of section 80A, an arrangement would be considered abnormal if:

- “(a) in the context of business—
- (i) it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or
  - (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;
- (b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or
- (c) in any context—
- (i) it has created rights or obligations that would not normally be created between persons dealing at arm’s length; or
  - (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).”

The fact that the main purpose of an arrangement is to achieve a tax benefit bears no relevance to the normality of the arrangement in question.<sup>910</sup> Similarly, the remedies available to the Commissioner in terms of section 80B may not be used to illustrate any alleged abnormality through combining steps to have them form part of a unitary scheme.<sup>911</sup> This is relevant specifically where the use of the corporate veil is concerned: until all four elements of the GAARs have been shown to be present, the separate legal personality of the company, for tax purposes, remains unaffected by the GAARs’ remedies.<sup>912</sup> The fact that the company is used purposefully to achieve a tax benefit is not enough for the GAARs to apply. It must also be shown that its use may be considered abnormal

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<sup>910</sup> See text to n 941 below.

<sup>911</sup> De Koker & Williams *Silke on South African Income Tax* ch 19.41.

<sup>912</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 194, approved in *CIR v Louw* [1983] 45 SATC 113 143.

in terms of section 80A.<sup>913</sup> In addition, involving a company for tax reasons in a transaction does not amount to the implicated transaction being simulated.<sup>914</sup>

Section 103(1) previously required normality to be determined by considering the circumstances under which the transaction, operation, or scheme was entered into or carried out.<sup>915</sup> Notably this no longer forms part of the test for normality under section 80A. Broomberg<sup>916</sup> argues that this change adversely affects taxpayers and cites a number of cases in support of his argument.<sup>917</sup> These cases indicate that the circumstances under which an arrangement takes place could only potentially justify a transaction, that would otherwise have appeared to be abnormal, as being “normal”. Broomberg’s view therefore appears to be correct.

If section 80A is distilled, abnormality may now exist in terms of any of the four indicators, being “abnormal means and manner” as well as the “arm’s length rights and obligations” tests. These tests have been retained from section 103(1).<sup>918</sup>

Section 80A also introduces two new indicators, namely the “misuse or abuse”

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<sup>913</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 194, also applicable to the current GAARs (*SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule 5*).

<sup>914</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 194.

<sup>915</sup> See *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195. The amendment to s 103(1) by s 29 of the Income Tax Act, 36 of 1996, in similar vein removed the requirement for the Commissioner to have regard to the nature of the transaction, operation or scheme involved.

<sup>916</sup> EB Broomberg “Then and now – III: The tainted element” (2008) 22 *Tax Planning*.

<sup>917</sup> De Koker & Williams *Silke on South African Income Tax* ch 19.39 disagree with this conclusion and argue that a consideration of the relevant circumstances is still implicit to the test for abnormality.

<sup>918</sup> See *SARS Tax Avoidance and Section 103 of the Income Tax Act, 1962: Revised proposals* (September 2006) 5 *et seq* which confirms that the new GAARs in ss 80A to 80L were meant to retain the two pre-existing normality tests. It is reasonable to conclude that the judgments which previously considered the normality requirement in s 103(1) appear equally applicable in applying ss 80A to 80L to the extent that the wording and context of the provisions allow therefor. See *Ex Parte Minister of Justice In Re Rex v Bolon* 1941 AD 345.

and the “commercial substance” tests.<sup>919</sup> Because the indicators for abnormality have increased from two to four, it is arguably more difficult to illustrate that transactions meet the requisite standards of “normality”.

Companies may be used in various ways to reduce the tax cost that would otherwise have been borne by the shareholders of the company, had the company been absent. Such tax benefits may be achieved by using a company to own the assets (previously those of the shareholder) even though the interposition of a company does little to vary the real economic substance of the shareholders (see Example 1). The mere interposition of a company through which to indirectly conduct business or hold investments does not drastically vary the prevailing economic realities of the shareholder. However, it may give rise to profoundly different tax consequences.<sup>920</sup> Examples of using the company to alter the tax consequences that would otherwise have resulted, include using a company to conduct business through in order to benefit from more beneficial corporate tax rates (see Example 2), or to become eligible to qualify for beneficial income tax regimes. These tax regimes would otherwise have been unavailable had the business been carried on directly by an individual or trust. Similarly, the interposition of companies in an established group may be used to avoid or significantly reduce withholding taxes charged in various countries (an exercise generally referred to as “treaty shopping”, as per Example 3) or to avoid or postpone dividends tax locally in South Africa (see Example 1).<sup>921</sup> Thus far it was unnecessary to distinguish between these “types” of transactions. However, as will become clear from the following analyses, a differentiation is now necessary, as the normality test will have a different result depending on what “type” of transaction is considered.

The applicability of the GAARs will depend on the specific facts at hand, yet

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<sup>919</sup> Cf SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 23.

<sup>920</sup> In UK law the difference between tax mitigation and tax avoidance has been suggested to rest largely on the economic consequences of taxpayers’ actions. See G Loutzenhiser *Tiley’s Revenue Law* 8 ed (2016) 100 and the discussion at n 941 below.

<sup>921</sup> See the text to ch 1 part 3 above.

generally two categories of avoiding tax by using a company may be identified. The first occurs where the company is used to manipulate the tax consequences of certain pre-identified and anticipated arrangements (for example, to ensure reduced withholding tax rates or delaying the levying of dividends tax – referred to below as “targeted avoidance”). Examples include those transactions contemplated in Examples 1 and 3 above.<sup>922</sup> The second category relates to instances where the company form is used to achieve a more beneficial tax regime generally and to access more beneficial corporate tax rates to which the company form as opposed to non-corporate persons may have exclusive access (referred to below as “general avoidance”).<sup>923</sup> Examples hereof may be found in

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<sup>922</sup> See the text to ch 1 part 3 above. By way of illustration, although these instances are already addressed by existing specific anti-avoidance legislative provisions, further examples of targeted avoidance would include making use of companies to receive salaries in an individual’s stead, as well as non-residents attempting to avoid capital gains tax on disposal of immovable property by owning these investments through companies indirectly and disposing of the shares in the company rather than the property directly. One could also contemplate how companies may be used as part of a restructure solely to facilitate relief in terms of the so-called “group relief” provisions contained in Part III of Chapter II of the Income Tax Act to facilitate the transfer of value between non-corporate taxpayers which would otherwise not have been possible to achieve without giving rise to the attendant tax consequences.

<sup>923</sup> The “controlled foreign company” legislation is aimed at targeting such instances of avoidance of tax. What is referred to here as “general avoidance” may very well in certain instances amount to tax mitigation or permissible tax avoidance as opposed to impermissible tax avoidance. The former is a reference to actions by taxpayers which will not be susceptible to the GAARs, whereas the latter will be. See the SARS *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)* (November 2005) 2 *et seq*; BT Kujinga *A comparative analysis of the efficacy of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa* LLD thesis, University of Pretoria (2013) 16. When distinguishing though between permissible and impermissible “the line is far from bright” (*Canada TrustCo Mortgage Co v R* 2005 SCC 54). Kujinga (2014) *CILSA* 439 notes that the fact that South Africa, Canada and Australia all identify impermissible avoidance arrangement differently shows how difficult the distinction is. Of specific note is the reference at 5 to the incorporation of a new business as an example of legitimate tax planning. It is noted though that the reference there is to a new business specifically,

the cases of *Secretary for Inland Revenue v Louw* (“*Louw*”)<sup>924</sup> and *SIR v Geustyn, Forsyth and Joubert* (“*Geustyn*”).<sup>925</sup>

These two categories, being “targeted” and “general avoidance”, are considered below for each of the four normality indicators.

### 3 3 1 *Arm’s length rights and obligations test*

*Hicklin*’s case considered the arm’s length test to be the appropriate starting point for the enquiry into the normality of a transaction.<sup>926</sup> That case determined that, in terms of section 103(1)(b)(ii), where parties to a transaction were engaging on an arm’s length basis with one another, the rights and obligations created in terms of a transaction, would more likely be regarded as being normal. However, abnormality would exist for purposes of section 103(1)(b)(ii) if an arrangement:

“... has created rights or obligations which would not normally be created between persons dealing at arm’s length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question ...”

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which appears to suggest that the transfer of an existing business to a company for tax driven reasons only or primarily may potentially amount to more than mere tax mitigation. In UK law, Loutzenhiser *Tiley’s Revenue Law* 100 suggests that tax mitigation occurs where taxpayers acquire tax benefits envisaged by the legislature through those taxpayers suffering the relevant anticipated economic consequences necessary for them to qualify for the tax benefits provided for. In contrast, tax avoidance would involve taxpayers acquiring those tax benefits through unanticipated means, in other words without bearing the necessary economic consequences that the legislature had intended. Where general avoidance is therefore achieved without meaningful economic consequences, such structuring could well be said to cross the divide between legitimate tax planning and impermissible tax avoidance. See also BT Kujinga “Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada” (2012) 45 *CILSA* 42 56 for the role that economic substance played in *Mathew v R* 2005 SCC 55.

<sup>924</sup> [1983] 45 SATC 113.

<sup>925</sup> [1971] 33 SATC 113. See also Examples 2 and 4 in the text to ch 1 part 3 above.

<sup>926</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195.

*Hicklin* then appears to go further and concludes that where the parties are at arm's length with one another, the means or manner in which they will enter into an agreement is also more likely to be normal rather than abnormal,<sup>927</sup> even though the "means or manner" test in section 103(1)(b)(i) makes no reference to arm's length terms of an agreement or the relationship between the parties. The reference to "arm's length" was only present in subsection (ii) dealing with rights and obligations. *Hicklin's* case decided that "arm's length" means "that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself."<sup>928</sup>

It is possible that the court in *Hicklin* considered the arm's length test relevant to interpret section 103(1)(b)(i) ("means or manner") too due to the fact that section 103(1) required abnormality to be considered by "having regard to the circumstances under which a transaction, operation or scheme was entered into" as well as the "nature of the transaction, operation or scheme in question".<sup>929</sup> The requirement to have regard to the circumstances surrounding a transaction and the type of transaction being entered into, was not retained in the current GAARs. The omission was likely deliberate and causes a substantial effect.<sup>930</sup> As a result, it is arguable that whether parties are in an arm's length relationship in relation to one another, is now irrelevant when considering whether the other indicators for abnormality, especially the "means or manner test",<sup>931</sup> may be present. The relationship between the relevant parties may even have become an irrelevant consideration in adjudicating the arm's length test itself, since it amounts to context drawn from the circumstances of the transaction. As a result, it is arguable

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<sup>927</sup> 195.

<sup>928</sup> 195.

<sup>929</sup> S 103(1)(b).

<sup>930</sup> EB Broomberg "Then and now – III: The tainted element" (2008) 22 *Tax Planning, SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 24. De Koker & Williams *Silke on South African Income Tax* ch 19.39.

<sup>931</sup> The "means or manner" test (see the text to part 3 3 2 of this chapter below) was the only other alternative indicator for abnormality that existed in s 103(1) and which *Hicklin* considered.

that the “arm’s length test” under the current GAARs simply means that the terms of the relevant transaction should be compared with the terms of a transaction that would have been entered into between unconnected or -related parties, to determine whether the terms actually agreed upon are at arm’s length.<sup>932</sup> In other words, the “arm’s length” test in section 80A(c)(i)<sup>933</sup> now only considers the terms of an arrangement and not the relationship between the parties entering into it.

As was the case for section 103(1), the “arm’s length rights or obligations test” under the new GAARs applies irrespective of whether a transaction is considered in the context of business or otherwise. The express reference to “any context” in section 80A(c)(i) links the test to the provisions of section 80A(i)(a) and (b) which deal with mutually exclusive contexts, being the context of business and otherwise. Consequently, a transaction would be abnormal, irrespective of whether in a business context or not, if its terms do not create arm’s length rights and obligations and irrespective of the means or manner that it employed. In the context other than business, in which transactions based on arm’s length terms would be less prevalent than in the context of business, such a conclusion is noteworthy. Although the wording of section 103(1)(b) was less explicit than section 80A, the latter cannot be seen as a departure from the previous position and in this sense,<sup>934</sup> the two tests appear to be identical. One would therefore

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<sup>932</sup> BT Kujinga *A comparative analysis of the efficacy of the general anti-avoidance rule as a measure against impermissible income tax avoidance in South Africa* LLD thesis, University of Pretoria (2013) 80, 81 and 116 where it is argued that the test in *Hicklin* may have been inappropriate to apply to s 103(1)(b)(i) where the parties involved were not in an arm’s length relationship. *Kujinga’s* views appear to be supported by *CIR v Louw* [1983] 45 SATC 113 118, which considers the arm’s length test to be a reference to the terms of the agreement, rather than the relationship between the parties involved. See also L Olivier 1197 (1997) 30 *THRHR* 725 738 as referred to with approval in *ITC 1699* [1999] 63 SATC 175 182; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 36 and 37.

<sup>933</sup> S 80A(c)(i) determines that a transaction would be abnormal if “... it has created rights or obligations that would not normally be created between persons dealing at arm’s length”.

<sup>934</sup> Other than for the comments above regarding the test in *Hicklin* and that the test in s 80A(c)(i) now only tests whether the terms of an arrangement is akin to that one would

expect that the case law dealing with the test in terms of section 103(1) should equally apply to the test now contained in section 80A(c)(i). One important exception should be noted, namely the omission of the phrase “under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question ...” from the test in section 80A(c)(i). This phrase formed the cornerstone of the judgment in *Louw*.<sup>935</sup> The court found that the act of incorporation was not at arm’s length if it were to be considered in isolation, yet it was still considered normal “under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question” (emphasis by Corbett JA). The change that section 80A(c)(i) brought about is therefore significant, as it effectively renders the *Louw* judgment irrelevant where the incorporation of a business creates rights and obligations that are not at arm’s length.<sup>936</sup> The

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expect to find between two unrelated parties, as opposed the view that s 103(1) may have previously considered the relationship between the parties as the relevant point of reference. See text to n 932 above.

<sup>935</sup> *CIR v Louw* [1983] 45 SATC 113 paras 137 and 138. The act of incorporation would not have been considered abnormal in terms of s 103(1)(b)(i), in other words incorporation would amount to normal manner or means being employed.

<sup>936</sup> SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 24*. Cf B Croome, A Oguttu, E Muller, T Legwaila, M Kolitz, RC Williams & C Louw *Tax Law, An Introduction* (2013) 498. *Contra De Koker & Williams Silke on South African Income Tax* ch 19.39 which argues that considering the nature of a transaction is an implicit requirement to the arm’s length test and therefore, irrespective thereof whether the wording referred to is present in s 80A(c)(i) or not, the test in *Louw* remains relevant. Broomberg (2008) *Tax Planning 9 et seq* presents the alternative argument to *De Koker et al* and with which I agree (and which correlates with the argument regarding the omission from s 80A that the circumstances of an arrangement must be taken into account when considering whether it is abnormal or not (see the text to part 3.3 of this chapter above), also addressed by *De Koker et al* (n 917 above)). A consideration of the nature of a transaction may in most circumstances present a justification for the terms of any arrangement to have been entered into on an arm’s length basis. In absence of a specific requirement in s 80A(c)(i) for the nature of an arrangement to be considered, one is simply left with the arm’s length test as set out by the AD in *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195 that needs to be applied. The test in s 80A(c)(i) should therefore simply be whether the terms of the arrangement is such that it is comparable to one where “each party is independent of the other and, in so dealing, ...

change strongly suggests that the legislature has purposefully intervened to ensure that facts such as those in *Louw* will not be considered normal again.

This statutory intervention does not cause the incorporation of a business to be abnormal automatically, even if it is done with a tax purpose in mind.<sup>937</sup> The effect is merely that when the incorporation of a business is not carried out on arm's length terms, it will be considered abnormal, irrespective of the "nature of the transaction, operation or scheme in question".

Where a business is incorporated, it amounts to an agreement of sale in which the business transferred to the company represents the *merx* and the amount paid for it, the *pretium*. When the "arm's length rights and obligations test" is applied in the context of a business being incorporated, the question becomes whether the business is transferred for equal counter-performance and at terms and conditions that one would expect to find in a sale of business agreement concluded between independent persons. If not, the transaction is abnormal, notwithstanding the earlier judgment of *Louw* dealing with the provisions of section 103. It is therefore clear that where the company is used for "general avoidance" purposes, transfer of assets to a company may still be carried out on arm's length terms (whether at incorporation of the company or subsequently) and will be considered "normal" in terms of section 80A(c)(i). It is then possible to use a company for "general avoidance" purposes without making use of non-arm's length transactions when the income-producing assets are transferred to the company.

The same would apply to "targeted avoidance" transactions, such as the taxation of dividends or the manipulation of withholding tax rates. Again, targeted avoidance may be achieved without necessarily entering into non-arm's length transactions when transferring the asset in question, such as a share portfolio, to

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strive[s] to get the utmost possible advantage out of the transaction for himself ...", irrespective of the nature of the transaction being considered. In other words, the terms of an arrangement must be considered as if concluded between independent persons, irrespective of the circumstances, the nature of the relationship, or the nature of the arrangement involved.

<sup>937</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 194.

a company. Subsequent income flows, such as dividend declarations or fees charged, will, however, now render a different tax result,<sup>938</sup> merely because of the involvement of the interposed company in the transaction. These tax benefits are achieved even if the initial transactions are carried out on arm's length terms. However, the tax consequences of subsequent transactions following such an arm's length transfer of assets to a company may differ, depending on whether the counter-party of the later transactions is a natural person or a company.

The arm's length test in section 80A(c)(i) therefore fails to address "general" and "targeted avoidance", both of which are perfectly capable of being achieved by way of transactions concluded on arm's length terms, whether it is at incorporation or using the characteristic of the company form for tax purposes at a later stage. The conclusion is therefore that both "general" and "targeted avoidance" may be achieved by using a company without it being considered abnormal under the "arm's length rights and obligations test".

However, a contrary view was expressed in *ITC 1606*:

*"In die huidige geval, waar H [BK] in die prentjie gebring is bloot om die vermindering van belastingpligtigheid ten doel te hê, kan die transaksie, onses insiens, in sy geheel gesien, nie as normaal of een, (sic) uiterste voorwaardes beding (one at arm's length) beskou word nie."*<sup>939</sup>

In other words, the court considered any transaction to amount to a non-arm's length one, if a company was involved only for tax purposes. That judgment, however, provides no support or reason for the remark. Although the *dictum* is clearly based on the specific facts of that case only, I submit that it loses sight of the principle in *Hicklin*. A company's assets and profits are those of the company alone and may only be disregarded if all four elements of the GAARs are shown to be present. In the above case, it would appear as though the tax purpose was considered to have tainted the court's consideration of normality; something, which the often-quoted judgment in *Hicklin* is clear, should not be taken into

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<sup>938</sup> Notably withholding taxes.

<sup>939</sup> *ITC 1606* [1995] 58 SATC 328 338.

account when a court considers the normality of a transaction.<sup>940</sup> If a transaction is considered on its own and found to have been concluded on arm's length terms, the fact that the transaction was entered into for tax purposes is of no consequence in considering whether the transaction has taken place at arm's length or not.<sup>941</sup>

The conclusion in *ITC 1714*<sup>942</sup> was that, although the trust may be a recognised business form through which to conduct business, using the trust for business does not render all transactions it executed normal: it depends on the terms of each of the transactions entered into by the trust. The conclusion holds true for the company form too. A company, even though a normal business form, is also capable of concluding abnormal, specifically non-arm's length, transactions. The question of normality therefore requires a transaction-by-transaction approach, irrespective of the nature of the entity involved.

### 3 3 2 *Means or manner not normally employed*

The second test for abnormality involves an enquiry into whether a transaction "was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* [business] purposes, other than obtaining a tax benefit".<sup>943</sup> The test differs, depending on the context in which the transaction concerned was entered into. If in the context of business, the means or manner employed in the arrangement under scrutiny are measured against the means or manner employed for *bona fide* business purposes other than for obtaining a tax benefit. If not in the context of business, the test is whether the means or manner would be used for any other *bona fide* purposes (excluding for the purpose of obtaining a tax benefit).

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<sup>940</sup> *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195.

<sup>941</sup> *ITC 1699* [1999] 63 SATC 175 183 sets out the correct approach:

"It is correct that a distinction must be drawn between purpose and abnormality such that it is indeed possible that, notwithstanding a tax saving purpose, a transaction may nonetheless be normal."

<sup>942</sup> [1996] 63 SATC 507 515.

<sup>943</sup> S 80A(a)(i) and (b) of the Income Tax Act.

Section 103(1) similarly distinguished between transactions taking place in- and outside the context of business. The distinction was only introduced with effect from 3 July 1996.<sup>944</sup> No case law exists to provide guidance on when a transaction will be considered to have been entered into in the context of business and when not. The distinction is accordingly not entirely clear.<sup>945</sup> In the context of business,<sup>946</sup> it has been argued that the test amounts to considering “[h]ow would businessmen generally, not motivated by any tax considerations but rather by ‘*bona fide* business purposes’, have structured that transaction?”<sup>947</sup>

It is not essential for purposes of this dissertation to conclude when an arrangement will fall within a business context and when it will fall in any other context. Suffice it to say that the context within which an arrangement has taken place must first be determined and classified. Thereafter it must be considered whether the means or manner in which that arrangement was entered into in that specific context would normally have been employed. Very little therefore appears to depend on the distinction of the context within which an arrangement is to be considered for purposes of applying the “normal means or manner” test, save for offering a benchmark against which to consider the actual means or manner employed in the arrangement under consideration.

*Hicklin’s* case states that if a transaction was entered into at arm’s length,<sup>948</sup> the means or manner employed would more likely be normal than abnormal. Should a court however find that a transaction was not entered into on an arm’s length basis contemplated in section 80A(c)(i), the other indicators for abnormality need not even be considered. This obviates the need to apply the

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<sup>944</sup> S 29(1) of the Income Tax Act 36 of 1996, which introduced the above subsections (aa) and (bb) of s 103(1)(b)(i).

<sup>945</sup> See also SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 24.

<sup>946</sup> S 103(1)(b)(i)(aa) of the Income Tax Act 36 of 1996.

<sup>947</sup> *ITC 1712* [2000] 63 SATC 499 at 501. The court here was prepared to accept for present purposes that this test reflects the law but declined to decide the point definitively.

<sup>948</sup> Whether between arm’s length parties or at arm’s length terms (see text to part 3 3 1 of this chapter and n 932 above).

“means or manner” test.<sup>949</sup> If it is therefore accepted that the “arm’s length rights and obligations test” is the appropriate point of departure when applying the test for abnormality,<sup>950</sup> an enquiry into the means or manner in which a transaction was entered into can therefore only depart from an acceptance that the relevant transaction has been entered into at arm’s length. Failing this, the transaction will be considered abnormal *ab initio* by virtue of section 80A(c)(i), and the application of the “means or manner” test becomes of academic importance only. This would be the case irrespective of whether the transaction in question has been entered into in the context of business or otherwise.

It is further significant that the purpose of obtaining a tax benefit is considered not to be a *bona fide* purpose in terms of this test, irrespective of whether this is in the context of business or otherwise. In this regard, section 80A(a)(i) and (b) expressly refers to a *bona fide* purpose, “other than obtaining a tax benefit”. Regardless of whether arguments may exist to support an assertion that entering into a transaction to obtain a tax benefit may be a *bona fide* purpose in- or outside the context of business, when applying the test in section 80A(a)(i) and (b) one must regard the obtaining of a tax benefit as not being a *bona fide* purpose.<sup>951</sup>

The test requires an objective test to be applied.<sup>952</sup> Irrespective of the potential tax benefits of an arrangement, how would other parties have structured the same arrangement? The test would largely depend on a fact-specific enquiry.

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<sup>949</sup> SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 37* confirms that this test is conceptually the same as its predecessor. Precedent relevant to the test as contained in s 103(1) therefore remains relevant.

<sup>950</sup> As is suggested by *Hicklin v Secretary for Inland Revenue* [1979] 41 SATC 179 195.

<sup>951</sup> Both the Margo and Katz Commissions recommended that the GAARs provide expressly that a tax purpose is not considered a *bona fide* purpose. The risk identified was that in the absence of such express provision, particular transactions widely engaged in for tax purposes may be considered to become “normal” over time as a result of its common and general occurrence. (See SARS *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)* 39 *et seq.*)

<sup>952</sup> SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 24*; see also *Kujinga* (2012) *CILSA* 52 for a similar conclusion on the position for the Canadian GAARs.

Objectively considered, one would typically expect any non-tax driven transaction to be structured in the most cost-effective and least complex manner possible, with as few steps as possible being entered into to bring about the desired commercial result.<sup>953</sup> Simplicity is therefore key in evaluating whether the means or manner in which an arrangement was entered into would have been normally employed. If a more complex structure is therefore preferred, the reasons for it must be demonstrable. For example, added complexity would result in reduced commercial risk or increased bargaining power. It bears reminding at this stage that the test is not simply whether the relevant arrangement exhibits unusual means or is entered into in an abnormal manner, but rather whether the arrangement's features present elements which one would not normally expect to encounter for parties seeking to achieve a *bona fide* purpose.<sup>954</sup>

The effectiveness of the means or manner test in curbing the intentional avoidance of tax by using corporate personality is limited by the fact that the "*bona fide* purpose" requirement is objective. Generally speaking, can it ever be objectively considered abnormal to incorporate a business, for example, given the many non-tax benefits associated with incorporation? Quite likely no, not even if subjectively done for tax purposes. One cannot ignore the non-tax consequences that using the corporate veil brings with it, such as protection of shareholders, which, objectively, is commercially attractive and which consequence would result due to the operation of law, whether in the context of business or otherwise.<sup>955</sup> Therefore, even if an arrangement would fall foul of a

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<sup>953</sup> On the assumption that no other non-tax related reasons may require the transaction to be structured in a more complex manner or through more complex means. It may be that a more complex structure may achieve the same economic result, yet with fewer commercial risks arising as a result.

<sup>954</sup> *ITC 1699* [1999] 63 SATC 175 183.

<sup>955</sup> In *Louw* it was concluded that the mere incorporation of a business cannot be considered abnormal. That case relied heavily though on the requirement that the means or manner test be applied by having regard to the nature of the transaction as well as the prevailing circumstances in which it is concluded. Both these requirements were subsequently removed from the GAARs and *Louw* can thus no longer serve as justification that the incorporation of a business presents a normal means or manner.

subjective purpose test, the objective *bona fide* purpose test would still be passed simply because the company as legal entity brings with it consequences which, objectively, will be commercially attractive.<sup>956</sup>

This poses a significant obstacle in applying the means or manner test in instances of “general” as well as “targeted avoidance”.

In relation to “general avoidance”, *Geustyn* makes clear that the incorporation of an existing business would generally not be considered abnormal.<sup>957</sup> It is therefore authority for the proposition that the incorporation of an existing business may pass the “means or manner” test. Although the rule laid down in *Geustyn* is by no means absolute and depends on the relevant facts,<sup>958</sup> it is

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This however does not derogate from the fact that a business or assets may still be transferred to a company by virtue of normal means or in a normal manner on the basis that objective reasons exist (other than a tax benefit) for the business or assets to be so transferred to a company.

<sup>956</sup> *Secretary for Inland Revenue v Geustyn, Forsyth and Joubert* [1971] 33 SATC 113 119:

“there is nothing abnormal in transferring an existing partnership business to a company: indeed, such a transaction may, I think, fairly be regarded as relatively commonplace in the commercial world.”

See also EB Broomberg “Then and now – VIII: Some conclusions” (2008) 22 *Tax Planning* where the author argues that the interposition of an entity is likely to fail the normality test if the entity has no objectively plausible interest in the subject matter of the interest. *ITC 1606* [1995] 58 SATC 328 338 presents an ostensibly contrary view where Tebbutt J held the view that

“... waar H in die prentjie gebring is bloot om die vermindering van belastingpligtigheid ten doel te hê, kan die transaksie, onses insiens, in sy geheel gesien, nie as normaal ... beskou word nie.”

It is considered that this *dictum* cannot be considered to have laid down a rule other than to confirm that where objectively (and not subjectively) the company has been interposed in a structure for a tax purpose it will then be considered abnormal in terms of the means or manner test. It is important here that the subjective purpose test in the introductory part of s 80A is not confused with the objective *bona fide* purpose test contained in the means or manner test as part of the normality requirement (*ITC 1699* [1999] 63 SATC 175 183).

<sup>957</sup> [1971] 33 SATC 113.

<sup>958</sup> [1971] 33 SATC 113 119.

unclear if the incorporation of a business can ever be considered abnormal in terms of the means or manner test, especially considering that it is an objective test which applies to this indicator. The same would generally be true for any transfer of assets to an existing company. The transfer of assets to a company for “general avoidance” purposes, whether transferred as part of an existing business or not, creates objective legal rights and obligations which would amount to a normal means or manner of dealing with one’s assets. These benefits would be relevant in a non-business context too. The means or manner of incorporation would be “normal” in the objective sense, even if subjectively these legal consequences are of secondary importance to the transferor. For “general avoidance” purposes, using the “means or manner” test to counter the use of corporate personality to manipulate the ultimate tax consequences of the shareholder is accordingly ineffective.

As regards “targeted avoidance”, the means or manner test presents varying results and its efficacy can therefore be called into question. Consider Example 1 above<sup>959</sup> where an individual chooses to hold share investments through a wholly owned company merely to delay dividends tax being levied. In such an example, as was the case for “general avoidance”, the means or manner employed may arguably be normal.<sup>960</sup> It may be argued that the same rights and obligations would be created, in the simplest way possible, by way of the same means or manner as in the case of any investor that would prefer to hold investments in a separate vehicle. Consequently, there is nothing objectionable to such a structure from a commercial perspective and this too would be the case for any other investor, irrespective of the subjective motive with which these shares are purchased in or transferred to the wholly owned company. Conversely, instances of treaty shopping (Example 3) prove to be more complicated. Complex structures that duplicate costs would more likely be considered abnormal if layers of companies are used and located in various

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<sup>959</sup> See the text to ch 1 part 3 above.

<sup>960</sup> It is submitted that it is not abnormal for an individual to hold listed shares through a holding company. Thus the means used by the individual, namely the use of the holding company, is not abnormal.

jurisdictions to act as extended conduits through which profits are repatriated to a holding company. The subjective purpose is irrelevant in considering whether such a structure would be abnormal in terms of the means or manner test. However, objectively, one must consider why various companies are used to repatriate dividends where the absence of any intermediary companies would have achieved the same commercial results. This could possibly be an example of where the means or manner in which a group structure is set up may amount to it being considered abnormal within the context of the means or manner test, although this is by no means definitive. Every single transfer of an asset or interposition of a company, considered on its own, may very well be implemented by way of normal means or in a normal manner. However, where an intricate string of companies is designed through which an investment is indirectly held, the question becomes more complicated. It is conceivable that a court will find that interposing a single company is in itself inadequate to exhibit a sufficient degree of abnormality to satisfy the “abnormal means or manner” test. In the absence of direct precedent on the matter, it is my view that a court may likely consider the transfer of an asset to a string of companies ultimately owned by the transferor as being abnormal for purposes of the means or manner test.

Interestingly, the incorporation and interposition of the companies in the various jurisdictions do not give rise to a tax benefit. The tax benefit from this intricate company group structure only manifests once dividends are declared from one company to the next. In other words, the tax benefit is not linked to the interposition of the conduit, but to the subsequent proverbial opening of the commercial tap. It is highly unlikely that the declaration of dividends alone would be considered abnormal. However, to the extent that one could show that the avoidance of withholding taxes in any applicable jurisdiction through treaty shopping was the ultimate objective of setting up the various companies, the incorporation of the various companies and the declaration of dividends could be considered a unitary scheme.<sup>961</sup> In such a case, the avoidance of withholding

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<sup>961</sup> See the text to part 3 1 of this chapter above for reasons why subsequent dividend declarations are unlikely to form part of a unitary scheme.

taxes on dividend declarations may be considered abnormal by virtue of the initial group structure created.<sup>962</sup> Suffice it to say that the means or manner test presents varying degrees of efficiency in addressing the use of the corporate veil for tax reasons.

### 3 3 3 *Lacks commercial substance*

The first of the two newly introduced indicators contained in sections 80A to L of the Income Tax Act applies to an arrangement if it “lacks commercial substance”.<sup>963</sup> The indicator is only applicable in the context of business. This could present a limitation on its application to prevent the abuse of the corporate veil for mainly tax purposes, as the test cannot apply as indicator in a context other than business. This is a unique limitation to the first of the four potential indicators of abnormality.

To establish whether an arrangement lacks commercial substance, the provisions of section 80C must be taken into account. In turn, section 80C is prescriptive as to when an arrangement would lack commercial substance. It is not clear whether it is possible for an arrangement to lack commercial substance in terms of section 80A(a)(ii) even if such an arrangement would fall outside the scope of section 80C. However, the context surrounding subsections 80C(1) and (2), and the broad and general test set out in section 80C(1), which was clearly not meant to apply to specific preconceived scenarios, indicates that section 80C is meant to serve as an exhaustive provision. In other words, an arrangement

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<sup>962</sup> *Crossland (Inspector of Taxes) v Hawkins* [1961] 2 All ER 812 as referred to in *Louw and Meyerowitz*. Cf *ITC 1862* [2012] 75 SATC 34 para 50 *et seq.* See also the text to part 3 1 of this chapter above.

<sup>963</sup> S 80A(a)(ii) of the Income Tax Act.

cannot lack commercial substance in terms of section 80A(a)(ii) if it does not meet the criteria in section 80C.<sup>964+965</sup>

Although the contents of subsections 80C(1) and (2) are analysed below,<sup>966</sup> the relationship between these two subsections is confusing and it is not clear whether the provisions are meant to be read together, or whether they are meant to serve as separate tests.<sup>967</sup> This dissertation does not offer a view on how this question should be approached. For the present analysis it will do to regard an arrangement as being abnormal on the basis of it lacking commercial substance if it qualifies as a transaction in terms of either section 80C(1) or 80C(2) as there appears at least a reasonable prospect that an arrangement falling within either of these provisions may be considered to lack commercial substance.<sup>968</sup> It is

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<sup>964</sup> See also SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 27* which agrees with this approach. EB Broomberg “Then and now – V: The commercial substance test” (2008) 22 *Tax Planning* 51 also suggests that the “lack of commercial substance” test is effectively defined in s 80C(1).

<sup>965</sup> If anything, the open-ended wording of s 80A(a)(ii) emphasises that which s 80C(2) makes clear, being that the indicators listed there present examples rather than a definitive list of instances when commercial substance would be lacking from an arrangement. An unrestrictive approach to “commercial substance” is therefore provided for in s 80C(2) already. The wide interpretation afforded by s 80C(2) therefore further supports the argument that s 80C should be relied upon as the defining provision of “commercial substance” as envisaged in s 80A(a)(ii). S 80C does not encroach upon or restrict an interpretation of what “commercial substance” would entail by setting predefined limitations through the predefined scenarios specifically addressed in s 80C(1) and (2).

<sup>966</sup> See the text to parts 3 3 3 1 and 3 3 3 2 of this chapter below.

<sup>967</sup> Broomberg (2008) 22 *Tax Planning* 51; EB Broomberg “Then and now – VII: Two more indicators” (2008) 22 *Tax Planning* 103 advances the view that the two tests should be treated as separate. The contrary view of De Koker & Williams *Silke on South African Income Tax* ch 19.39 is that s 80C(2) offers examples of arrangements which would lack commercial substance as envisaged in s 80C(1).

<sup>968</sup> Broomberg VII (2008) *Tax Planning* 103; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 29* argues that an arrangement falling into one of the preconceived categories of s 80C(2) should be subjected to the presumptive test contained in s 80C(1). As argued persuasively by Broomberg VII (2008) *Tax Planning*, it

therefore suggested that section 80A(a)(ii) may apply if an arrangement falls either within the provisions of section 80C(1) or exhibits any one of the traits specifically mentioned in section 80C(2) or exhibits some similar characteristic.

### 3 3 3 1 Section 80C(1): The arrangement's effect upon business risks and cash flow

Section 80C(1) provides that:

“... an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party ... but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained ...”

Earlier it was assumed that a tax benefit exists for the arrangements being considered.<sup>969</sup> Whether a “significant” tax benefit is achieved by using the corporate veil remains to be considered. Furthermore, whether either the business risks or net cash flows of the shareholder have been significantly affected as a result, must also be examined.

It is uncertain what a “significant” tax benefit would entail and how it would differ from an “ordinary” tax benefit. The test to determine what would be regarded as significant<sup>970</sup> is also uncertain. Would it involve a mere quantitative exercise,<sup>971</sup> or does it require a more involved approach by having regard to the relevant facts and circumstances of each case?<sup>972</sup> It is equally unclear whether a tax benefit which creates a mere postponement of liability for tax could also amount to a “significant” tax benefit being achieved. Since the possibility that a “significant” tax benefit may be created by using the corporate veil for tax purposes exists,

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would accordingly have been unnecessary to include the non-exhaustive list in s 80C(2) to start off with, should this interpretation be correct.

<sup>969</sup> See text to ch 5 part 2 above.

<sup>970</sup> As relates to a “tax benefit”, “business risks” or “net cash flows”.

<sup>971</sup> *Broomberg V* (2008) *Tax Planning* 50.

<sup>972</sup> *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule 18 et seq.*

this dissertation assumes that the tax benefit created as a result will also be a “significant” tax benefit.

Incorporating either an operating business or a passive investment would not immediately alter the economic value of the investment in the hands of the owner. However, that is not the test that should be applied. The question is not whether there has been an increase in value as a result of the transfer. Rather, the question to be asked is to what extent the business risks and net cash flows of the relevant parties have been affected. It has been argued that the test is two-pronged, namely:<sup>973</sup>

- (a) Were there any significant changes to the business risks or net cash flows of each party involved in the arrangement?
- (b) If “no” for any party in (a) above, has there been a significant tax benefit created for that party as a result of the arrangement?

If “yes” in (b), the arrangement in question would lack commercial substance.<sup>974</sup> From an anti-avoidance perspective, the weakness of the “business risks or net cash flows” test lies therein that the test requires the position of “a party” to the arrangement to be considered. The corporate veil creates that additional party to an arrangement. For the company, its business risks and potential cash flows (where applicable) will change when the assets are transferred to it. Irrespective of whether the transferee company obtained a significant tax benefit or not,<sup>975</sup> the assets transferred to it will necessarily have a significant effect on the business

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<sup>973</sup> BT Kujinga “The economic substance doctrine against abusive tax shelters in the United States: lessons for South Africa” (2015) 27 *SA Merc LJ* 218 244.

<sup>974</sup> Naturally if the answer in (a) is “yes”, the inquiry stops there and there is no lack of commercial substance.

<sup>975</sup> It is arguable whether the transferee company will actually be better off from a tax perspective. It will not be paying less tax than before acquisition of the assets transferred to it. By involving the company in the corporate structure of the transferor, the tax benefit arising is not that of the company, but ultimately that of the transferor which will be in a net better tax position on an economic consolidated basis.

risks and net cash flows for all parties to that arrangement, thereby ensuring that the provisions of section 80C(1) cannot be applied to it as part of the asset transfer.<sup>976</sup>

The business risks that are inherently attached to an asset, are transferred to the company, when it takes transfer of the assets. For example, the risk of the assets being lost, destroyed, or decreasing in value, is assumed by the company on transfer. This has a significant effect on the business risks of both the transferor and transferee, which puts the arrangement beyond the scope of section 80C(1) for both parties.<sup>977</sup>

Since the business risks<sup>978</sup> linked to an asset transferred to a company will necessarily have a significant effect on the business risks of the parties involved, it becomes irrelevant in terms of the commercial substance test whether such a transfer will also affect any person's cash flows. For even if cash flows are unaffected, section 80C(1) applies only where neither business risks nor cash flows are affected by the arrangement. If business risks are affected, then commercial substance is still present. For purposes of the current enquiry the question whether cash flows are altered appears to be irrelevant since the tax benefits achieved through use of the corporate veil could very well be achieved with or without altering cash flows.

Consequently, section 80C(1) on its own would be ineffective in combatting impermissible tax avoidance resulting from using the corporate veil to achieve a tax benefit, whether in the context of "targeted" or "general avoidance".<sup>979</sup>

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<sup>976</sup> Broomberg V (2008) *Tax Planning* 50.

<sup>977</sup> The wording of s 80C(1) suggests that that provision will be inapplicable even if the tax benefit is more significant than the effect on net cash flows or business risks, as long as these too are significant.

<sup>978</sup> "Business risks" is an undefined term, but could include a variety of risks attendant to conducting business, such as market risk, credit risk, operational risk, and foreign exchange risk (De Koker & Williams *Silke on South African Income Tax* ch 19.39).

<sup>979</sup> When applying the provisions of s 80F(a) in conjunction with s 80C(1) though, a different result appears to emerge. See the text to ch 3 part 3 3 3 below.

### 3 3 3 2 Section 80C(2): Indicators for lacking commercial substance

Section 80C(2) expressly does not intend to present an exhaustive list of criteria indicative of whether an arrangement would lack commercial substance or not.<sup>980</sup>

The introductory part of that provision is clear that the indicators of a lack of commercial substance “are not limited to” those indicators listed in section 80C(2)(a) and (b).<sup>981</sup> It is not entirely clear what other characteristics would also be indicative of an arrangement lacking commercial substance.<sup>982</sup> This will ultimately depend on the facts. However, if the *ejusdem generis* rule of statutory interpretation is applied, the other tests already specifically listed in section 80C(2)(a) and (b) will be important.<sup>983</sup> These potential other characteristics will be considered after first considering what those factors already listed in section 80C(2)(a) and (b) comprise.

Section 80C(2)(a) requires the legal substance or legal effect of an arrangement which achieves a tax benefit to accord with its legal form:

“(2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to –

- (a) the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps ...”

Due to the legal fiction of separate legal personality, this test is wholly inapplicable where the corporate veil is used to achieve a tax benefit. Although legal personality involves a legal fiction and may be considered an exception to the substance over form doctrine,<sup>984</sup> it is nonetheless a statutorily created legal

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<sup>980</sup> SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 26.

<sup>981</sup> See also the National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill* (2006) 63.

<sup>982</sup> National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill* (2006) 64 provides only one further example. This example is irrelevant to this dissertation.

<sup>983</sup> Cf De Koker & Brincker *Silke on International Tax* 46.22.

<sup>984</sup> See the text to ch 2 part 4 2 1 above.

rule.<sup>985</sup> At the transfer of any asset to a company to achieve a tax benefit, the legal substance and effect and legal form will be consistent, insofar as the corporate veil is concerned, due to the operation of law.<sup>986</sup> The corporate veil's existence is a manifestation of legal substance. Upon a valid transfer of an asset to a company, the company will be the owner of that asset. Therefore, both in substance and form the company will be the owner of the assets and not the transferor. Consequently, for both "targeted" and "general avoidance", section 80C(2)(a) could not apply to pierce the corporate veil. Income generating assets transferred to a company will not lack commercial substance as contemplated in section 80C(2)(a).

Section 80(2)(b) provides as follows:

- "(2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to –
- (a) ...
  - (b) the inclusion or presence of -
    - (i) round trip financing as described in section 80D; or
    - (ii) an accommodating or tax indifferent party as described in section 80E; or
    - (iii) elements that have the effect of offsetting or cancelling each other."

As argued earlier, where the corporate veil is used for tax purposes and the arrangement is not a unitary scheme, the GAARs can only apply to the transfer

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<sup>985</sup> See the text to ch 2 part 1 above.

<sup>986</sup> Kujinga (2015) *SA Merc LJ 228 et seq* compares how the economic substance doctrine in the USA may be applied to assist with an interpretation of the "commercial substance" test in s 80C(1) of the Income Tax Act (at 221). While the conclusions and recommendations there would potentially be helpful in approaching s 80C in future, care should be taken not to confuse "substance" or "commercial substance" with "legal substance" (which is the test prescribed by s 80C(2)(a)). While Kujinga's conclusions and recommendations may certainly be applied in most cases where s 80C(1) generally (as well as potentially subsection (2)(a) specifically) is concerned (in other words, where "substance", "economic substance" and "legal substance" may amount to the same notion), this is not the case where the "legal substance" of separate corporate personality is concerned. "Legal substance", where corporate personality is involved, differs fundamentally from "substance" or "economic substance".

of the assets to the company (step one) and not to the subsequent arrangements, when those assets are utilised to generate income (step two).<sup>987</sup>

Section 80C(2)(b)(i), dealing with round trip financing, will not apply when an asset is transferred to a company, as such a transfer of ownership will not involve round trip financing.<sup>988</sup>

Section 80C(2)(b)(ii) deals with “accommodating or tax-indifferent parties” and is equally inapplicable. Section 80E, which defines this concept, sets one of two potential preconditions for a person to be considered an “accommodating or tax-indifferent party”.<sup>989</sup>

The first potential basis to be considered as such is that that person or any amount received by that person must not be “subject to normal tax”.<sup>990</sup> Most South African resident companies are subject to South African income tax and thus “normal tax”.<sup>991</sup> Given the generally strict tax regulatory framework within which accommodating or tax-indifferent parties are required to operate,<sup>992</sup> it is difficult to see how the involvement of such a party in an arrangement as transferee would still meet the commercial requirements of the shareholder.<sup>993</sup> In

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<sup>987</sup> See the text to part 3 1 of this chapter above.

<sup>988</sup> As contemplated in s 80D of the Income Tax Act and which is referred to by s 80C(2)(b)(i) of that Act.

<sup>989</sup> S 80E(1)(a)(i) and (ii).

<sup>990</sup> S 80E(1)(a)(i). Normal tax is levied in terms of s 5 of the Income Tax Act and is the income tax – refer definition of “income tax” in s 1 of the Income Tax Act. See also the example in *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 31.

<sup>991</sup> Various limited exceptions exist, and which companies are specifically mentioned in s 10(1) of the Income Tax Act as being exempt from income tax. These companies include either non-profit companies (the position of which is not considered in this dissertation (see the text to ch 1 part 2 2 above)) or involve instances so exceptional that it is also not considered here in any further detail.

<sup>992</sup> Such as public benefit organisations and those other entities specifically dealt with in s 10 of the Income Tax Act.

<sup>993</sup> In *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* [1996] 58 SATC 229, a pension fund was used as part of a tax motivated scheme. Although the case was not decided in terms of the then operative GAARs, the role of the pension fund in the relevant scheme might be described as that of a tax indifferent party.

the unlikely cases where the use of an accommodating or tax-indifferent party could still be used to achieve a tax benefit, section 80C(2)(b)(ii) may very well present a potential basis for piercing in terms of the GAARs.

From the position of the transferor, due to the South African residence basis of taxation applied by the Income Tax Act, all non-resident companies will be subject to South African income tax on South African source income.<sup>994</sup> In a transaction aimed at achieving an income tax benefit,<sup>995</sup> the transferor of an asset will not be a tax accommodating or tax-indifferent party, as such party would otherwise not have needed to transfer the asset, since it was already not subject to South African income tax.<sup>996</sup> The same logic extends to amounts that may be received exempt from income tax by the transferee entity (such as local dividends).<sup>997</sup> Considering that the GAARs are intended to act as remedial provision only, it is unlikely that the provisions of section 80E(1)(a)(i) could be invoked where the amounts in question would have been exempt from income tax in the hands of the transferor.

The second basis upon which persons may qualify as accommodating or tax-indifferent parties in terms of section 80C(2)(b)(ii) relates to the offsetting of amounts as described in section 80E(1)(a)(ii). That provision is inapplicable for the same reasons that section 80C(2)(b)(iii), also dealing with offsetting, is inapplicable. It is therefore appropriate to discuss section 80E(1)(a)(ii) read with

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<sup>994</sup> See the definition of “gross income” in s 1 of the Income Tax Act.

<sup>995</sup> S 80E(1)(a)(i) does not extend to taxes other than the income (or normal) tax.

<sup>996</sup> It is possible that a person not subject to normal tax may be subject to other taxes on income (such as any of the withholding taxes) and that it transfers the assets in an attempt to avoid these. However, these persons (typically not subject to income tax by virtue of their tax residence) would become subject to the income tax based on the source of the income received. It is therefore difficult to contemplate a scenario where a person will not be subject to income tax, yet subject to other source-based taxes (such as any of the South African withholding taxes) which it seeks to avoid. It is considered unlikely that examples exist where the transferor would qualify as a tax-indifferent or accommodating party yet consider it necessary to transfer assets to achieve a relief from South African taxes.

<sup>997</sup> S 10(1)(k)(i) of the Income Tax Act.

section 80C(2)(b)(ii), together with section 80C(2)(b)(iii) to illustrate why neither will apply in the piercing context.

Section 80C(2)(b)(iii) contemplates arrangements whereby elements of the arrangement will “have the effect of offsetting or cancelling each other”. For purposes of this dissertation, the applicability of this test is only considered where a transfer of assets to a company takes place on arm’s length terms. If the transfer of asset did not take place on arm’s length terms, the arrangement would already be considered abnormal.<sup>998</sup> I submit that an arm’s length transfer of assets to a company cannot be considered as “offsetting or cancelling each other” and therefore by implication lacking commercial substance. When a business is incorporated, or assets sold to a company on arm’s length terms, a sales transaction is entered into. Therefore, counter-performance in the form of either cash, debt, the assumption of the transferor’s debt or the issuance of shares is required. None of these resemble the characteristics envisaged in either sections 80E(1)(a)(ii) or 80C(2)(b)(iii).

To conclude an analysis of the specific provisions in terms of which an arrangement may lack commercial substance: none of these will apply in a situation where the veil is pierced for tax purposes. To consider which other transactions, not specifically addressed by section 80C(2)(a) or (b), may nonetheless potentially fall within the ambit of section 80C(2),<sup>999</sup> it is necessary to consider what trait subsections (2)(a) to (2)(b)(iii) have in common and then to consider whether this may be applied to abuse of corporate personality for tax purposes.

Broomberg suggests that the theme of section 80C(2) involves the interposition of a party in a transaction, in which such party has no economic interest, so as to secure a tax benefit for the “real parties”.<sup>1000</sup> This appears to be an appropriate summary and encapsulates the essence of section 80C: an

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<sup>998</sup> See text to ch 5 part 3 3 1 above.

<sup>999</sup> Which provision has been drafted in an open-ended fashion.

<sup>1000</sup> Broomberg VII (2008) *Tax Planning* 103; see also the further examples listed in the SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule 35 et seq*, although notably the Draft Guide fails to identify a general consistent principle which s 80C(2) seeks to achieve.

arrangement would be considered to lack commercial substance if a party is left commercially in substantially the same position before and after a transaction, except for the tax benefit achieved. However, the suggested approach does carry the risk of being applied too liberally. In my view, the test cannot simply be an examination of whether a party to an arrangement has been enriched as a result of the arrangement. If the test was applied too liberally, many arm's length negotiated transactions could be regarded as lacking commercial substance, leading to absurd results. I therefore submit that the question should rather be whether there is a reasonable possibility that a party involved in an arrangement may reasonably be considered to benefit commercially from the arrangement either immediately or in future, through commercial benefits created as a result of the arrangement. The substance-based enquiry for section 80C(2) proposed here is therefore a potentially much wider test than the "business risks" and "net cash flow" analysis required by section 80C(1). Whereas the test in section 80C(1) takes what can be described as an immediate or short-term view of the results of a transaction, section 80C(2) requires a longer term and potentially more permanent effect before an arrangement will be regarded as indeed having commercial substance.

At a more general level, the problem when using the commercial substance test in section 80C to address the abuse of corporate personality for tax purposes is two-fold.

In the first instance, a company has legal substance. This is significant since the **legal** substance afforded to a company cannot be entirely separated from the question of **commercial** substance in the corporate personality context. Barring the application of section 20(9) of the Companies Act, the company, as separate legal person, is able to act as a party to an arrangement. Therefore, it is able to benefit commercially itself, even if it is with the ultimate goal of creating a tax benefit for its shareholder(s). The commercial realities thus draw on the legal substance created by the fiction of legal personality. The company can create commercial benefits (in other words commercial substance) for itself by virtue of its ability to own assets.

This is relevant for the use of the company in instances of “general avoidance”, where the company would generate wealth for its own account by employing the assets transferred to it. To a more limited extent, the barrier would also be present in instances of “targeted avoidance”, which would typically entail the company being used as a conduit: receiving profits and passing it on in due course, typically by way of dividends payments. Especially where the distribution of profits to shareholders is not immediate, those profits would also belong to the company, both legally and commercially, thus creating commercial substance for it.

The second barrier to employing the commercial substance test as a means of combatting impermissible tax avoidance using corporate personality, is that the test is objective, a point relevant for “targeted avoidance”. The question, at the stage when an asset is transferred to a company,<sup>1001</sup> is whether that company is objectively able to use that asset for its own commercial benefit. It is irrelevant whether it in fact intends to use it for its own commercial benefit. The objective test would have to be applied by having regard to the rights and obligations linked to such a transfer. For example, if a company acquires the use of an asset as a lessee but is obligated to sublease this asset to another party on exactly the same terms, it could be argued that the main lease agreement is without any commercial substance. The same argument applies where a company is employed to hold investments yet is obliged in terms of a contract and the terms of a specific class of shares to distribute any distributions received to its shareholders upon receipt thereof. In such an instance too, any share investments held by the company could quite reasonably be considered to lack commercial substance, as there is no reasonable, objective prospect that the company will hold the shares for its own commercial benefit. The problem with the objective test however, is that a company may very well not be obliged to pass on distributions to shareholders. Yet that may be the exact intent with which the investments in question were transferred to it, namely to ensure the timeous distribution thereof to its shareholder who ultimately controls it. In terms of the objective commercial substance test, such a subjective intention would be irrelevant. Objectively, the company can utilise its investment for its own

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<sup>1001</sup> See the text to part 3 1 of this chapter above.

commercial benefit. Whether it actually intends utilising it for that purpose is another question altogether and cannot change the fact that the acquisition of an investment (or the right of use of a property through a lease agreement) is commercially substantive.

It follows that whether an arrangement lacks commercial substance or not appears to present a limited remedy in combatting the intentional avoidance of tax through use of the corporate veil. This is primarily because the legal substance granted to the company by virtue of incorporation in terms of the Companies Act enables a company to also have commercial substance.

### 3 3 3 3      The effect of section 80F(a)

Section 80C should not be considered in isolation. Section 80F(a) has a direct bearing on the application of section 80C and provides that:

“[f]or the purposes of applying section 80C or determining whether or not a tax benefit exists for purposes of this Part, the Commissioner may treat parties who are connected persons in relation to each other as one and the same person ...”

This provision presents another example of a piercing provision contained in the Income Tax Act.<sup>1002</sup> Section 80F(a) allows for piercing of the corporate veil of a company in relation to a connected person<sup>1003</sup> to determine whether an arrangement, such as the transfer of an asset, lacks commercial substance. For purposes of that enquiry, the company and the connected person (such as potentially a shareholder) are treated as the same person. An exercise of this nature would conceivably involve considering the economic unit holistically to

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<sup>1002</sup> The piercing provision in s 80F(a) is a piercing provision of general application, as opposed to those piercing provisions identified elsewhere in the Income Tax Act aimed at curbing specific instances of tax avoidance – see the text to part 1 of this chapter above.

<sup>1003</sup> The term “connected person” is widely defined in s 1 of the Income Tax Act. Although the term is to be applied within the confines of the definition, it would almost always include a significant shareholder of a company.

determine whether the transaction has brought about any significant commercial benefits to that unit.

As discussed earlier, neither section 80A(a)(ii), nor section 80C provides a clear definition of what “commercial substance” entails. What is clear from an analysis of section 80C,<sup>1004</sup> is that for a transaction to have commercial substance, it must have some sort of “effect”. Therefore, where an asset is transferred between a company and a connected person, the application of the piercing provision in section 80F(a) would result in that transaction having no net effect, other than for the tax benefit created.

Through section 80F(a), the GAARs may be applied as remedy against both “targeted” and “general avoidance” where the corporate veil is used. Consider the “targeted avoidance” example of treaty shopping in Example 3.<sup>1005</sup> Where numerous companies are interposed in various jurisdictions to ensure that the repatriation of profits result in as little withholding tax as possible, the structure will most likely fail at the commercial substance hurdle, when considered in light of section 80F(a). Whether various companies are interposed or not, the commercial substance of the economic unit as a whole remains unchanged, indicating a lack of commercial substance through the interposition of the companies involved. The same would apply for “general avoidance” where a company is employed to house a business or a share investment: the commercial substance of the economic unit comprising the shareholder and company will be the same, irrespective of whether a company would have existed as a means to house the assets or not. In the context of section 80C(1) specifically, the business risks and cash flows of the economic unit would remain unaltered if considered on a net consolidated basis, yet it would achieve a significant tax benefit as a result.

An exception will be where real economic benefits can objectively be created in the hands of the company, which would otherwise have been impossible if ownership of the asset remained with the shareholder. Such a result may very well occur, for example where assets which will create economic synergies are

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<sup>1004</sup> See the text to part 3 3 3 2 of this chapter above.

<sup>1005</sup> See the text to ch 1 part 3 above.

transferred to a company, or where more than one shareholder pool assets together in a single company. Where the company however serves no objective purpose, other than to act as the puppet of the shareholder, one may very well find that such a transfer holds no economic or commercial substance when viewed holistically, as enabled by section 80F(a).

Although section 80C would appear to apply in instances of abuse of the corporate veil for tax purposes, two reasons exist why it may nevertheless be an ineffective remedy for SARS.

In the first instance, it should be borne in mind that section 80C only operates in the context of business and what would have been an effective remedy against the abuse of legal personality for tax purposes, cannot be applied in a context other than business. Therefore, section 80F(a) as applied to section 80C can likewise only apply in a business context. This may present an obstacle where an individual chooses to hold share investments through a company to avoid the immediate instance of dividends tax (Example 1), although it remains unclear whether such a scenario would be in the context of business or not.

Secondly, and of broader application, section 80B presents inherent limitations for the GAARs to apply in instances of abuse of the corporate veil, even where an impermissible avoidance arrangement can be said to exist. These limitations are discussed in more detail below.<sup>1006</sup>

### *3 3 4 Misuse or abuse of the Income Tax Act*

The final of the four potential indicators of abnormality involves the question if in any context the arrangement would “result directly or indirectly in the misuse or abuse of provisions of” the Income Tax Act.<sup>1007</sup>

#### **3 3 4 1 “Misuse or abuse” in the general anti-avoidance rules**

Whereas the “commercial substance” test discussed above<sup>1008</sup> contains specific statutory guidelines relating to its implementation, such guidelines are not

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<sup>1006</sup> See the text to part 3 4 of this chapter below.

<sup>1007</sup> S 80A(c)(ii) of the Income Tax Act.

<sup>1008</sup> See the text to part 3 3 3 of this chapter above.

provided for the “misuse or abuse” test in the GAARs. Furthermore, in the absence of any reported judgments on the application of section 80A(c)(ii) to date, the potential scope of the test remains uncertain.

The wording of the provision itself provides no clear direction on how the provision should be approached. Yet, as is the case in interpreting section 20(9) of the Companies Act,<sup>1009</sup> the essence of the test lies in the meaning of the phrase “misuse or abuse”.

There appears to be consensus that the provision calls for the adoption of a purposive statutory approach to the interpretation of the Income Tax Act and for the interpreter to conclude on this basis whether a statutory provision has been misused or abused.<sup>1010</sup> South African courts already apply a purposive approach to statutory interpretation as part of a three-pronged approach.<sup>1011</sup> The function of the “misuse or abuse” test is therefore called into question.<sup>1012</sup> It is difficult to conceive of a situation where a court would interpret and apply a provision in the Income Tax Act in line with a purposive approach, yet simultaneously consider it to have been “misused or abused”. The test therefore contains a contradiction,

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<sup>1009</sup> See the text to ch 4 part 2 above.

<sup>1010</sup> D Clegg “Use it or abuse it” (2007) 21 *Tax Planning* 36 and the sources cited there. See also n 1012 below.

<sup>1011</sup> See the text to ch 4 part 2 1 above.

<sup>1012</sup> The so-called “modern” approach to statutory interpretation (as described in SARS *Tax Avoidance and Section 103 of the Income Tax Act, 1962: Revised proposals*) was only specifically embraced in South Africa after the GAARs in their current form had been enacted. It is clear from the *Revised proposals* that the motivation behind introducing the Canadian “misuse or abuse” test was to reinforce this approach to statutory interpretation and as set out in the Canadian judgment of *Canada TrustCo*, a judgment dealing with the Canadian “misuse or abuse” equivalent provision. That judgment also endorsed the now prevailing position in South Africa, being that statutes should be applied in line with the three-pronged literal, purposive and contextual approach. Now that that approach has been explicitly adopted in South Africa, it is questionable whether the “misuse or abuse” provision has any further function to serve. Cf EB Broomberg “Then and now IV” (2008) 22 *Tax Planning*; Y van der Westhuizen “Abusing the Income Tax Act by misusing the letter of the Act” (2008) 71 *THRHR* 613; Kujinga (2012) *CILSA* 46 *et seq*; De Koker & Brincker *Silke on International Tax* 46.20 and 19.39; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 40 (compare with 44).

because if a provision has already been interpreted purposefully, and the arrangement falls within or outside it, the provision cannot have been misused or abused.<sup>1013</sup> It may therefore be that section 80A(c)(ii) previously had a role to fulfil under a dispensation where fiscal statutes were subject to a strict literal interpretation only.<sup>1014</sup> However, as this is no longer the case for South African fiscal statutes, it appears unclear what further role the provision can play.<sup>1015</sup>

Authority<sup>1016</sup> suggests that the phrase has its origins in the Canadian GAARs.<sup>1017</sup> It appears likely that the Canadian roots of the provision are the

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<sup>1013</sup> Clegg (2007) *Tax Planning* 36 and the sources cited there. See also n 1012 above.

<sup>1014</sup> The so-called “modern” approach to statutory interpretation (as described in SARS *Tax Avoidance and Section 103 of the Income Tax Act, 1962: Revised proposals*) was only specifically embraced in South Africa after the current GAARs were introduced.

<sup>1015</sup> Kujinga (2012) *CILSA* 47. See the text to ch 4 part 2 1 above. Prior to the “modern approach” to statutory interpretation being explicitly adopted by the SCA in South Africa (see the text to ch 4 part 2 1 above), Van Schalkwyk & Geldenhuys (2010) *JJS* 183 in 2009 considered s 80A(c)(ii) to act as a “reinforcement” to the modern approach to statutory interpretation, to the limited extent to which it was already followed in South Africa at that stage. Given the recent changes to the approach to the interpretation of statutes in 2014 (see the text to ch 4 part 2 1 above), their view supports a conclusion today that s 80A(c)(ii) does little more than what is now already required when interpreting legislation.

<sup>1016</sup> National Treasury *Explanatory Memorandum on the Revenue Laws Amendment Bill* (2006) 63. Clegg (2007) *Tax Planning*; Broomberg IV (2008) *Tax Planning*; C Cilliers “Thou shalt not peep at thy neighbour’s wife: s 80A(c)(ii) of the Income Tax Act and the abuse of rights” (2008) 57 *The Taxpayer* 85; De Koker & Williams *Silke on South African Income Tax* ch 19.39; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 39; Van Schalkwyk & Geldenhuys (2010) *JJS* 172. Kujinga (2012) *CILSA* 48 points out that the misuse or abuse test is in part also derived from the abuse of rights doctrine applied in many European jurisdictions. He adds though that this doctrine is not applied in Canada and that it is likely that South African courts would opt to apply a purposive interpretative approach to tax legislation (as is the case in Canada), rather than incorporate elements of the abuse of rights doctrine (which is also not applied in South Africa) when giving content to the misuse or abuse test. *Cf Cassidy* (2012) *Stell LR* 339.

<sup>1017</sup> S 245(4) of the Canadian Income Tax Act, R.S.C. 1985 c. 1 (5<sup>th</sup> Supp). That test involves a two-part inquiry, being firstly a legislative interpretative exercise regarding the content of the allegedly abused provision followed by an application of the facts in

primary cause for the provision not fitting neatly within the South African context.<sup>1018</sup> The “misuse or abuse” test’s seemingly uncomfortable existence in the South African GAARs may be attributed to a number of factors. It could be as a result of the strong civil law links that the Canadian legal system has compared to our own common law system,<sup>1019</sup> the different approach adopted in that jurisdiction concerning statutory interpretation,<sup>1020</sup> or due to the dissimilar context within which the provision operates in the Canadian GAARs compared to its South African counterpart.<sup>1021</sup> It is finally notable that the “misuse or abuse” test in the Canadian GAARs fulfils a much more prominent role compared to its South African equivalent. In terms of the Canadian GAARs, the “misuse or abuse” test is a required element before a transaction can be subjected to the GAARs,<sup>1022</sup> whereas in South Africa it is but one of four potential indicators for abnormality.<sup>1023</sup>

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considering whether the object, spirit or purpose of the relevant provision was defeated or frustrated (*Canada TrustCo Mortgage Co v R* 2005 SCC 54 para 50).

<sup>1018</sup> De Koker & Brincker *Silke on International Tax* 46.20; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 39.

<sup>1019</sup> Cilliers (2008) 57 *The Taxpayer*.

<sup>1020</sup> Cilliers (2008) 57 *The Taxpayer*; see n 1010 above.

<sup>1021</sup> Van der Westhuizen (2008) *THRHR* 620; Broomberg IV (2008) *Tax Planning*; Kujinga (2012) *CILSA* 49, 50 and 51 notes that the South African GAARs, unlike their Canadian counterpart, were introduced to address the perceived failure of earlier versions of the GAARs. This dissertation is not concerned with a detailed interpretation of the general application of specific provisions of s 80A. It considers only whether s 80A may potentially be applied to address the abuse of the corporate veil for tax purposes. A detailed consideration of the Canadian authorities on s 80A, and specifically the cases of *Canada TrustCo* and *Mathew* considering the Canadian “misuse or abuse” provision, would amount to an unwarranted deviation of focus of this dissertation. Suffice it to say that the test is accurately summed up in *Canada TrustCo Mortgage Co v R* 2005 SCC 54 para 6:

“Abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.”

<sup>1022</sup> Kujinga (2012) *CILSA* 43; S 245(4) of the Canadian Income Tax Act.

<sup>1023</sup> See the text to part 3.3 of this chapter above.

Despite the lack of clarity that surrounds section 80A(c)(ii),<sup>1024</sup> its provisions cannot be ignored. It is quite possible that courts may, for policy considerations, wish to have recourse to a more flexible provision. Such a provision may be found in section 80A(c)(ii) and may be capable of providing the remedy that courts seek. In light of the less than satisfactory results achieved in the application of the other three indicators for abnormality in cases of abuse of corporate personality, a more flexible provision may be desired.<sup>1025</sup> It is further clear that section 80A(c)(ii) should be afforded a wide interpretation, as it aims to address actions that would “result directly **or indirectly** in the misuse or abuse of the provisions of ...” the Income Tax Act.

In applying section 80A(c)(ii) in the piercing context, two questions should be answered upfront: who is perpetrating the alleged abuse, and which provision of the Income Tax Act is being abused?

As far as the former is concerned, the company cannot abuse itself, even though its use causes a tax benefit. Rather, the shareholder exercising ownership control over the company and the ultimate beneficiary of the tax benefit, would perpetrate the abuse. The shareholder interposes a company to abuse the provisions of the Income Tax Act. The company can therefore not be said to have abused the provisions of the Income Tax Act when it is party to a transaction

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<sup>1024</sup> See Broomberg IV (2008) *Tax Planning* specifically. The author argues further that the lack of clarity will lead to courts adopting a severely conservative approach and be willing to apply the provision in but the most limited of circumstances. See also Kujinga (2012) *CILSA* n 24; Kujinga (2014) *CILSA* and referring to the approach in *King*; B Geldenhuys *An analysis of section 80A(c)(ii) of the Income Tax Act no. 58 of 1962 as amended* MAcc thesis, University of Stellenbosch (2009) 5. In *Canada TrustCo Mortgage Company v The Queen* [2003] 4 CTC 2009 at paragraph 91 the court warns that the application of the GAARs would reach dangerous levels where it is used to replace legal provisions with policy. For a similar approach in South Africa, see Cassidy (2012) *Stell LR* 336. Kujinga (2014) *CILSA* 446 accurately identifies the source of uncertainty in the context of s 80A(c)(ii), being that the misuse or abuse test presupposes that a single purpose can be identified for each provision in the Income Tax Act, where the reality rather is that development of the provisions of that Act is much more complex.

<sup>1025</sup> See the text to parts 3 3 1 to 3 3 3 of this chapter above.

giving rise to the tax benefit for the shareholder.<sup>1026</sup> The only transaction that the shareholder will be a party to is the transfer of assets to the company. The company will enter into all subsequent transactions giving rise to a tax benefit. As was the case with section 80A(a)(ii),<sup>1027</sup> section 80B likewise presents a disconnection from section 80A(c)(ii) which is potentially fatal to the application of the “misuse or abuse” provision as anti-avoidance remedy where the corporate veil is used for tax purposes. This point will be addressed below.<sup>1028</sup>

The “misuse or abuse” test is inefficient for another reason. The test requires the identification of the relevant provision of the Income Tax Act that is being abused. The Income Tax Act recognises a company as a separate taxpayer, which is entitled, in its own right, to the appropriate relief afforded by the Income Tax Act. Consequently, any alleged abuse does not arise from the provisions of the Income Tax Act, but rather by virtue of an abuse of the Companies Act, specifically section 19(1) thereof. The tax consequences associated with legal personality follow by operation of law, because of the fiction of legal personality created by the Companies Act and are no different from the tax treatment that other companies are entitled to.<sup>1029</sup>

The question therefore arises whether an abuse of the provisions of the Income Tax Act takes place if its provisions are applied for the purposes that they

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<sup>1026</sup> See the text to ch 5 part 3 1 above.

<sup>1027</sup> The “commercial substance” test in s 80C(2) considered in the text to part 3 3 3 2 of this chapter above.

<sup>1028</sup> See the text to part 3 4 below.

<sup>1029</sup> As an example, s 5(1)(d) of the Income Tax Act (the so-called “charging provision”) determines that “there shall be paid annually for the benefit of the National Revenue Fund, an income tax ... in respect of the taxable income received by or accrued to or in favour of ... any company during every financial year of such company”. [own emphasis] The definition of a “company” in s 1 in turn includes in paragraph (a) any company incorporated in term of the Companies Act. The charging provision therefore derives content from the Companies Act. The primary provision therefore potentially the subject of misuse or abuse to achieve a tax benefit must therefore be the relevant provisions of the Companies Act. The operation of the Income Tax Act naturally follows on the interpretation provided in terms of the Companies Act as a consequence of law.

were designed for. It is difficult to foresee a situation where the tax consequences, which will arise for a company in terms of the Income Tax Act, can be said to amount to a misuse or abuse of a relevant provision of that Act.<sup>1030</sup> Its provisions are applied, or “used”, as intended because of the legal effect that the Companies Act brings about.

Nonetheless, the words “indirect” misuse or abuse may suggest that a wider interpretation should be followed for this test. Thus interpreted, the test goes further than the other three indicators for abnormality which are applied on a “per arrangement” basis. As mentioned earlier, the abuse of the corporate veil is achieved by way of a two-stepped process, namely the transfer of assets to a company, and thereafter through generating income in that company through the use of the assets. The second step creates the tax saving. However, as argued above, the GAARs are not very effective against these two steps. On the other hand, if the “misuse or abuse” test is interpreted widely the second step may also be taken into account in evaluating the tax consequences under the GAARs of the first step. Such an approach would be unique to the misuse or abuse test when compared to the other three abnormality indicators. The reason why section 20(9) of the Companies Act is effective, is because it is not applied on a “per arrangement” basis, but on a “per corporate structure” basis. It therefore evaluates the effect that a corporate structure has on income tax. Arguably, a “per corporate structure-based” approach as opposed to a “per arrangement-based” one is what is required to address the tax use of the corporate veil. The misuse or abuse test appears to allow for such an approach.

The argument nevertheless remains that the GAARs only provide a remedy to alter those tax consequences that arise from an “impermissible avoidance arrangement”. The GAARs do not allow the Commissioner to determine the tax consequences of subsequent transactions not part of the “impermissible avoidance arrangement”. It is these transactions that give rise to the actual tax benefit but the shareholder is not a party to them and the company does not enter into these transactions for tax purposes.

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<sup>1030</sup> De Koker & Williams *Silke on South African Income Tax* ch 19.39.

To conclude, the indicator for abnormality contained in section 80A(c)(ii) has failed to provide clear protection against instances of abuse of the corporate veil for tax purposes.

### 3 3 4 2 Comparing “abuse” in section 80A(c)(ii) with section 20(9) of the Companies Act

The words “misuse or abuse” are used in section 80A(c)(ii). If this section is applied to pierce the corporate veil, these words may be contrasted to the “unconscionable abuse” test, used in section 20(9) of the Companies Act.<sup>1031</sup>

Can the “unconscionable **abuse**” test in section 20(9) of the Companies Act be used to inform the “**misuse or abuse**” test in section 80A(c)(ii), or *vice versa*? It could even be argued that where section 80A(c)(ii) is applied to achieve piercing, its meaning may be informed by section 20(9).

Courts have often used the phrase “misuse or abuse”, contained in section 80A(c)(ii), to describe shareholders’ approach to companies’ separate corporate personality.<sup>1032</sup> “Abuse” has similarly been used in the corporate, statutory law piercing provisions.<sup>1033</sup>

Clearly though, the two phrases used in the Income Tax Act and the Companies Act have distinctly different historical origins.<sup>1034</sup> The phrase

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<sup>1031</sup> Kujinga (2012) *CILSA* 54 cites *Canada TrustCo (SCC)* as potential authority for the view that the use of “misuse or abuse” in the Canadian GAARs is tautologous and that “abuse” is a broad enough term to include instances of “misuse”. The South African position may likely be similar, which creates a greater prospect for “abuse” in the GAARs’ and s 20(9) contexts to be used to inform one another’s content.

<sup>1032</sup> *Cape Pacific*, *Hülse-Reutter* and *Lategan* being but some of the South African examples.

<sup>1033</sup> S 20(9) of the Companies Act and s 65 of the Close Corporations Act. See also text to n 634 above.

<sup>1034</sup> The phrase as used in the Income Tax Act has been borrowed from the Canadian and certain European jurisdictions’ GAARs (see the *Explanatory Memorandum on the Revenue Laws Amendment Bill of 2006* 63), whilst the word “abuse” as used in the Companies Act clearly has its origins in the Close Corporations Act (see the text to ch 4 part 1 1 2 2 above).

contained in section 80A of the Income Tax Act is moreover used in a very different context compared to section 20(9) of the Companies Act or section 65 of the Close Corporations Act.<sup>1035</sup> Although these provisions are all used as anti-avoidance mechanisms to prevent circumvention of the respective provisions, the potential instances of abuse, which the relevant provisions aim to address, are vastly different. The different contexts in which the phrases appear, make it practically impossible to ascribe any meaning to “misuse or abuse” that could apply in both the corporate law context as well as the anti-avoidance context of the law of taxation.

It is conceivable that the instances of abuse may overlap to a certain extent in certain scenarios. For example, where the corporate veil is abused in a company law context, the provisions of the Income Tax Act may also be “misused or abused”. The examples considered in this dissertation illustrate situations where the legal form is abused to achieve a tax benefit, which may potentially also qualify as a misuse or abuse of the provisions of the Income Tax Act. However, the principle remains that the test in section 20(9) of the Companies Act is meant to counter abuse of the corporate veil, whereas section 80A(c)(ii) of the Income Tax Act addresses abuse of the provisions of this Act. As such, the requirements and approaches to the two statutory tests are different. Moreover, it would be inappropriate to attribute a meaning to the phrase in the Income Tax Act similar to that in the Companies Act only when section 80A is applied in a piercing context. Such an approach would imply that the meaning ascribed to section 80A(c)(ii) would be different depending on whether it is applied in a piercing or a non-piercing context. Furthermore the word “abuse” as used in the Income Tax Act is without the adverb “unconscionable” or “gross” as is the case in the Companies Act and Close Corporations Act respectively.

It would accordingly be inappropriate to attempt to attribute any meaning to the phrase “misuse or abuse” as used in the Income Tax Act that is informed by an interpretation linked to either section 20(9) of the Companies Act or section 65 of the Close Corporations Act.

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<sup>1035</sup> See text to n 635 above.

### 3.4 Applying section 80B to address the abuse of the corporate veil for tax purposes

Section 80B contains an exhaustive list of remedies available to the Commissioner when an “impermissible avoidance arrangement” is present:

“The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by—

- (a) disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement;
- (b) disregarding any accommodating or tax-indifferent party or treating any accommodating or tax-indifferent party and any other party as one and the same person;
- (c) deeming persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;
- (d) reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
- (e) re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
- (f) treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.” [own emphasis]

It is apparent that sections 80B(a) to (f) provide remedies to the Commissioner to apply in instances of abuse of the corporate veil.<sup>1036</sup> Primary among these remedies would be section 80B(c). However, the provision may only be applied to determine the tax consequences of the “impermissible avoidance arrangement” itself. In other words, an “impermissible avoidance arrangement” must already exist before the remedy applies.

It is important to distinguish between a “tax benefit”, a requirement of an “impermissible avoidance arrangement”, and the “tax consequences” thereof, which section 80B aims to address. A “tax benefit” must exist for the

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<sup>1036</sup> Provided that an impermissible avoidance arrangement can be shown to be present first and without having recourse to s 80B. De Koker & Williams *Silke on South African Income Tax* ch 19.41.

Commissioner to be able to access the remedies in section 80B. The Commissioner's remedy is to determine the "tax consequences" of the impermissible avoidance arrangement in a variety of ways listed in subsections (a) to (f). Arguably, "tax consequences" can only be addressed to the extent that they have materialised. If tax consequences are yet to materialise, there would be nothing for the Commissioner to determine through the application of section 80B. Where a "tax benefit" might be present (which includes a future tax benefit),<sup>1037</sup> but no tax consequences have arisen yet, section 80B cannot apply. In other words, it is possible that a "tax benefit", and therefore an "impermissible avoidance arrangement", may exist, but that the "tax consequences" linked thereto have not yet arisen.<sup>1038</sup> In such a situation, section 80B cannot be applied yet.

It is useful to refer here to an argument advanced above, namely that an arrangement, which is not a unitary scheme, consists of two steps, namely the incorporation of the company and the subsequent flow of income. It was further argued that an arrangement which is not a unitary scheme, is limited to the first step. The second step does not form part of the arrangement.<sup>1039</sup>

Section 80B can therefore only be applied to the first step of an arrangement that is not a unitary scheme. However, there are no tax consequences that can be determined differently in terms of section 80B, because no direct tax consequences arise from step one. This remains true, even though a "tax benefit" as defined may exist, and even if the transfer of the asset to the company is abnormal.<sup>1040</sup> Section 80A therefore brings those transactions within the purview of an "impermissible avoidance arrangement", yet section 80B cannot be applied

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<sup>1037</sup> See the definition of "tax benefit" in s 1 of the Income Tax Act, which definition is wide enough to also include future tax benefits to be achieved. Also see the three judgments in *Hicklin*; *Smith* and *King*.

<sup>1038</sup> *Contra SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule 4* which states that s 80B may be applied to address any "tax benefit". This assertion is not borne out by the wording of s 80B.

<sup>1039</sup> See the text to part 3 1 of this chapter above.

<sup>1040</sup> See *Hicklin* which illustrates the point that it would be important to identify the specific transaction which gives rise to the relevant tax benefit in order to determine to which the transaction the remedies in the GAARs may be applied.

given the absence of any “tax consequences” arising at that stage. Where the corporate veil is abused, the beneficial tax consequences for the shareholder will only arise from the subsequent commercial transactions that the company enters into (step two). The question is therefore whether the tax consequences of the subsequent transactions (step two) can also be regarded as consequences of the “impermissible avoidance arrangement” (which comprises only of step 1) and therefore be susceptible to section 80B’s remedies. The answer to this question seems to be “no”, since none of the parties to the subsequent transactions receives a tax benefit or has any tax related purpose in mind for entering into these transactions. Applying section 80B will likely also negatively affect the tax consequences for the company, which has not achieved any tax benefit for itself. Furthermore, these subsequent transactions will be considered normal. The remedies provided by section 80B only contemplate transactions which by themselves give rise tax consequences that arise immediately. It does not apply to “tax benefits” which will only arise as a result of future transactions which themselves will not amount to “impermissible avoidance arrangements” and to which different persons will be party to.

Arguably there is a *lacuna* in section 80B when it comes to addressing tax benefits which will only arise through future transactions, entered into as a result of earlier “impermissible avoidance arrangements”.<sup>1041</sup>

The GAARs’ remedies in section 80B are intended only to prevent the avoidance of “the tax consequences under [the Income Tax] Act of any impermissible avoidance arrangement for any party”. Section 80B is not meant to serve as a taxing<sup>1042</sup> or a penal<sup>1043</sup> provision where an “impermissible

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<sup>1041</sup> On the assumption that the “avoidance arrangement” can be said to be abnormal, which may prove to be difficult to argue. See tax to parts 3 3 1 to 3 3 4 of this chapter above.

<sup>1042</sup> *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 4 SA 715 (A) 727 *et seq.*

<sup>1043</sup> See the discussion in *ITC 963* [1961] 24 SATC 707 (T) of Watermeyer CJ and Schreiner JA’s judgments in *King*. It confirms that the GAARs are not intended to be applied as penal provisions. Rather, the GAARs are intended to apply as remedial

avoidance arrangement” has been entered into. The GAARs call upon the Commissioner to identify the specific tax benefit that was the result and purpose of the arrangement entered into. The creation of any other tax benefits as a consequence of an arrangement being entered into, and for which ancillary tax benefits were not the sole or main purpose of entering into that arrangement, become irrelevant.<sup>1044</sup> It becomes difficult to apply section 80B where the tax benefit of step one is the tax consequence of step two.

A tax benefit will be created for the shareholder from subsequent transactions entered into by the company, whether as part of “targeted” or as “general avoidance”. However, these are entered into by the company to further the legitimate commercial purposes of the company, whether it is to receive dividends from an investing company or to conduct business generally at beneficial tax rates. It is submitted that section 80B cannot be applied to these subsequent transactions, nor to the company entering into them, since these arrangements

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provisions (see for example s 80B(2)). In other words, the GAARs should not be applied to widen the net beyond the general scope of the Income Tax Act (*ITC 1636* [1997] 60 SATC 267), nor be applied without reference to the scheme of that Act. Applied to the current instance, the GAARs may only be applied to address the tax benefit purposefully sought to be achieved. Anything more would amount to the GAARs being applied either as penal or taxing provisions outside of the general scope or scheme of the Income Tax Act.

<sup>1044</sup> *Secretary for Inland Revenue v Gallagher* [1978] 40 SATC 39; De Koker & Williams *Silke on South African Income Tax* chs 19.35 and 19.39. Consider Example 4 (in the text to ch 1 part 3 above): where the trust transfers the asset in question to the company by virtue of the corporate roll-over relief contained in s 42 of the Income Tax Act, two tax benefits arise: one being the roll-over relief provided for capital gains tax purposes on the transfer of the asset itself, and secondly the future tax benefit to be achieved in the form of lower tax rates to apply when the asset is subsequently disposed of by the company. Even though both tax benefits will have been achieved by the same arrangement, the former cannot be denied by the Commissioner in terms of s 80B, as s 80B will then be applied as a penal provision. The tax benefit afforded in terms of s 42 is not the purpose of the transfer, but rather the tax benefit that will only arise subsequently through lower tax rates achieved, and s 80B should only be applied as remedy against that tax benefit (provided the other elements of an “impermissible avoidance arrangement” can also be said to be present).

will be normal and will not create (nor intend to create) a tax benefit for the company.

The apparent disconnect between sections 80B and 80A appears to be detrimental to the effective application of section 80B to avoidance arrangements perpetrated by way of employing the corporate veil. For these reasons, none of the remedies in section 80B will address the tax benefit created.

The identified deficiency is seemingly absent in Canada. The Canadian Income Tax Act provides for the GAARs' remedies to apply more flexibly to "deny a tax benefit that would ... result, directly or indirectly, from an avoidance transaction" [own emphasis].<sup>1045</sup> Based on the wording of the remedial provisions, the Canadian GAARs may potentially be applied even when a unitary scheme is absent and where a tax benefit is created "indirectly" through an "avoidance transaction".<sup>1046</sup>

To conclude, section 80B provides for the attribution of different tax consequences to the specific impermissible avoidance arrangement identified. The tax consequences of subsequent transactions<sup>1047</sup> that no longer form part of the impermissible avoidance arrangement cannot be altered. It is submitted that the tax consequences of any transaction are primarily that of the transaction itself. This is as much true for transactions forming part of an "impermissible avoidance arrangement" as it is for transactions entered into, subsequent to an

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<sup>1045</sup> S 245(5) of the Canadian Income Tax Act.

<sup>1046</sup> The positions in the UK and Australia are less clear. In the UK, an indirect approach appears similarly to be justified. The UK Finance Act explicitly provides that arrangements forming part of the specifically identified "tax arrangements" should also be subjected to scrutiny (S 207(3) of the Finance Act, 2013 (c 29)). The Australian Income Tax Assessment Act 27 of 1936 provides that the Commissioner may apply the remedies contained in s 177F where the GAARs apply "to a scheme in connection with which a tax benefit has been obtained". Cassidy identifies shortcomings in that jurisdiction in defining how wide an arrangement may be considered to be and which steps may be said to be included in that arrangement or scheme. Cassidy (2009) *SALJ* 746 *et seq.* Once the arrangement or scheme has been identified, it is necessary to consider whether the tax benefit has been achieved from that arrangement (Cassidy 756 *et seq.*). This makes the Australian GAARs susceptible to the same deficiency that the South African GAARs exhibit in this regard.

<sup>1047</sup> Not forming part of a unitary scheme (see the text to part 3 1 of this chapter above).

“impermissible avoidance arrangement”. The tax consequences of an arrangement cannot primarily be the consequence of an earlier transaction. It must be that of the transaction itself. To illustrate, in Example 1, the consequences of the company receiving a dividend arise because the underlying investments generated a dividend. However, there is also a link, albeit indirect, to the earlier transfer of the share investments to the company (even if the dividend declaration was not expected at that stage). The fact that in Example 1 no dividends tax arises is causally linked to the interposition of the company. However, the actual tax saving consequence arose only once the dividend itself was declared. At the point when section 80B is applied to the transfer of the shares to the company, the dividend has not yet been declared. The tax consequence to be remedied by section 80B, namely the absence of dividends tax, has not occurred yet.

When considered in isolation, the dividend declaration cannot be seen as an impermissible avoidance arrangement, since the declaration will not be abnormal, carries no tax benefit more than would have been the case otherwise for the parties involved and is in no way driven by tax motives on the part of the company or its underlying investments. It can moreover not be said to form part of a “unitary scheme” as it is not aimed at achieving the tax benefit that the interposition of the company itself was aimed at achieving.<sup>1048</sup>

Even where a unitary scheme may be said to exist, and that scheme has been entered into abnormally, section 80B can only be applied if the Commissioner delays taking action until after the actual tax consequence has occurred, for example at the declaration of the dividend in Example 1. Whether prescription will allow for section 80B to still be applied at that stage is a further question that will need to be determined on a case-by-case basis.<sup>1049</sup>

It remains to be seen how South African courts will approach the question of section 80B’s application. It is quite possible that an empowering and wide

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<sup>1048</sup> See text to part 3 1 of this chapter above.

<sup>1049</sup> S 99(1) of the Tax Administration Act. This issue falls outside the scope of this dissertation and will not be examined in detail.

constructive approach will be applied when considering the application of these rules;<sup>1050</sup> one which requires the provision to be construed as operative rather than restrictive. This may result in an interpretation of section 80B that allows it to apply to any “impermissible avoidance arrangement”, even if its tax consequences only arise subsequently through unrelated transactions. It is submitted that such an interpretation would be too wide and too far removed from the wording of section 80B itself. It is suggested that neither the wording nor the purpose of section 80B stretches far enough to allow the Commissioner to apply the GAARs to alter the tax consequences of transactions which do not form part of an impermissible avoidance arrangement. The potential application of section 80B, even in those limited circumstances identified above where the use of the company can potentially amount to an “impermissible avoidance arrangement”, is therefore questionable at best.

#### **4 The general anti-avoidance rules and burden of proof**

Which party bears the onus of proof in relation to three<sup>1051</sup> of the four elements contained in section 80A, is not settled.

Section 102 of the Tax Administration Act makes it clear that a taxpayer bears the burden of proof in virtually all disputes with the Commissioner. It is somewhat contentious whether section 102 applies to the GAARs. Its predecessor in section 82 of the Income Tax Act was considered not to have applied to section 103 of that Act.<sup>1052</sup> The latter was regarded as a specific provision containing its own particular provisions relating to onus,<sup>1053</sup> as opposed to section 82, a general provision.

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<sup>1050</sup> *Cf Glen Anil Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 4 SA 715 (A) 716; *CIR v Nemojim* [1983] 2 All SA 485 (A) 505.

<sup>1051</sup> The “arrangement”, “normality” and “tax benefit” requirements.

<sup>1052</sup> *ITC 1636* [1997] 60 SATC 267 318 to 324, and 323 in particular.

<sup>1053</sup> See discussion of ss 103(4) and 80G(1) in the text to part 4 1 of this chapter below.

Whether the previous position in relation to the onus is still relevant to the new regime introduced by section 102 of the Tax Administration Act read with sections 80A to 80L of the Income Tax Act, is considered below.

#### 4 1 “Purpose” requirement

Similar to section 103(4),<sup>1054</sup> section 80G(1) of the Income Tax Act places the onus relating to the purpose of an arrangement on the taxpayer:

“An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.”

Section 80G(1) creates a rebuttable presumption that a taxpayer has entered into an avoidance arrangement with a tax purpose. The burden of proof is therefore on the taxpayer to show differently. It is therefore uncontentionous that the taxpayer bears the burden of proof relating to the sole or main purpose of entering into an arrangement.<sup>1055</sup>

#### 4 2 Abnormality requirement

The existence of specific presumptions in section 103 clearly weighed heavily with the court in *ITC 1636*, which is considered the leading judgment as far as the onus of proof in relation to section 103 is concerned. From this judgment it is clear that the presumption in section 103(4), dealing with the taxpayer’s purpose for entering into a transaction, was to be given a constructive and empowering meaning.<sup>1056</sup> The court was of the view that the onus was usually on the

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<sup>1054</sup> De Koker & Brincker *Silke on International Tax* 46.9.

<sup>1055</sup> De Koker & Brincker *Silke on International Tax* 46.9; SARS *Draft Comprehensive Guide to the General Anti-Avoidance Rule* 29; Broomberg II (2007) *Tax Planning*.

<sup>1056</sup> The same applied to the now repealed s 103(3), which introduced a rebuttable deeming provision as related to the arm’s length nature of specific transactions, and thus

Commissioner in section 103, but that the presumption created an exception to this. If such an interpretation was not adopted, section 103(4)'s content would have been superfluous, considering the onus created generally against taxpayers in terms of the former section 82. To afford section 103(4) a constructive interpretation would therefore imply that the onus of proof would otherwise have been on the Commissioner to show the presence of the "purpose" requirement. Therefore, so the reasoning went, there is no reason why the remaining three requirements of the GAARs should be approached differently. In other words, the onus of proof will be on the Commissioner in the absence of a deeming provision such as that contained in section 103(4) and which relates to the purpose requirement only.<sup>1057+1058</sup>

Whether the onus rests on the Commissioner in respect of the abnormality (as well as the two further remaining requirements of the GAARs), hinges to a

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had a potential bearing on one of the two indicators in the previous GAAR as related to the requirement of "abnormality". Unlike the "purpose" presumption still present in the current version of the GAARs (s 80G(1)), no equivalent provision to s 103(3) is contained in the current GAARs. The absence of a provision similar to the repealed s 103(3) in the current GAARs is considered insignificant though in creating statutory interpretative context, since the judgment in *ITC 1636* suggests that the presence of any one presumption would have sufficed as indication that the presumption is intended to create an exception to where the onus of proof would ordinarily have laid in its absence.

<sup>1057</sup> SARS *Tax Avoidance and Section 103 of the Income Tax Act, 1962: An Interim Response* (2006) 15.

<sup>1058</sup> In relation to where the onus of proof would lie to show abnormality, both *ITC 1862* [2012] 75 SATC 34 and *ITC 1699* [1999] 63 SATC 175 considered the onus to rest upon the Commissioner, both with reference to the judgment in *Conhage*. It is considered that that judgment endorsed the conclusions of its *a quo* judgment in *ITC 1636* (see also *ITC 1862* [2012] 75 SATC 34 para 9). *ITC 1712* also concludes that the onus to show abnormality rests on the Commissioner (at 501 *et seq*), though without giving reasons why this was considered to be the case. Considering that this judgment was subsequent to that of the reasoned judgment in *ITC 1636*, it can probably be safely assumed that the conclusion in *ITC 1712* was based on the reasoning applied in *ITC 1636* which at that point in time represented good persuasive authority. In relation to the elements of "tax benefit" and an "arrangement" being present, *ITC 1636* likewise endorses the position that the onus falls on the Commissioner to prove the presence of these two elements too.

significant extent on the rebuttable presumption created by section 103(4) (and section 103(3) to a limited extent).<sup>1059</sup> The question relating to the current GAARs is thus whether the same approach is still appropriate. The matter therefore becomes worth revisiting given the absence of a comparable provision to the erstwhile section 103(3).

Unlike section 103(4), section 80G(1) is capable of being interpreted in a constructive fashion and without affecting how the burden of proof in relation to the remaining three elements of the GAARs should be dealt with.

Section 103(4) contained a presumption which only applied once the relevant assessment was disputed. Section 103(4) therefore only became relevant once the Tax Court heard the matter, in other words when such a matter was litigated. Before the dispute was heard in the Tax Court, the presumption in section 103(4) would have had no effect.

In terms of the new GAARs, this is no longer the case. Section 80J of the Income Tax Act, which did not have an equivalent provision in section 103, requires the Commissioner to invite the taxpayer to make representations as to why the provisions of section 80A should not apply. This invitation may only be extended after the Commissioner has been satisfied that all four requisite elements of an “impermissible avoidance arrangement” are present.<sup>1060</sup> Nothing stops the Commissioner from relying on the presumption created against the taxpayer at that stage. In other words, the Commissioner may invite the taxpayer to make representations regarding the applicability of section 80A, even when only three of the four requirements are present. The purpose of the presumption can therefore no longer be seen as establishing the onus of proof in the Tax Court, but rather as lowering the barrier for the Commissioner for invoking the provisions of the GAARs. If this is the case, and if section 80G(1) already

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<sup>1059</sup> The court in *ITC 1636* [1997] 60 SATC 267 323 goes as far as mentioning several considerations which would, barring the presence of s 103(3) and (4), have led it to conclude that the onus to prove the absence of any of the four requirements of the GAARs to be on the taxpayer. Had s 103(3) and 103(4) not provided context to s 103, Kroon J appears willing to accept that the onus would have been on the taxpayer in terms of s 82 to illustrate the absence of any of the four requirements present in s 103(1).

<sup>1060</sup> S 80J(1) of the Income Tax Act.

becomes operative prior to dispute proceedings, the provision is arguably no longer intended to inform dispute proceedings. Therefore, in the absence of a deeming onus provision, there remains little reason why disputes involving the GAARs should be treated any differently from other disputes and inconsistent with section 102 of the Tax Administration Act. As a result, it would appear that the onus for proving the absence of any of the four requirements the Commissioner alleges to be present in the section 80J notice issued, will now rest on the taxpayer.

Considered in light of the above, it is quite possible that the other considerations the court identified in *ITC 1636*<sup>1061</sup> may now compel a court to conclude that the question of onus should be approached differently in sections 80A to 80L than it was in section 103.<sup>1062</sup> Such conclusion enjoys support considering that section 103(4) clearly related to dispute proceedings, whereas section 80G(1)'s operation is no longer limited to dispute proceedings only.<sup>1063</sup>

#### 4 3 Arrangement and tax benefit requirements

The onus to prove the existence of an “arrangement” and a “tax benefit” was on the Commissioner in terms of section 103(1).<sup>1064</sup> For the same reasons above, in relation to the “abnormality” requirement, this position too appears to have changed.<sup>1065</sup>

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<sup>1061</sup> See n 1059 above.

<sup>1062</sup> See the contradictory views in *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 24 and 44 compared to 48. Broomberg II (2007) *Tax Planning* gives further potential motivation for a shift in the onus as relates to the various elements of the GAARs. Cf *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 48 for two views contradicting one another as to where the onus lies. See also the text to part 4 3 of this chapter below.

<sup>1063</sup> Broomberg II (2007) *Tax Planning* notes that the phrase in s 103(4) “whenever in proceedings relating thereto it is proved” is notably absent from s 80G(1). See also *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 48.

<sup>1064</sup> See *ITC 1636* and the authority mentioned there.

<sup>1065</sup> See the contradictory views in *SARS Draft Comprehensive Guide to the General Anti-Avoidance Rule* 18 compared to 48.

#### 4.4 Conclusion

Statute prescribes onus in relation to the GAARs. It is not a common law principle. Given the significant differences between the erstwhile section 103(1) and (4) and the current sections 80A to 80L, it is questionable whether the precedent on this specific question, specifically as established in *ITC 1636*, remain relevant.

It follows that the Commissioner may now no longer bear the onus to show that any of the four elements in section 80A is satisfied when investigating an arrangement. Rather, it appears that the taxpayer may now very well be required to show that any one of the four elements necessary for the GAARs to apply is lacking. Such an approach would be in line with the manner in which all other assessments are approached by virtue of the application of section 102 of the Tax Administration Act, and no reason remains why the new GAARs should be approached any differently.<sup>1066</sup>

### 5 Conclusion

The GAARs' biggest weakness in addressing the use of the corporate veil to create a tax benefit, lies in the abnormality requirement.<sup>1067</sup> An analysis of the GAARs' requirements show at best limited possibilities for SARS to address this form of abuse through the GAARs. The efficacy of sections 80A to 80L varies depending on whether "targeted" or "general avoidance" is sought to be achieved and depending on which indicator of "normality" is relevant.

The same is arguably true of the Canadian GAARs which also exhibits shortcomings in the fight against the abuse of the corporate veil for tax purposes.<sup>1068</sup>

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<sup>1066</sup> *ITC 1636* [1997] 60 SATC 267 323.

<sup>1067</sup> SARS *Tax Avoidance and Section 103 of the Income Tax Act, 1962: An Interim Response* 15; see also the references in *SARS Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)* 39 *et seq* to extracts from the reports of the Margo and Katz Commissions.

<sup>1068</sup> IFA *Cahiers de droit fiscal international* (2010 Rome Congress) Volume 95a. *Tax treaties and tax avoidance: Application of anti-avoidance provisions* 171.

The GAARs in their current form are generally further unable to apply at the moment that the corporate veil is used for tax purposes. That moment is not when income accrues to the company, but rather when the assets and resources necessary to generate that income is transferred to the company.<sup>1069</sup> The GAARs will apply only to the earlier transaction. The tax purpose required for the GAARs to apply will only exist for the shareholder, and the transfer of the assets will be the only transaction to which the shareholder will be a party. Moreover, when the company subsequently uses the assets, it will be utilised to generate income on which a tax benefit is achieved for the shareholder. Yet another party, the company, will enter into the income producing transactions for commercial reasons on a normal basis and not for tax purposes.

When the arrangement, whereby assets are transferred to a company, is considered in terms of the four potential indicators for abnormality, varied results are achieved. The two new indicators,<sup>1070</sup> not previously present in the now repealed section 103(1) of the Income Tax Act, show a potential increase in effectiveness when addressing the use of corporate personality for tax purposes, compared to the “arm’s length rights and obligations”<sup>1071</sup> and “normal means or manner”<sup>1072</sup> tests. It would also appear that the onus is now on the taxpayer to show that an arrangement should not be considered “abnormal” in terms of any of the four indicators, which differs from the position under the repealed section 103(1).

However, even the “commercial substance”<sup>1073</sup> and “misuse or abuse”<sup>1074</sup> tests prove to have their limitations in addressing the use of the corporate veil for tax purposes, for the reasons discussed above and linked to the inherent two-stepped nature of using the corporate veil for tax reasons.<sup>1075</sup>

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<sup>1069</sup> See the text to part 3 1 of this chapter above.

<sup>1070</sup> See the text to parts 3 3 3 and 3 3 4 of this chapter above.

<sup>1071</sup> See the text to part 3 3 1 of this chapter above.

<sup>1072</sup> See the text to part 3 3 2 of this chapter above.

<sup>1073</sup> See the text to part 3 3 3 of this chapter above.

<sup>1074</sup> See the text to part 3 3 4 of this chapter above.

<sup>1075</sup> See the text to part 3 4 of this chapter above.

Even if the onus of proof regarding the application of the GAARs has shifted to the taxpayer, the effectiveness of the GAARs are overall limited in addressing the use of corporate personality for tax purposes.

## CHAPTER 6: CONCLUSION

### 1 Introduction

The legal fiction of separate legal personality is a fundamental part of the modern commercial legal framework. Although legal personality is not limited to companies, the company form has been the focus of this dissertation.

The limited liability of the company was developed to satisfy a particular commercial need.<sup>1076</sup> Limited liability serves as an obvious incentive to economic growth, promoting economic activity whereby individuals can, through a company, undertake economic ventures with the assurance that potential losses that may result are limited. This is the purpose that separate legal personality serves in an economic context.<sup>1077</sup>

Nowadays legal personality usually flows from statute,<sup>1078</sup> even though legal personality has strong common law roots.<sup>1079</sup> As a separate legal person the company is able to own assets and to earn its own income by using those assets.<sup>1080</sup> Due to its separate legal personality the law of taxation also treats a company as a taxpayer in its own right, capable of being subject to tax on the income generated by the deployment of its assets.<sup>1081</sup>

For income tax purposes in particular it may be of benefit for individuals to involve companies or layered company structures in transactions due to the beneficial regimes that the Income Tax Act affords companies. Involving a company in commercial activities may be beneficial for a non-corporate entity from an income tax perspective, even though commercially very little else is

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<sup>1076</sup> See the text to ch 2 part 2 3 above.

<sup>1077</sup> See the text to ch 2 part 2 2 above.

<sup>1078</sup> In South Africa through s 19(1) and (2) of the Companies Act.

<sup>1079</sup> See the text to ch 2 part 2 1 above.

<sup>1080</sup> See the text to ch 2 part 2 3 above.

<sup>1081</sup> *ITC 1618* [1996] 59 SATC 290 and *ITC 1670* [1998] 62 SATC 34.

achieved.<sup>1082</sup> As already said, I consider the use of the company solely for tax purposes to amount to an abuse of the doctrine of separate legal personality.<sup>1083</sup>

The four examples listed in chapter 1 part 3 above present instances where the company form may be used only to serve the tax saving purposes of the individuals who are shareholders of the companies discussed there.

Example 1 illustrates how an individual can avoid the imposition of dividends tax by transferring his share investment portfolio to a company wholly owned by him.

Similarly in Example 2 a businessperson transfers a business owned in his own name to a company. The economic unit comprised of the individual and the company may now benefit from so-called tax arbitrage due to the more beneficial corporate tax rates applying to the business now operated in the company, compared to what would have been the case had the business remained in the individual's hands.

Example 3 involves an instance of treaty shopping, achieved through the incorporation of an intricate web of companies situated in different countries. These companies would each in turn receive and pass on profits in order to benefit from reduced withholding tax rates under a double tax treaty, repatriating profits to their ultimate shareholder in an as tax effective manner as possible.

Finally, Example 4 involves a trust transferring capital assets to a company in which it owns shares in anticipation of the sale of those assets to third parties. In doing so the trust and company considered holistically will benefit from the more beneficial tax rates applying to the company upon the subsequent disposal of the assets than would have been the case had the trust disposed thereof itself.

This dissertation considered whether the application of the doctrine of piercing of the corporate veil can address such abuse of legal personality, be it in terms of the common law, section 20(9) of the Companies Act or the GAARs in the

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<sup>1082</sup> See the text to ch 5 part 1 and n 244 above.

<sup>1083</sup> See the text to ch 2 part 2 2, ch 3 part 3 3 2 3 and ch 4 part 2 2 above.

Income Tax Act.<sup>1084</sup> In what follows, each of these three potential piercing mechanisms is applied to the four examples.<sup>1085</sup>

## 2 Piercing the corporate veil

As said above, piercing of the corporate veil involves disregarding the legal personality of a company for limited purposes.<sup>1086</sup> Through the application of the piercing doctrine the shareholder and company are considered the same person in law: the company is therefore no longer considered a separate legal entity.<sup>1087</sup> Other legal doctrines may in certain circumstances have the same practical effect as piercing.<sup>1088</sup> However, the unique legal requirements for the piercing doctrine to apply clearly distinguish piercing from other legal constructs and confirm its existence in law as a separate, self-standing doctrine.<sup>1089</sup>

This dissertation considered the possibility of applying the piercing doctrine in any one of three forms as a remedy to address shareholders' abuse of the company form for income tax purposes.<sup>1090</sup> These three forms are: in terms of the common law,<sup>1091</sup> through application of section 20(9) of the Companies Act<sup>1092</sup> or through application of the GAARs in the Income Tax Act.<sup>1093</sup> Should the doctrine in any of these forms find application, piercing would be an effective remedy to address the intentional avoidance of tax since piercing have the effect that income legally accruing to a company will be deemed to have accrued

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<sup>1084</sup> Ss 80A to 80L of the Income Tax Act.

<sup>1085</sup> See the text to parts 2 1 to 2 3 of this chapter below.

<sup>1086</sup> See the text to ch 2 parts 3 1 and 6 1 above.

<sup>1087</sup> See the text to ch 2 parts 3 1 and 6 1 above.

<sup>1088</sup> See the text to ch 2 parts 4 2 1 to 4 2 8 above.

<sup>1089</sup> See n 136 above.

<sup>1090</sup> As already said, piercing as considered in this dissertation is limited to a consideration of the remedy's potential application as remedy against impermissible tax avoidance (ch 2 part 5 2 above) *vis-à-vis* taxpayers avoiding payment of pre-existing tax obligations (ch 2 part 5 1 above).

<sup>1091</sup> Ch 2.

<sup>1092</sup> Ch 3.

<sup>1093</sup> Ch 4.

directly to the shareholder.<sup>1094</sup> The potential unique tax advantages that the company form may have otherwise secured under these circumstances would then be unavailable to the shareholder.<sup>1095</sup>

## 2 1 Common law piercing doctrine and abuse of the corporate veil for tax purposes

The content of the common law piercing doctrine in South Africa is best set out in *Cape Pacific*.<sup>1096</sup> It involves using the separate identity of the company to perpetrate fraud, dishonesty or other improper conduct; policy considerations are then relevant to determine whether such use is serious enough to warrant a disregarding of the corporate veil.

The potential application of the doctrine for tax purposes involves two questions of fact and two questions of law. The questions of fact are whether the alleged abuser was in a position to exercise control over its share of the corporate veil,<sup>1097</sup> and further whether it did so for tax related reasons.<sup>1098</sup> The questions of law are whether the use of the corporate veil for tax purposes amounts to improper conduct,<sup>1099</sup> and then whether policy considerations deem such improper conduct serious enough to warrant withdrawing the protection afforded by the corporate veil to shareholders.<sup>1100</sup>

Improper conduct would be present where a person attempts intentionally to evade<sup>1101</sup> a legal obligation from arising for him or her. Although applied in *Cape Pacific* in the context of the evasion of contractual obligations, there is no reason

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<sup>1094</sup> See the text to ch 2 part 6 1 above.

<sup>1095</sup> See the text to ch 2 part 5 2 above.

<sup>1096</sup> See the text to ch 3 part 3 3 2 above.

<sup>1097</sup> In other words, whether the person was able to exert shareholder control.

<sup>1098</sup> Be it in the capacity as *de facto* shareholder or in-substance shareholder (see the text to ch 3 parts 3 3 2 3 and 5 2 above).

<sup>1099</sup> See the text to ch 3 part 5 1 1 above.

<sup>1100</sup> See the text to ch 3 part 5 1 2 above.

<sup>1101</sup> See the text to ch 3 parts 3 3 2 3 and 4 1 above which confirms that a subjective approach is required.

why the piercing doctrine should not also apply to the evasion of obligations imposed by statute.<sup>1102</sup> The evasion of an otherwise legal tax obligation from arising amounts to impermissible tax avoidance.<sup>1103</sup> When persons with shareholder control over a company use it mainly for tax purposes, it would by implication amount to improper conduct.

In my view a definitive societal shift has taken place in the area of tax avoidance, which is in line with Benade's "*doelmatigheidsreël*". Public policy is especially relevant in the current South African context where Government which levies tax is regarded as the mechanism through which a more equitable distribution of wealth and economic opportunities should be effected.<sup>1104</sup> Public policy considerations should therefore play a significant role in developing the common law. Even if the intentional avoidance of tax on its own was previously not considered serious enough to warrant piercing,<sup>1105</sup> strong arguments exist for the piercing doctrine to be so applied now.<sup>1106</sup> The effect of piercing of the corporate veil is limited<sup>1107</sup> and the other rights and obligations of the company remain unaffected. Consequently, many of the objections usually raised against the piercing of the corporate veil fall away when it is used to fight impermissible tax avoidance.<sup>1108</sup>

South African courts are yet to consider the two questions of law referred to above where a shareholder intentionally uses a company to mitigate the shareholder's own ultimate tax cost. As far as the questions of fact are concerned, the burden of proof rests on the taxpayer to show that he or she as shareholder did not use his or her control over the company to create a tax benefit.<sup>1109</sup>

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<sup>1102</sup> See also the generality of the rule laid down by Lord Sumption in *Prest* (see the text to ch 3 part 4 1 above).

<sup>1103</sup> See the text to ch 3 part 5 1 1 above.

<sup>1104</sup> See the text to ch 3 part 5 1 2 above.

<sup>1105</sup> Even though no authority could be found to suggest that this was the case.

<sup>1106</sup> See the text to ch 3 part 5 1 2 above.

<sup>1107</sup> See the text to ch 2 part 6 1 above.

<sup>1108</sup> See the text to ch 3 part 5 1 2 and ch 4 part 4 above.

<sup>1109</sup> See the text to ch 3 part 5 2 3 above.

In each of the four examples<sup>1110</sup> it was assumed that the taxpayer in question mainly used a company for tax purposes. Applying the piercing doctrine on this basis, common law piercing would present an adequate remedy against a shareholder's tax use of the company.

If piercing was applied in Examples 1 and 3 withholding tax consequences would arise for the shareholders as if they had directly held the interests in the underlying investments. In Examples 2 and 4 piercing would have the effect of the individual and the trust respectively being taxed themselves at their relevant tax rates and on the profits realised by the company.

## 2.2 Section 20(9) of the Companies Act and abuse of the corporate veil for tax purposes

Section 20(9) of the Companies Act embodies the common law piercing doctrine in legislated form.<sup>1111</sup> While there may have been doubt previously as to whether the piercing doctrine is still relevant,<sup>1112</sup> section 20(9)'s introduction removed such doubt. Section 20(9) also clarifies that the piercing doctrine is also no longer a remedy of last resort.<sup>1113</sup>

I anticipate that South African courts will now apply the piercing doctrine with less circumspection than in the past, and not only because the doctrine was previously only applied as a remedy of last resort. The principle of separation of powers played an important role in this regard.<sup>1114</sup> Where the judiciary had in the past been willing to pierce the corporate veil in terms of the common law, it only did so in those clear cases where it was satisfied that it was not overstepping in terms of the separation of powers doctrine by disregarding legal personality created by the legislature. In the absence of statutory guidance to the contrary,

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<sup>1110</sup> See the text to ch 1 part 3 and part 1 above.

<sup>1111</sup> See the text to ch 4 part 2 3 5 above.

<sup>1112</sup> See n 136 above.

<sup>1113</sup> Although this perhaps never was the case in South African common law (see the text to ch 3 part 2 above). See also the text to ch 4 part 3 3 above.

<sup>1114</sup> See the text to ch 3 part 1 and ch 4 part 3 2 above.

the courts would only have been entitled to disregard statutorily created legal personality where it was clear that the use of separate legal personality in a particular instance was beyond what the legislature intended it to be used for.<sup>1115</sup> A good example would be where a company is used to commit fraudulent acts.<sup>1116</sup> Section 20(9) now removes this fundamental barrier. The legislature now expressly empowers courts to pierce the corporate veil. They may now do so within the boundaries of the Companies Act and without applying an overly conservative approach through fear of overstepping. The courts are now expressly authorised by the legislature in section 20(9) to pierce the veil where it is being unconscionably abused.

This research has come to the conclusion that where a shareholder subjectively uses the separate legal personality of a company mainly for tax purposes that use would amount to an unconscionable abuse as contemplated in section 20(9).<sup>1117</sup> As is the case with the application of the common law remedy considered in part 6 2 1 above, section 20(9) could find application in Examples 1, 2 and 4. In all three examples the shareholders used the company form primarily for tax reasons. Avoiding a statutorily created legitimate tax obligation and avoiding a contractually established obligation<sup>1118</sup> should be treated in the same manner. Both instances amount to an unconscionable abuse of the corporate veil.

Example 3 which deals with a scenario involving treaty shopping, will in all likelihood involve the interposition of foreign incorporated companies not governed by the provisions of the Companies Act.<sup>1119</sup> Although arguably exempt from the application of section 20(9), it is conceivable that the South African courts will seek to develop the common law piercing doctrine in line with section 20(9)'s provisions. Foreign companies could ultimately become subject to the

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<sup>1115</sup> Not dissimilar to what a purposive approach to the Companies Act may have required.

<sup>1116</sup> See the text to ch 3 part 3 3 2 1 above.

<sup>1117</sup> See the text to ch 4 part 4 above.

<sup>1118</sup> *WT v KT* in ch 4 part 2 3 5 above.

<sup>1119</sup> See the text to ch 4 part 3 4 above.

same standards in terms of the South African common law as South African companies are in terms of section 20(9) of the Companies Act.

### 2.3 The Income Tax Act's general anti-avoidance rules and abuse of the corporate veil for tax purposes

If a company is used for tax purposes, one would in the context of the Income Tax Act expect to find that three of the four requirements for the GAARs would already be present. The only factor that normally would remain to be considered would be whether the use of the corporate veil in such an instance would also amount to "abnormality" in terms of any one of the four indicators in section 80A. In this regard there are strong arguments that the onus of proving the absence of all the indicators for abnormality rests on the taxpayer.<sup>1120</sup>

The "arm's length rights and obligations test" appears to be wholly ineffective to curb the tax use of the corporate veil.<sup>1121</sup> Using the company primarily to achieve an avoidance of tax involves exploiting the company's ability to own assets rather than participating in non-arm's length-based transactions. A company achieves a tax saving benefit for its shareholders merely by virtue of holding and utilising its assets and resources. In transferring the ownership of assets to a company, which assets the company can acquire by entering into transactions on perfectly legitimate arm's length terms, the company attracts the more beneficial tax consequences illustrated in Examples 1 to 4. This is especially the case where a company acquires assets in exchange for the issuance of shares.<sup>1122</sup>

The second "means or manner test" proves to be almost equally ineffective for largely the same reasons as the arm's length test above.<sup>1123</sup> Where a tax benefit would arise by virtue of ownership of assets being placed in a company *vis-à-vis* ownership being retained by its shareholder, the ownership of the assets may be

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<sup>1120</sup> See the text to ch 5 part 4 above.

<sup>1121</sup> S 80A(c)(i) of the Income Tax Act.

<sup>1122</sup> See the text to ch 5 part 3.3.1 above; see also Example 4.

<sup>1123</sup> See the text to ch 5 part 3.3.2 above.

transferred to the company by normal means or in a normal manner, thus not falling foul of the provisions of section 80B(a)(i) or (b).

It may be different in the treaty-shopping scenario illustrated in Example 3. A court would be likely to regard the repatriation of profits to an ultimate shareholder through an intricate web of companies to involve abnormal means or be an abnormal manner in which to structure commercial share ownership. The difficulty with such an argument would again be that the act of repatriating profits itself will not be done abnormally; it would merely flow in accordance with the earlier created legal structure. To show that a tax benefit arises through abnormal means or in an abnormal manner, it is necessary to show that the initial creation of the corporate structure was done by abnormal means or in an abnormal manner.

The commercial substance test in section 80C(1) does not present a clear remedy against the abuse of the corporate veil for tax purposes if not applied in conjunction with section 80F(a).<sup>1124</sup> The same would apply to the specific scenarios identified in section 80C(2).<sup>1125</sup> The operation of section 80C(2) is nevertheless not limited to the specific pre-conceived scenarios identified in sections 80C(2)(a) and (b).<sup>1126</sup> It is conceivable that the scope of section 80C(2) is wide enough to include instances where an entity is purposefully interposed in a corporate structure solely for tax related purposes.<sup>1127</sup> This is particularly the case when section 80F(a) is applied in conjunction with section 80C.<sup>1128</sup> Section 80F(a) enables the Commissioner to treat two or more connected persons as one when considering whether commercial substance exists. This is significant: commercial substance for purposes of section 80C would ordinarily exist because a company has commercial substance through, for example, the ownership of assets. However, this legal reality may be ignored by application of section 80F(a). In virtually all instances where shareholders use the corporate veil for tax

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<sup>1124</sup> See the text to ch 5 part 3 3 3 1 above.

<sup>1125</sup> See the text to ch 5 part 3 3 3 1 above.

<sup>1126</sup> S 80C(2) of the Income Tax Act.

<sup>1127</sup> See the text to ch 5 part 3 3 3 2 above.

<sup>1128</sup> See the text to ch 5 part 3 3 3 3 above.

purposes, the shareholder and company will be connected persons as defined. It follows that for a taxpayer to pass the commercial substance test in section 80C it must be clear that commercial substance is created when including a company in a corporate structure. If one keeps in mind that the commercial content of the company and the shareholder separately would in most instances be the same as the commercial substance of the two considered as a single economic unit, insufficient commercial substance could exist, resulting in section 80C finding application.

A significant limitation to the application of section 80C as an indicator for abnormality is that it only applies in the context of business.<sup>1129</sup> Where the commercial substance test is applied to the examples above, all of which are arguably framed within the context of business,<sup>1130</sup> the use of a company in Examples 1 to 4 would seem to lack commercial substance when section 80C(2) is applied in conjunction with section 80F(a).

A further limitation on the application of the GAARs is the wording of section 80B. This limitation is equally applicable when applying the “misuse or abuse” indicator for abnormality.<sup>1131+1132</sup>

Section 80B’s ineffectiveness stems from the fact that its scope is limited to addressing the tax consequences of the particular impermissible avoidance arrangement.<sup>1133</sup> In order for section 80B to apply, it is necessary to identify both the relevant impermissible avoidance arrangement as well as its tax consequences. This arrangement will involve the transfer of assets to a company as part of an effort to craft a more favourable tax result in future. In all four of the examples given in this dissertation, such a transfer of assets takes place.<sup>1134</sup>

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<sup>1129</sup> S 80A(a)(ii) of the Income Tax Act.

<sup>1130</sup> Although guidance on which transactions would be considered to take place in a business context and which not, remain unclear. See the text to ch 5 part 3 3 3 2 above.

<sup>1131</sup> See the text to ch 5 part 3 4 above. Considering the uncertainty linked to the content or purpose of s 80A(c)(ii), it is considered unlikely that this provision may be applied to even begin with.

<sup>1132</sup> S 80A(c)(ii) of the Income Tax Act.

<sup>1133</sup> See the text to ch 5 part 3 4 above.

<sup>1134</sup> See text to ch 1 part 3 above.

In all of these cases, tax is avoided by using a two-step transaction.

The tax benefits of the structure created by the first step will only materialise when the second step takes place. The income-earning transactions forming part of the second step, are not entered into for tax purposes. The company enters into them for its own commercial non-tax purposes. These transactions do not amount to impermissible avoidance arrangements. It is also doubtful whether these transactions through which the company earns income, will display sufficient unity with the first step to be considered part of the same arrangement as the first step. Furthermore, it is improbable that the remedial provisions in section 80B can be applied to either step one or step two.<sup>1135</sup> Since little or no tax consequences arise by virtue of the transfer of assets to the company, section 80B presents no real remedy to the Commissioner to apply in such cases.

Overall the GAARs present little prospect of being effective remedies against taxpayers using the corporate veil as a tax reducing mechanism. The inherent weakness of the GAARs in this respect is largely due to the Income Tax Act's recognition of the separate legal personality of the company form. The Income Tax Act's acceptance of this gives rise to the point of departure that a company should be treated as a thing of legal substance, even where the fiction is used contrary to the purpose and context of the Act as a whole.

### **3 Comparison of effectiveness**

When comparing the common law piercing doctrine and section 20(9) of the Companies Act, I concluded that, save for companies incorporated outside South Africa,<sup>1136</sup> the two remedies are the same.<sup>1137</sup> The remedy in section 20(9) will mostly mirror the South African common law doctrine, but the corporate veil of a foreign company may still be pierced in terms of the common law as the ambit of the Companies Act does not extend to non-South African companies.

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<sup>1135</sup> See the text to ch 5 part 3 1 above.

<sup>1136</sup> See the text to ch 4 part 3 4 above.

<sup>1137</sup> See the text to ch 4 part 2 3 5 above.

Remarkable similarities exist when comparing the potential remedy in section 20(9) in a tax context with the GAARs in the Income Tax Act. Both require a tax purpose as main motivation for entering in an arrangement and ultimately for that tax benefit to be achieved. The onus of proof will also be on the taxpayer irrespective of whether SARS applies the GAARs or section 20(9) as remedy.<sup>1138</sup>

The difference between the two remedies is that the GAARs in the Income Tax Act require “abnormality” to be present in a particular arrangement involving the company, whereas section 20(9) of the Companies Act requires the company’s use to amount to an “unconscionable abuse”. Abnormality is not a requirement to pierce, which is why this dissertation argues that piercing is a much more effective remedy in a tax context than the existing GAARs for which abnormality is a requirement. In all four Examples, the dissertation shows that the GAARs may in all likelihood be ineffective, where the primary objective is tax avoidance. The reason is that the GAARs require “abnormality”, but these transactions are entered into in a normal manner.<sup>1139</sup>

This dissertation identified the abnormality requirement as the main reason for the limited potential application of the GAARs to address the intentional avoidance of tax through use of a company, in spite of the two additional potential indicators introduced in 2006.<sup>1140</sup> The absence of any reported judgments on the application of the GAARs since their re-introduction as sections 80A to 80L of the Income Tax Act hints at the inadequacy for these rules to address the intentional avoidance of tax in South Africa. An analysis of each of the four potential indicators for abnormality in this context also shows that the GAARs are an ineffective remedy. Their potential application appears to be limited to a few specific examples.<sup>1141</sup>

The remedy in section 20(9) of the Companies Act is a much more adaptable and effective one due to its inherent generality. Unlike the provisions in the

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<sup>1138</sup> See the text to ch 3 part 5 2 3 above.

<sup>1139</sup> See the text to ch 5 part 3 1 above.

<sup>1140</sup> See the text to n 1067 above.

<sup>1141</sup> See the text to ch 5 parts 3 3 2 and 3 3 3 2 above.

Income Tax Act, this section's effectiveness is bolstered by the explicit provision that legal personality is not absolute.

The test in section 20(9) is whether the use of the corporate veil can be said to amount to an "unconscionable abuse" of the legal personality of the company. In other words, was the corporate personality of the company used to escape an otherwise legitimate legal obligation from arising<sup>1142</sup> to the extent that policy considerations would require such separate legal personality to be disregarded? When the legal obligation being evaded involves the avoidance of a legitimate tax liability for a shareholder, the use of the corporate veil for this purpose will necessitate piercing in terms of policy considerations – a conclusion also reached in this dissertation.<sup>1143</sup>

Section 20(9) creates the possibility that the corporate veil may be pierced in general. Save for the provisions of section 80C(2) read with section 80F(a), the GAARs in the Income Tax Act stop short thereof.<sup>1144</sup> And even this piercing provision is also bound to be ineffective due to the remedial provision in section 80B which maintains the principle that the company as separate taxpayer suffers its own tax consequences.<sup>1145</sup>

#### **4 Recommendation**

This dissertation identified the broad potential use of the corporate veil for tax purposes<sup>1146</sup> and concluded that there exists a clear remedy against it in section 20(9) of the Companies Act.<sup>1147</sup> It is surprising that neither the previous common law piercing remedy nor the legislated remedy in section 20(9) of the Companies Act has been used to any significant degree in this context before.<sup>1148</sup> This becomes even more surprising when one considers how clearly ineffective the Income Tax Act's GAARs are in addressing such abuse.

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<sup>1142</sup> See the text to ch 3 parts 5 1 1 and ch 5 part 3 3 4 2 above.

<sup>1143</sup> See the text to ch 5 part 3 3 4 2 above.

<sup>1144</sup> See the text to ch 5 part 3 3 2 above.

<sup>1145</sup> See the text to ch 5 part 3 4 above.

<sup>1146</sup> See the text to ch 2 part 5 2 above.

<sup>1147</sup> See the text to ch 4 part 4 above.

<sup>1148</sup> See n 248 above.

Two alternative solutions are available to address the South African Revenue Service's persistence to try and apply the GAARs even though it has a much more appropriate remedy available in section 20(9) of the Companies Act.

The first alternative is to create awareness of the potential application of section 20(9) as a remedy against impermissible tax avoidance. Taxpayers and SARS alike are well aware of the provisions of the GAARs, but this does not seem to be the case with section 20(9). I regard the lack of application of section 20(9) in a tax context to be due to a lack of awareness of the potential application of the remedy rather than the inappropriateness of piercing as a remedy against impermissible tax avoidance. Moreover, considering SARS' increased appetite in recent years to use common law remedies<sup>1149</sup> as tools against impermissible tax avoidance as well as its apparent misgivings regarding the efficacy of the GAARs, it is suggested that there should be an increased awareness of the piercing doctrine in SARS.

The second recommendation would be to strengthen the GAARs in the Income Tax Act to address the abuse of the corporate veil for tax purposes, both in determining whether an "impermissible avoidance arrangement" is present as well as in applying the remedial provisions contained in section 80B of that Act. The presence of the piercing provision in section 80F(a) has the potential to be an effective remedy to counter the abuse of the corporate veil for tax purposes.<sup>1150</sup> I would therefore propose that the wording of section 80C, read with section 80F, be extended to include a context outside business in section 80A. The GAARs would further benefit from an amendment of section 80B making its remedies also applicable to the tax consequences arising from transactions following on and enabled by an impermissible avoidance arrangement. This would follow the approach currently adopted in other jurisdictions.<sup>1151</sup>

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<sup>1149</sup> Various reported judgments (*Sasol Oil*, *Bosch* and *NWK* are pertinent examples) illustrate a reliance in South Africa on the common law simulation doctrine and where it has been applied as a remedy against transactions aimed at avoiding tax.

<sup>1150</sup> See the text to ch 5 part 3 3 2 above.

<sup>1151</sup> See the text to ch 5 part 3 4 above.

Of the two recommendations above creating increased awareness of the potential ambit of the piercing remedy would involve a less dramatic intervention, yet achieve the same result as statutory amendments to the GAARs. Increased awareness can also be achieved without intervention on the part of the legislature and would keep the existing legal framework intact. Increased awareness should therefore, in my view, be the preferred option. In comparison, changes to the GAARs would require statutory intervention which would be superfluous given that sufficient remedies already exist in section 20(9) of the South African Companies Act to address the abuse of the corporate veil for tax purposes.

It may be tempting to consider a third approach whereby specific anti-avoidance remedies are introduced to address specific incidences of impermissible tax avoidance. However, given the wide-ranging potential for abuse, it would be difficult to anticipate and legislate against all possible instances of abuse in this manner.

Experience with specific anti-avoidance remedies discussed in this dissertation<sup>1152</sup> exposes the reality that specific anti-avoidance measures have the inherent problem that they require extremely careful drafting so as to not affect legitimate commercial transactions or structures being entered into. It is therefore my view that a remedy of general application is required to address a problem that requires a policy-based intervention. Such an intervention may take the form of either the legislature strengthening the GAARs in the Income Tax Act or the judiciary ensuring that section 20(9) is interpreted and applied in such a manner that it allows a policy and economic substance-based approach.<sup>1153</sup>

## 5 Conclusion

Separate legal personality is a legal fiction developed to satisfy the commercial requirements of society and to encourage economic activity.<sup>1154</sup> When these

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<sup>1152</sup> See the text to n 244 above.

<sup>1153</sup> Kujinga (2012) *CILSA* 42 argues that the spirit of tax laws can never be to allow taxpayers to avoid tax with no economic justification or commercial substance being obtained. I would argue that this principle extends beyond tax laws.

<sup>1154</sup> See the text to ch 2 part 2 2 above.

commercial objectives are attained, using the separate legal personality of a company is justified. However, where those consequences of separate legal personality are utilised for purposes other than what the doctrine of legal personality was developed for, it is questionable whether the recognition of legal personality should be persisted with, given that the doctrine of separate legal personality is being abused.

Using the separate legal personality of a company mainly for tax purposes not only fails to achieve the commercial objectives that the doctrine was developed for, but also frustrates the otherwise legitimate imposition of taxes by the same legislative body that grants legal personality to the company form to begin with.<sup>1155</sup> This dissertation concludes that such a use of the separate legal personality of the company constitutes an unconscionable abuse as contemplated in section 20(9) of the Companies Act.<sup>1156</sup>

Through the introduction of section 20(9) the legislature has explicitly recognised that legal personality is not an absolute consequence of incorporation and that there are limits to the circumstances under which separate legal personality will be recognised. When legal personality is unconscionably abused, the separate legal personality of a company will not be recognised in spite of the policy considerations favouring the strict observance of that legal personality.<sup>1157</sup> In the tax context the only consideration identified which may militate against the application of piercing is that of legal certainty. Piercing could nevertheless be a reasonable consequence if that danger is addressed.<sup>1158</sup>

This dissertation concludes that SARS may apply section 20(9) of the Companies Act as a remedy against impermissible tax avoidance when taxpayers enter into arrangements with the subjective purpose of achieving a tax benefit by using the corporate veil.<sup>1159</sup> Section 20(9) is the legislative equivalent of the common law piercing doctrine of South African law. This remedy appears

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<sup>1155</sup> See the text to ch 3 part 5 1 2 above.

<sup>1156</sup> See the text to ch 4 part 3 above.

<sup>1157</sup> See the text to ch 3 part 3 3 2 2 above.

<sup>1158</sup> See the text to ch 4 part 3 above.

<sup>1159</sup> See the text to ch 4 part 3 above.

to be much more effective in combatting abuse of the corporate veil for tax purposes than reliance by SARS on the GAARs contained in the Income Tax Act.



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