INTRODUCTION

The purpose of the South African Close Corporations Act 69 of 1984 (the “Act”) is the provision of a simple, deregulated, streamlined, inexpensive and flexible free-standing limited liability vehicle for the single entrepreneur or small number of participants, to meet their reasonable needs and expectations without the burden of legal requirements that would not be meaningful in the circumstances.

The total number of registrations, that is incorporations of new close corporations and conversions from companies to corporations, during the period 1995 to 2008 amounted to 1,494,488 close corporations compared to 387,757 companies of all kinds and types. During 2007 and 2008 a further 519,634 close corporations and 63,504 companies were incorporated. This puts the total for the period 1995 to 2008 to 2,014,122 close corporations and 453,861 companies.

In this contribution attention will be given to the far-reaching, if not drastic changes to be wrought by the provisions of the Companies Act 71 of 2008 (the “new Companies Act”) when it comes into operation.

SOUTH AFRICAN CLOSE CORPORATION

Under the Act the South African close corporation is a juristic person that confers on its members the usual advantages associated with legal personality and in which all or most members are more or less actively involved. In principle there is no separation between ownership and control. Every member is entitled to participate in the management of the business, to act as an agent for the corporation, and owe a fiduciary duty and a duty of care to the corporation. The consent of all the members is required for the admission of a new member.

It is ideally suited to small businesses. The managerial and administrative requirements for close corporations are less formal than for companies. The typical small entrepreneur will be able to complete the constituting documentation and register the corporation personally without expensive professional advice. Although a close corporation is required to have an accounting office, a formal audit of financial statements is not required. There are no requirements for compulsory meetings, such as annual general meetings. Meetings are usually held between members on an ad hoc basis. The members do not all have to take an active role in the running of the business but are in principle entitled to do so.

The concept and development of the close corporation elicited international interest and even enthusiastic admiration. A recent in-depth comparative study emphasises the importance of the continued availability of the close corporation and its potential as a role model for an eventual societé au capital variable – an intermediate form between that of a business trust and the close corporation of the Scandinavian states and the United Kingdom. It does not only serve as a highly significant indication of the importance of the preservation and development of such legal entities but also sounds as very timely notice of warning to South African law reformers to proceed with greater caution, circumspection and more deliberation in this regard.

THE CORPORATE LAW REFORM PROCESS

The Department of Trade and Industry (the “Department”) released its policy document on corporate law reform entitled South African Company Law for the 21st Century – Guidelines for Corporate Law Reform for public comment on June 24, 2004. It suggested that only one formal business vehicle should be recognised, which should be distinguished on the basis of size of turnover, and which would in turn determine the reporting requirements. The policy document asserted that the current distinction between close corporations, private companies and public companies is artificial and does not allow an easy transition from one type to another.

Towards the end of 2004 newspaper reports suggested that close corporations would have to convert to private companies to avoid losing their corporate status. Starting with relatively low key and tentative statements, these reports eventually explicitly suggested the need to convert.

In May 2006, the ECJ issued its findings supporting the UK’s approach to joint and several liability:

“Being a Member State to enact legislation, such as that in the main proceedings, which provides that a taxable person, who is liable to apply the rules of VAT, must be jointly and severally liable, with the person liable for the payment of VAT, for the input tax claimed by the second person and for any interest and penalties.”

The ECJ made it clear that any national legislation such as joint and several liability must comply with EU law in that it must be applied in a manner which reflects the gravity of any abuse and must offer legal certainty:

“Such legislation must, however, comply with the general principles of law which form part of the Community legal order and which include, in particular, the principles of legal certainty and proportionality.”

Both Bond House and FTI sent clear messages to tax administrations that in tackling fraud they must take care to act proportionally and provide taxpayers with legal certainty. However, the ECJ also sent a clear message to knowing participants in fraudulent transaction chains that they could not benefit from the fraud by relying on EU VAT rules.

Kittel

The concept is accepted practice that businesses must apply corporate governance processes to protect themselves from financial exposure. The extent of any corporate governance is determined by the level of the risk.

The decisions in Bond House and FTI (joint and several liability) reaffirmed HMRC’s expectation of appropriate corporate governance. The directors should have knowledge of their customer/supplier checks and proper risk management. This message was reinforced in a later ECJ decision. The decisions in the cases of Kittel & Reccio, a co-joined Belgian case published in July 2006 (C-489/04 and C-449/04), Kittel v. Belgian State and Belgische Staat v. Roksho Rejening (2006) ECR I-6161.

Kittel has become very much the model by which tax administrations verify the veracity of input tax claims. If a person reasonably could have known that, by his purchase, he was taking part in a fraudulent transaction connected with fraudulent evasion of VAT must, be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT tax, to that effect. (Case C-384/04, Federation of Technological Industries and Others [2006] ECR I-1491, para 33).”

The ECJ however qualified this in that no entitlement to input tax would be denied to any input tax previously paid to the claimant:

“It is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their input VAT tax, to that effect (Case C-384/04, Federation of Technological Industries and Others [2006] ECR I-1491, para 33).”

The ECJ was asked whether, if a trader entered into a contract for the purposes, as a participant in the fraud, regardless of whether they profited from the fraud or not:

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neutral. Many tax administrations and professionals still refer to the articles of the Sixth VAT Directive.

Article 17 of the Sixth VAT Directive provides a taxable person with the fundamental right to deduct input tax, therefore declaring to the tax authority that a commercial transaction has taken place. This right to deduct must be exercised immediately in respect of all the VAT charged on the cost components (see C-62/93; BP Supergas [1993] ECR I-1881, para 18, and joined cases C-118/98 to C-147/98 Goldfinche and Others [2000] ECR I-1177, para 45).

Tax administrations aim to ensure that the right amount of tax is paid by the right person at the right time. A business must declare all the output tax due on its inputs and pay the net amount to the tax authority.

It is reasonable that an honest taxable person is not liable if his supplier fails to pay over any tax charged and his fundamental right to deduct tax paid on his purchases is unaffected. However, in organised criminal attacks on the VAT system, such as MTIC fraud, the challenge for a tax administration is how to tackle such abuse in a proportionate manner which pinpoints the non-compliant without penalising the honest taxpayer, or the requirement for legal certainty.

HMRC’s approach to this challenge has been to explore both operational and legislative measures which focus on the threat to the revenue whilst at the same time ensuring that legitimate businesses can operate on a level playing field.

Article 4(2) of the Sixth Council Directive 77/388/EEC.

In May 2002 the UK began to deny input tax claims submitted by UK exporters on the basis that, where there were circular supply chains, the goods were carafilled and did not conclude in sales to final consumers. There was no commercial rationale behind the transactions, ergo no economic activity. HMRC argued that where the only intention was to commit fraud then such transactions did not fall within the scope of the Sixth VAT Directive.

This approach was challenged by a number of brokers whose input tax claims had been denied, eventually reaching the ECJ (see C-154/00, C-155/01 and C-484/03, Optun Ltd, Fulham Electronics Ltd, and Bank House Systems Ltd v Commissioners of Customs and Excise [2006] ECR I-1488). The question put to the ECJ was whether transactions constituting a part of a fraudulent scheme set up by others qualified as economic activities within the meaning of Article 4(2) of the Sixth Council Directive 77/388/EEC.

In its judgment of January 12, 2006, the ECJ found that transactions within a fraudulent trade are within the scope of the Directive.

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In its judgment of January 12, 2006, the ECJ found that transactions within a fraudulent trade are within the scope of the Directive.
Then again, under section 57(2) of the new Companies Act, if a profit company (other than a state-owned company) has only one shareholder, the shareholder may exercise any or all of the voting rights pertaining to that company on any matter, at any time, without notice or compliance with any other internal formalities, except to the extent that its memorandum of incorporation provides otherwise. In addition its governance is exempted from the detailed requirements of sections 59 to 65 of the new Companies Act.

In terms of section 57(1) of the new Companies Act, if a profit company (other than a state-owned company) has only one director, that director may exercise any power or perform any function of the board at any time, without notice or compliance with any other internal formalities, except to the extent that the company’s memorandum of incorporation provides otherwise. In addition sections 71(1) to (7), 73 and 74 do not apply to the governance of such a profit company.

Section 57(4) of the new Companies Act stipulates that if every shareholder of a company (other than a state-owned company) is also a director of that company any matter that is required to be referred by the board to the shareholders for decision may be decided by the shareholders at any time after being referred to by the board, without notice or compliance with any other internal formalities, except to the extent that the memorandum of incorporation provides otherwise.

**Single Act approach**

The approach of the drafters of the new Companies Act by preferring a single Act for small and large businesses and by de-emphasising the close corporation, through additional onerous regulation and prohibiting the formation of new ones, contrasts with the basic philosophy underlying the Act that proved so successful. At the root of the development of the Act is the conviction that it is very difficult for a single Act to provide a satisfactory legal form for both the large and sophisticated as well as the small and often marginalised entrepreneur. Historically, South African company legislation developed mainly in response to the needs of and problems posed by large public companies. It had to provide for the large industrial or financial conglomerate with its listed shares and professional management reflecting a clear separation between ownership and control, or direct and indirect control of say an institutional investor, scattered and powerless small shareholders and group problems. Hence it inevitably outgrew the needs and problems of the small entrepreneur who, typically, has restricted means and limited access to professional advice.

As far as the new Companies Act is concerned, a case in point is the dispensation concerning capacity and representation, which are applicable to both public and private companies alike, whether closely-held and/or exempted or not.

The ordinary rules of agency provide the foundation for the representation of juristic persons, but have not been able to supply solutions in all cases. A special or characteristic branch of agency has consequently developed with specific common law doctrines such as the doctrine of constructive notice; the ultra vires doctrine and the Turquand rule. The legislation considered it unwise to burden close corporations with the accumulated learning on the ultra vires doctrine and the doctrine of constructive notice. This Act, instead, in effect provides that these doctrines have no application and are not relevant to the question of whether a close corporation is bound by a particular contract made on its behalf.

A company incorporated under the new Companies Act is a juristic person. Therefore all the common law doctrines applicable to the capacity and representation of juristic person will apply except to the extent that the new Companies Act provides to the contrary.

From section 19(4) and (5) of the new Companies Act it should be clear that the doctrine of constructive notice, although curtailed, has not been completely abolished. In fact, a person will be regarded as having received notice and knowledge of any provision of a company’s memorandum of incorporation contemplated in section 13(2)(h) if the company’s notice of incorporation or a notice of amendment has drawn attention to the provision as contemplated in section 11(1), or of the effect of section 19(1) on a personal liability company. To this extent the doctrine of constructive notice will be applicable and still remain relevant to the consideration of the legal position of a company within this context.

Section 19(1) of the new Companies Act provides that a company has all of the legal powers and capacity of an individual, except to the extent that the company’s memorandum of incorporation provides otherwise. Thus the powers and capacity of a company may be limited in the company’s memorandum of incorporation and, to this extent, the ultra vires doctrine applies. In contradiction to close corporations law, the ultra vires doctrine is thus not completely abolished, consequently complicating the legal position of the company and third parties dealing with the company with the accumulated learning on this doctrine.

This seems to have been realised by the drafters, because it is sought to address some of the doctrine’s consequences, reflecting to some extent the approach followed in section 39 of the present Companies Act. In terms of section 20(1) of the new Act, if a company’s memorandum of incorporation limits, restricts or qualifies the purposes, powers or activities of that company, no action of the company is void by reason only that the action was prohibited by that limitation, restriction or qualification or as a consequence of that limitation, restriction or qualification, the directors had no authority to do so.
to authorise the action by the company. In any legal proceeding no person may rely on such limitation, restriction or qualification to assert that such an action is void. Exceptions are proceedings between the company and its shareholders, directors or prescribed officers, or between the shareholders and directors or prescribed officers of the company. The similarity between section 201(1) of the new Companies Act and section 36 of the present Act is striking. Even the criticised expression “the directors” has been retained.

In terms of section 201 of the new Act an outsider dealing with a company in good faith is entitled to presume that the company, in making a decision in the exercise of its powers, has complied with all of the formal and procedural requirements in terms of this Act, its memorandum of incorporation and any rules of the company unless, in the circumstances, the person knew or reasonably ought to have known of any failure by the company to comply with any such requirement. A director, prescribed officer or shareholder of the company is not regarded as an outsider. The new Companies Act stipulates that this provision must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers. The primary, if not the only, “common law principle” in this regard is contained in the “unipartite rule.”

Clearly, the new Companies Act creates a far more complicated legal position in regard to capacity and representation than the Act. This is especially so because of the continued, though limited, application of complex common law doctrines and their accumulated learning to companies, even small one-man or closely-held private companies.

It amply illustrates the difficulty to cater for the reasonable needs and expectations of all types and sizes of companies, their stakeholders and persons dealing with them, with a “one size fits all” approach.

**Continuation of existing close corporations**

The new Companies Act provides for its co-existence with the Act. It amends the latter extensively “to avoid regulatory arbitrage”. The new Companies Act repeals the present Companies Act and amends the Close Corporations Act as provided for in Schedule 1. The result is the indefinite continued existence of the Act and thus of existing close corporations. Close corporations will continue to exist until de-registered or dissolved in terms of the Act or converted to companies under the New Companies Act.

**New close corporations**

From the effective date of the coming into operation of section 13 of the new Companies Act, the incorporation of new close corporations will be proscribed. Thus new close corporations can still be registered until the coming into operation of section 13 of the Act. In terms of section 225, the new Companies Act comes into operation on a date fixed by the President by proclamation in the Gazette. That date may not be earlier than one year following the date on which the President assented to the Act, namely April 8, 2009. Obviously that date may be later than one year after the date of the amendment.

**Conversion of companies into close corporations**

From the date on which Schedule 2 of the new Companies Act comes into operation the conversion of companies into close corporations will be proscribed. Until that date companies can still be converted into close corporations under section 27 of the Act.

Schedule 2 provides for the conversion of existing close corporations into companies under the new Companies Act. A close corporation may file a notice of conversion in the prescribed manner and form, with a filing fee, at any time. The notice must be accompanied by a certified copy of a “special resolution” approving the conversion of the close corporation, and either a memorandum of incorporation, or an amendment to the existing memorandum of incorporation complying with the new Companies Act.

It is clear that a member of a close corporation will in the future no longer be faced with an obligation to become a member of the company upon conversion, but will have the freedom of choice to decide whether or not to become a shareholder of that company.

**Section 14 of the new Companies Act**

Read with the changes required in context, applies with respect to the filing of a notice of conversion, as if it were a notice of incorporation in terms of the new Act. Every member of a converted close corporation is entitled to become a shareholder of the company, but the shares need not be in held in proportion to the members’ interests.

Upon conversion of a close corporation in terms of Schedule 2, the Companies and Intellectual Property Commission must cause the registration of the close corporation in terms of the Close Corporations Act, give notice in the Gazette of the conversion of the close corporation into a company and enable the Registrar of Deeds to effect the necessary changes resulting from conversions and name changes.

On the registration of a company converted from a close corporation, the juristic person that existed as a close corporation before the conversion continues to exist as a company. All assets, liabilities, rights and obligations of the close corporation vest in the company. Existing legal proceedings are deemed to have been done by or in respect of the company, and the liability of any member for the

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**Missing trader intra community or MTIC fraud**

Missing trader intra community or MTIC fraud has been a problem across the European Union for over 10 years, and much has been written about its effects and how best to tackle it. So what is MTIC fraud and why does it pose such a challenge to tax administrations across the EU?

In order to understand how MTIC fraud is perpetrated, it is important first to understand how the VAT system functions. VAT is a consumption tax, operating via a fractionated collection system, the VAT on the value added at each stage of a supply chain is paid to the tax authority by VAT-registered businesses. When a business sells goods, the supplier will charge VAT (output tax) on the price of the goods. It will normally deduct from the output tax any VAT incurred on its purchases (input tax) relating to the supply of the goods and pay the net amount to the tax authority. This way the cost of VAT is only borne by the final consumer of the supply.

VAT is charged by all Member States of the EU. However, transactions between VAT-registered persons in differing Member States (extra-territorial transactions) are exempt from VAT (zero rated). The customer is responsible for payment of the VAT on its extra-territorial purchases but retains the normal right to deduct input tax. In those circumstances the customer effectively has in its hands VAT-free goods (or services).

MTIC fraud exploits this zero-rated supply across national boundaries as a means for stealing revenues from national states (carousel fraud) or creating a VAT debt to be used as a subsidy for undertaking legitimate supplies (acquisition fraud). The fraud is perpetrated when a business obtains a VAT registration number in one EU Member State, often with the sole intention of purchasing goods VAT-free from a business in another EU Member State and then selling them on to another business at a VAT-inclusive price but without paying the VAT charged to their tax authority.

In many cases the fraudulent business “disappears” immediately. Such businesses are often called “missing traders.” In some circumstances, the registered business will keep on trading and building up a debt until the tax authority finds them and takes action to close down the company. Such businesses are often referred to as “defaulting traders.”
close corporation’s debts in terms of the Close Corporations Act which arose before its registration: as a company remains the liability of that person as if the conversion had not occurred.

For the conversion of a close corporation into a company section 29C(4)(b) of the present Companies Act requires a statement by the close corporation’s accounting officers, based on the performance of his duties under the Act, that he is not aware of any contravention of the Act by the close corporation or its members or of any circumstances which may render the members of the close corporation jointly and severally liable for the corporation’s debts. Interestingly enough, Schedule 2 of the new Companies Act does not contain a similar requirement.

**Loans and the provision of security by or to a close corporation**

Section 55(1) of the Act provides for the mutatis mutandis application of the provisions of section 37 of the present Companies Act to the employment of funds of a subsidiary company in a loan to its holding corporation or fellow subsidiary company, or the provision of security by a subsidiary company to another person in connection with an obligation of its holding corporation or fellow subsidiary. Where a subsidiary company makes such an “upward” or “sideward” loan, or provides “upward” or “sideward” security, the subsidiary company must furnish detailed particulars of the loan or security in its annual financial statements for every year during which the loan or security is in operation. The directors and officers of the subsidiary company and the members and officers of the holding corporation who authorise or permit or are party to the transaction, are personally liable to the subsidiary for damages, should the terms of the loan or security be unfair to the subsidiary or not provide reasonable protection for its business interests and as a result the subsidiary suffers loss.

Subject to certain exceptions, section 226(1) of the present Companies Act, as applied by section 55(3) of the Close Corporations Act, prohibits loans or the provision of security by a subsidiary company to:

(a) a member or officer of its holding corporation; or
(b) a director or officer of its fellow subsidiary corporation; or
(c) a close corporation, company or other body corporate controlled by one or more of the members or officers of its holding corporation; or
(d) a close corporation, company or other body corporate controlled by one or more of the directors or managers of its fellow subsidiary company.

A loan or provision of security contrary to the prohibition is fatal to the validity of the transaction.

Unless the express prior consent in writing of all members to the particular transaction is obtained, loans and the provision of security by a close corporation to another corporation in which one or more of its members hold more than a 30 per cent interest, or to a company or other juristic persons controlled by one or more members of the corporation, is prohibited by section 52 of the Close Corporations Act. This provision is in effect a simplified version of the prohibition in section 226 of the present Companies Act.

The new Companies Act provides for the repeal of section 55 of the Act in toto. The definitions of “holding company” and “subsidiary” in the Act are amended to reflect the corresponding definitions in the new Companies Act.

Section 45 of the new Companies Act regulates loans or other financial assistance by a company to directors or prescribed officers of the company or of a related or inter-related company, or to a related or inter-related company or corporation, or to a member of a related or inter-related corporation, or to a person related to any such company, corporation, director, prescribed officer or member.

In contrast, section 52 of the Close Corporations Act (dealing with loans and the provision of security by a close corporation) will not be repealed by, or even amended to refer to, section 45 of the new Companies Act. Section 52 will therefore not only continue to reflect the arrangement contained in (the then repealed) section 226 of the present Companies Act, but will continue to refer pertinently to (the then repealed) section 226(1A)(b) for the definition of control.

This does not augur well for the attainment a “seamless match” between the various statutory arrangements regulating the provision of loans and security by and to companies and close corporations.

**Accounting and disclosure**

**Annual financial statements**

Within six months after the end of every financial year, annual financial statements in one of the eleven official languages will have to be prepared by the close corporation’s members. Presently the period is nine months.

**Compulsory audit of financial statements**

Presently a close corporation must appoint an accounting officer who has to report on the annual financial statements. A formal audit of annual financial statements is, however, presently not required. Although chartered accountants qualify for an appointment as accounting officers, quite a number of other sufficiently qualified professions have also been permitted. It should be emphasised that it is quite possible to have audited annual financial statements for instance where the members need it for their own purposes or because a potential creditor requires it. Hence audits are carried out where they serve a meaningful purpose.

**CONCLUSION**

Civil recovery is an important tool in the armory of prosecutors to deprive those who have obtained property through unlawful conduct. Its importance must not be under-estimated. Mutual legal assistance is also very important as without it assets can be transferred overseas, and the person who obtained these ill-gotten gains cannot be deprived of those assets.

The whole purpose of civil recovery and criminal confiscation is to deprive offenders of their ill-gotten gains; its purpose is not to enrich the state. Asset recovery is important because it deters offenders from committing financial crime, disrupts the criminal economy and does not allow offenders to enjoy the benefit of their crimes.

Philip F J Mobedji
Senior Restraint and Confiscation Lawyer, Serious Fraud Office
The new Companies Act introduces a compulsory audit of the financial statements of certain close corporations. A close corporation may be required by the regulations made in terms of the new Act to have its annual financial statements audited. The Minister may make regulations prescribing the categories of close corporations that are required to have their respective annual financial statements audited, taking into account whether it is desirable in the public interest, having regard to the economic or social significance of the companies, as indicated by its annual turnover, the size of its workforce, or the nature and extent of its activities.

A qualifying close corporation’s financial statements must comply with section 30(1) to (6) of the new Companies Act and not section 55(2) of the Close Corporations Act.

The annual financial statements may also be audited voluntarily at the option of a close corporation.

**Accountability**

A close corporation may voluntarily make the enhanced accountability and transparency provisions of Chapter 3 of the new Companies Act applicable. In such an event, the provisions of Chapter 3 of the Act, read with the changes required by the context, applies to such a corporation and prevails over any conflicting provision of the Close Corporations Act.

**Financial reporting standards**

The provisions of the Financial Reporting Standards Council may make regulations prescribing financial reporting standards or the form and content requirements for summaries of financial statements of close corporations, as those regulations have been made in terms of the Act. These regulations must promote sound and consistent accounting practices. In the case of financial reporting standards, they must be consistent with the International Financial Reporting Standards of the International Accounting Standards Board or its successor body.

**Disqualification from participation in management**

Disqualification of a person to act as director of a company will in general also exclude that person from managing a close corporation. Section 47(1)(c) of the Act will be amended to incorporate all the grounds of disqualification as a director of a company specified in section 69(8), as well as the provisions of section 69(9) to (11) of the new Companies Act.

Despite being disqualified on one of the grounds detailed in section 69(8)(b) of the new Companies Act, a person may participate in the management of a close corporation if 100 per cent of the members’ interest in the corporation is held by that disqualified person or the disqualified person and other persons who are all related to that disqualified person, and each person has consented in writing to the disqualified person participating in the management of the corporation.

The provisions of the new Companies Act relating to an application to declare a director disqualified or under probation apply as to a member of a close corporation. A reference in section 162 of the new Companies Act to a company must be regarded as referring to a company or a corporation, while a reference to a director must be regarded as referring to a director of a company, or a member participating in the management of a close corporation.

A person who has been placed under probation by a court in terms of section 162 of the new Companies Act or section 47(1C) of the Act may not participate in the management of a business of a corporation, except to the extent permitted in the probation order.

**Winding-up and liquidation**

The Department of Justice and Constitutional Development has developed a common insolvency legislation for quite some time which may conflict with the regime set out in the present Companies Act for dealing with and winding-up insolvent companies. In order to avoid any future conflict, the new Companies Act provides for transitional arrangements that retain the current disposition set out in Chapter 14 of the present Companies Act for the winding-up and liquidation of companies until such time as the new uniform insolvency legislation is enacted. However, if there is any conflict between the provisions of Chapter 14 of the present Companies Act and Part G of Chapter 2 of the new Companies Act, concerning the winding-up of solvent companies and deregistration of companies, the provisions of the latter prevail. The Minister may by notice in the Gazette determine a date on which this arrangement ceases to have effect. This may not be effected until the Minister is satisfied that alternative legislation has been brought into force adequately providing for the winding-up and liquidation of insolvent companies. The Minister may prescribe ancillary rules as may be necessary to provide for the efficient transition from the present provisions to the provisions of the alternative legislation.

This transitional arrangement, with the changes required by the context, also applies to the liquidation of a close corporation in respect of any matter not specifically provided for in the Act. The winding-up and liquidation of a close corporation, while a reference to a director must be regarded as referring to a director of the close corporation.

**Business rescue**

Neither judicial management under Chapter 114 nor a so-called “judicial management scheme” in terms of section 311 of the present Companies Act is available currently to a close corporation. In terms of the amendment to the Act by the new Companies Act, the

Furthermore, it might defeat the policy of self-reporting unaided conduct and in practical terms may be self-defeating.

**INTERNATIONAL MATTERS**

The Proceeds of Crime Act 2002 (External Requests and Orders) Order 2005 has been made under section 444 of POCA and came into effect on January 1, 2006. Now any country can make a request to the UK jurisdiction for a restraint order or registration of a confiscation order made in the requesting state. The designated countries requirement has been abolished. As a consequence of this the SFO has been able to give assistance to countries such as the Islamic Republic of Iran in restraint proceedings (see judgment of Gross J in Al-Duraz [2008] EWHC 315 (Chm)).

**Principal definitions**

An external request is a request to restrain relevant property identified in the request (s 447(1)). An external order is one which is made by an overseas court against property obtained as a result, or in connection with, of unlawful conduct, and is for the recovery of specified property or money (s 447(2)). Unlawful conduct is “criminal conduct” as defined by English law (s 447(3)).

**Action required on receipt of request**

When a request is received the Secretary of State will refer it to the appropriate restraining authority. The restraint order may be made under Article 8 of the external order if the conditions in Article 7 are satisfied, ie either an investigation has begun or criminal proceedings have commenced in the requesting state; there is reasonable cause to believe that the offender named in the request has committed an act of criminal conduct; the removal or alteration of property is necessary to prevent its use for the commission of an act of criminal conduct. This order is one which is made by an overseas court against property identified in the request (s 447(1)).

An external order if the conditions in Article 7 are satisfied, ie either an investigation has begun or criminal proceedings have commenced in the requesting state; there is reasonable cause to believe that the offender named in the request has committed an act of criminal conduct; the removal or alteration of property is necessary to prevent its use for the commission of an act of criminal conduct. This order is one which is made by an overseas court against property identified in the request (s 447(1)).

**UK requests to foreign jurisdictions**

These are made pursuant to section 74 of POCA if the conditions in section 40 have been satisfied. The UK may make requests to apply for restraint orders obtained in the court in terms of Article 6 of ECHR to the registration of external confiscation orders. To satisfy the external order a receiver may be appointed, and time to pay may be allowed – see Article 26(2) of the 2005 order.

The assistance that can be provided amounts to:

(a) protecting property from dissipation by obtaining a restraint order;

(b) managing property by appointing a management receiver;

(c) enforcing an external confiscation order.
BUSINESS RESCUE PROVISIONS IN CHAPTER 6 OF THE NEW COMPANIES ACT APPLY ALSO TO CLOSE CORPORATIONS. ANY REFERENCE IN CHAPTER 6 TO A COMPANY MUST BE REGARDED AS A REFERENCE TO A CLOSE CORPORATION. ANY REFERENCE TO A SHAREHOLDER OF A COMPANY, OR THE HOLDER OF SECURITIES ISSUED BY A COMPANY, MUST BE READ AS A REFERENCE TO A MEMBER OF A CLOSE CORPORATION.

OTHER ARRANGEMENTS INCORPORATED BY REFERENCE

The provisions of the new Companies Act are applied also to regulate the names, dissolution and deregistration of close corporations as well as the administration and enforcement of the Act.

CONCLUSION

The main impact of the new Companies Act on the South African close corporation may be summarized as two-fold.

First, the proscription of new close corporations: this not only translates into the phasing out of close corporations, however gradual, but leaves small entrepreneurs with only one avenue for new incorporations and that is under the new Companies Act.

If the new “exempt” private company is really so much more deregulated and simplified than the present close corporation it only serves to beg the question why the present choice of incorporation has perforce to be limited and why it is necessary to overburden the close corporation with additional regulation. The philosophy is apparent: “out with the old in with the new.”

Second, there is the clearly discernible tendency to subject the close corporation to more and more onerous administrative duties and arrangements. A prime example is the introduction of annual returns, with their attendant duties and liabilities. This impact is significantly added to by the approach to supplant numerous arrangements in the Act by that of the new Companies Act, by repealing some of the provisions and first by incorporating large tracts of the latter by reference.

It is unfortunate that the new Companies Act will proscribe new close corporations and encourage existing close corporations by duties and obligations contrary to their very nature and fundamental design philosophy.

Civil process to confiscate property obtained through unlawful conduct is too good to waste. It hurts criminals in the most effective way. The importance of civil recovery should not be underestimated.

RETROSPECTIVE EFFECT

The powers given to prosecuting authorities as of April 1, 2008 can be used retrospectively. This is clear from section 316(3) of POCA. This sub-section with this interpretation is referred to in the judgment of Waller LJ in ARA v Szepietowski & Others [2007] EWHC 766. The redistribution of civil recovery powers is irrelevant to this issue; it simply alters the identity of the claimant not the scope of the action. It should, however, be noted that the new cause of action was made retrospective but subject to a limitation period of 12 years. Time runs from the date the cause of action accrues (see ss 279U and 394 of The Limitation Act 1980).

LESSONS TO BE LEARNED FROM BALFOUR BEATY CASE

BACKGROUND

In civil recovery, property obtained by unlawful conduct can be recovered. The provisions do not require a specific offence to be established against any individual or company. Balfour Beatty voluntarily brought to the attention of the SFO certain unlawful conduct.

The unlawful conduct related to irregular payments and inaccurate accounting which failed to comply with the SFO certain unlawful conduct. It should, however, be noted that the new cause of action was made retrospective but subject to a limitation period of 12 years.

A consent order was agreed before the High Court on October 6, 2008. Balfour Beatty agreed a settlement of £2.25 million, together with a contribution to costs of the civil recovery order proceedings.

In simple cases where an agreed sum is to be received by the authority which conducted civil recovery proceedings, the Director of that authority is required to appoint a trustee to receive the agreed sum and deal with it (ie transfer it to the Home Office). In complex cases it may be necessary to appoint a receiver. A substantial part of that sum returns to the prosecuting authority under the incentive scheme. The trustee is nominated under section 266(2) of POCA and must be indemnified by the Director against any claim or action brought against the trustee.

This was the very first civil recovery under the new powers made available since April 2008 to the Serious Fraud Office and other prosecuting authorities — powers which were available only to the now abolished Asset Recovery Agency.

The main lessons to be learned from this case are:

(a) Encourage corporates and individuals to self-report wrongdoing so that the prosecuting authority may consider whether civil recovery is appropriate as opposed to criminal prosecution; the latter always remains an option.

(b) If civil recovery is appropriate then long and protracted criminal investigations can be avoided with obvious implications with regard to costs and resources. This case showed the importance of new powers and how they can be used effectively. There were also some lessons to be learned with regard to overseas corruption (the SFO’s policy in regard to overseas corruption is set out in the booklet SFO Policy in dealing with overseas corruption).

(c) If there are parallel civil recovery and criminal investigations then the costs of the criminal investigation cannot be claimed from any civil recovery settlement but there is nothing to stop prosecuting authorities from negotiating costs.

(d) If there are victims to be compensated (and there were none in the Balfour Beatty case) then criminal confiscation may be the best option as a compensation order can be made through a confiscation order on conviction.

(e) In civil recovery proceedings the victim has to ask for a declaration from the High Court for compensation from unlawfully recovered property. However, there is nothing in the legislation to stop the prosecuting authority, if satisfied, to do this on the victim’s behalf and include it in any settlement or successful civil recovery proceedings.

The second case of civil recovery conducted, once again by the SFO, is that of AMEC Plc (an international engineering and project management firm). It was AMEC that brought the matter to the attention of the SFO in March 2008 following an internal investigation into receipt of unlawful payments.

There was an investigation and it was determined that the payments received were contrary to section 221 of the Companies Act 1985. AMEC paid nearly £5 million under an agreed consent order and also costs of the civil recovery proceedings.

The lesson to be learned from both the Balfour Beatty and AMEC cases, in particular, is that corporates are bringing irregular conduct to the attention of the appropriate authorities and improving their internal practices to stamp out unlawful conduct rather than face prolonged criminal investigations. It is interesting to note that unless an undertaking is given that there will be no criminal proceedings upon civil settlement, criminal proceedings remain an option in law, but if such proceedings are commenced then there is scope for an abuse argument.

PROFESSOR J J HENNING

Distinguished Defence of Overseas Law and Dean of the Faculty of Law, University of the Free State, South Africa; Senior Research Fellow and previous Director of the Centre for Corporate Law, Institute of Advanced Legal Studies, University of London.