

**AN HISTORICAL ANALYSIS OF THE DEVELOPMENT OF A COMPANY AS A  
SINGLE ENTERPRISE AND THE IMPACT ON GROUP COMPANY TAXATION**

A mini thesis submitted in partial fulfilment of the requirements for the degree of

MASTER OF COMMERCE (TAXATION)

of

RHODES UNIVERSITY

By

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May 2019

## DECLARATION

### Certificate

I certify that the attached mini thesis is my own work, except where specifically indicated otherwise by way of acknowledgement, accompanied by the appropriate reference. I am aware of the penalties for plagiarism.

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## **ABSTRACT**

The company is considered a separate legal entity in both legislation and jurisprudence. The “veil” separating the company and its shareholders is a doctrine entrenched in company law that originated centuries ago. The doctrine is based on conditions that existed during a period that commenced with trading forms less complicated than the corporate groups found today. Trading forms known as guilds could be traced back to 1087, which gradually developed into regulated companies and, in the last century, into the joint-stock company form. The modern era has seen the development of groups of companies carrying on business as economic units. Company law, in regulating business forms, has failed to acknowledge the corporate group as a new business entity.

The main purpose of this research was to analyse the origins of the separate legal personality of a company and its relevance for the present corporate group structures. The research aimed to understand company law and jurisprudence in South Africa in relation to the legal personality of a company and a corporate group. The final objective of this reform-orientated doctrinal research thesis was to provide clarity on the need to consider granting separate legal identity to corporate groups in recognition of their economic unity.

A historically contextualised analysis was carried out on the development of trading through unregulated forms of businesses to the creation of the company as a regulated entity. The development of the legal persona of a company in legislation as well as jurisprudence was critically analysed in on the context of companies within a corporate group. A case study of a South African corporate group was used to highlight the different characteristics of the companies doing business in the form of a corporate group. The thesis concluded by recommending that legal personality should be extended to include a corporate group in order to facilitate the introduction of a group taxation regime.

### **KEY WORDS**

Company; corporate group; group taxation; company law; separate legal personality.

## **ACKNOWLEDGEMENTS**

I was privileged to have the opportunity to write my thesis under the supervision of Professor Elizabeth Stack. Her support, inspiration and undeniably high academic standards ensured that this research project was ultimately one of personal growth. All my thanks to you Professor.

I would further also like to express my sincere gratitude to Professor Wendy Jacobson for her advice and patience throughout the process of completing this dissertation.

Finally thank you to Liza and Robin. At the end it is all about you and for you.

*Study the past if you would define the future – Confucius*

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## **CHAPTER 1: INTRODUCTION**

### **1.1 THE CONTEXT OF THE RESEARCH**

Numerous modern large businesses operate through group structures which consist of various subsidiaries and associates. The responsibility for the management, control, and strategy of subsidiaries often remains predominantly that of the parent company thus forming one economic unit. With each entity in the group considered to be a separate legal entity, the economic reality of the whole group can be ignored (Strasser & Blumberg, 2009: 1-5). Ting (2013:1-5) shares this view and contemplates whether tax law is being challenged by the increase in corporate groups over the last century; he describes the doctrine of separate entity and the doctrine of corporate groups as follows: the separate enterprise doctrine is the traditional treatment of a company as a legal entity as distinct from its shareholder(s). The enterprise doctrine does not focus on separate entities within the group as being separate components, but on the entity's forming one economic unit. The legal structure of the separate entities forming a corporate group is overridden by the economic substance of the corporate group.

According to Correia (2013:1-2) jurisprudential and doctrinal debates regarding the possible recognition of a corporate group as a legal persona have been ongoing over the last few decades. One of the arguments in these debates is against the legal personification of a corporate group. This is because legal systems rest on the concept of a legal personality of a separate entity. Correia explains that due to existing corporate income tax legislation's being based on the doctrine of a corporation as a legal entity, corporate groups that have different economic, legal, and functional natures are considered difficult to tax. Correia states that tax legislators with an uncertain approach to taxing corporate groups "oscillate between the attribution of a separate tax existence to corporate group members and the treatment of corporate groups as single entities". This has created loopholes for tax avoidance by corporate groups that undermine the structural logic of corporate income. Specifically referring to the Organisation for Economic Co-operation and Development (OECD) member countries, Correia explains that in order to prevent this tax avoidance, some countries have developed a "complex arsenal of anti-abuse rules" and he describes these anti-abuse rules as "piecemeal reforms", which only motivate corporate groups to create more complex

structures and transactions to circumvent the rules; "...this overall state of affairs currently results in a substantial deadweight loss for the entire economic system, creating problems for the government, the corporate groups and the society".

Correia's viewpoint is shared by Ting (2011:429) and he specifically lists South Africa as one of the countries that has resorted to complicated tax structures to curb tax evasion by corporate groups.

Examples of "piece meal" reforms in South Africa are explained by Wilcocks and Middelmann (2004:38-40) as follows: in terms of section 5(1) (d) of the Income Tax Act No. 58 of 1962 (Income Tax Act of 1962), legal entities are taxed as separate taxpayers and, except for certain provisions in the Income Tax Act, no dispensation is available for a "system of group taxation". One of the few provisions in the Income Tax Act of 1962 for a corporate group is the exemption from donations tax. In terms of section 56(1) (r) donations between companies will be exempt from donation tax if both companies form part of the same corporate group, and the donee is a resident of South Africa. A second example provided by the authors is the Dividends Tax. Section 64FA(1)(b) of the Income Tax Act of 1962 provides for an exemption in respect of dividends *in specie* if the beneficial owner forms part of the same corporate group.

**64FA. Exemption from and reduction of tax in respect of dividends in specie.** - (1) Where a company declares and pays a dividend that consists of a distribution of an asset *in specie*, that dividend is exempt from dividends tax to the extent that it constitutes a distribution of an asset *in specie* if:

(a)...

(b) the beneficial owner forms part of the same group of companies, as defined in section 41, as that company.

Part III, sections 41– 47 of the Income Tax Act of 1962 contains corporate restructuring rules which, as explained by the Davis Tax Committee (2018:54), were introduced with two objectives in mind. The one objective was to mitigate unintended hardship with respect to intercompany re-organisation, as well problems associated with assets and shares transferred in a corporate group that arose with the introduction of capital gains tax on 1 October 2001. The second objective was a policy objective of competitiveness and the promotion of domestic economic growth.

In a presentation by the Finance Portfolio Committee (National Treasury, 2001: slide 3) the policy goals for the Corporate Restructuring Reform were listed as follows:

1. Corporate Restructuring Reform acts [as] a standard measure to reduce the potential cascading impact of the capital gains tax on multi-tier groups.
2. Corporate Restructuring Reform is consistent with international practice, thereby keeping the South African tax system internationally competitive.
3. Corporate Restructuring Reform promotes onshore restructurings.
4. Corporate Restructuring Reform is comprehensive, going well beyond capital gains tax relief.

The significance of the tax system being able to place the listed companies on the Johannesburg Stock Exchange on the same footing as companies listed on international stock exchanges in relation to mergers and unbundling was explained to Parliament as one of the common policy threads (National Treasury, 2001: slide 4):

The tax system should ensure that transactions on the JSE are competitive with international stock exchanges, such as the New York and London exchanges. The tax system should accordingly cater to the ebbs (combinations) and flows (unbundlings) naturally occurring within the JSE.

The then Minister of Finance, Mr. Pravin Gordhan, announced, with the tabling of the 2013/14 Budget, that: “A review will be initiated this year of our tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability” (National Treasury, 2013:4).

In July 2013 effect was given to this announcement and the members of the Tax Review Committee were announced, as well the terms of reference of the committee. In the inaugural meeting it was decided to refer to the Committee as the Davis Tax Committee (2013a:1-3). The terms of reference of the Davis Tax Committee (2013b:2-3) stipulated that the tax system had to be evaluated “against the international tax trends, principles and practices, as well as recent international initiatives to improve tax compliance and deal with tax base erosion”. The Davis Tax Committee is required to

pay attention to nine specific aspects of which the following two are considered relevant to this thesis:

3) A review of the corporate tax system with special reference to:

a. the efficiency of the corporate income tax structure; and

...

9) An evaluation of the legislative process with a view to enhancing simplicity, ensuring the protection of the tax base and to provide recommendations on how to improve the current process.

On 7 December 2016 the Davis Tax Committee (2016b) published a media statement in which a call was made for written submissions on corporate income tax, specifically referring to group taxation. After reviewing the submissions received, the Davis Tax Committee issued the final report on the Corporate Income Tax System of South Africa in 2018. The Committee submits in this report that the introduction of a full group taxation model is recommended but the economic environment of South Africa needs to be more positive. According to the Davis Tax Committee (2018:74) the recommended model to be introduced is the “group relief regime that is applied in the UK, given the similarities between the South African tax system and the UK tax system”. According to the Committee a phased-in approach could be considered by adding the set-off of assessed losses to the current corporate rules.

It is submitted that South Africa, as part of the global community, should be providing for the economic reality of modern business structures when considering tax policies. Otherwise, not only could South Africa find itself a less preferred investment destination, but internally the fiscus could, by not adjusting tax legislation to suit the modern economy, find itself with many more compliance and interpretation cases impacting on the efficiency of raising tax revenues. From the provisions for corporate groups in the Income Tax Act of 1962 discussed above, as well as the recommended approach suggested by the Davis Tax Committee, should group taxation not be introduced, it appears that corporate groups in South Africa will remain dependent on the complicated and costly piecemeal reform. In a report issued by the Davis Tax Committee (2016a: 87) it was acknowledged that the complexity of corporate tax legislation has a negative effect on its transparency and renders’ interpretation thereof uncertain.

Adam Smith, the “the father of the free market” according to Baars (2012:12), formulated the canons of taxation. Adam Smith (Smith, 1776:803-806) states that all taxes must be certain as to timing, amounts of payment, and the manner of payment. Further that taxes must be equitable, meaning that taxpayers must pay an amount “in proportion to their respective abilities”. The timing of the tax should also be convenient for the taxpayer. On this maxim Smith explains that when tax is due on rent it must be paid when the rent is received. The last maxim is that taxation must be efficient so to avoid additional costs incurred in the collection of tax.

On 1 October 2012 the Tax Administration Act No. 28 of 2011 (Tax Administration Act of 2011) was promulgated. In the *Memorandum on the Objects of the Tax Administration Bill, 2011*, it is acknowledged that South Africa must keep legislation updated with “modern approaches, business practices, accounting practices and constitutional rights” (National Treasury, 2011: 178):

In essence, therefore, the rationale for a tax administration review in South Africa is to adapt to a fast developing world, and lower the cost and burden of tax administration [emphasis added].

Chapter 7, sections 75 to 90 of the Tax Administration Act of 2011 are of specific interest to the question on hand concerning the complicated group tax regime. The advance tax rulings system was previously provided for in the Income Tax Act of 1962 and the Value-Added Tax Act No. 89 of 1991. This has now been consolidated in the Tax Administration Act of 2011. Section 76 of the Tax Administration Act of 2011 provides the purpose of the system and section 77 the scope of such ruling:

**76. Purpose of advance ruling.** – The purpose of the ‘advance ruling’ system is to promote clarity, consistency and certainty regarding the interpretation and application of a Tax Act by creating a framework for the issuance of ‘advance rulings’.

**77. Scope of advance rulings.** – SARS may make an ‘advance ruling’ on any provision of the tax Act.

In terms of section 75 of the Tax Administration Act of 2011 an “**advance ruling**” means a ‘binding general ruling’, a ‘binding private ruling’ or a ‘binding class ruling’.” The categories of the rulings are defined in section 75 of the Tax Administration Act of 2011:

**‘binding class ruling’** means a written statement issued by SARS regarding the application of a tax Act to a specific ‘class’ of persons in respect of a ‘proposed transaction’;

...

**‘binding general ruling’** means a written statement issued by a senior SARS official under section 89 regarding the interpretation of a tax Act or the application of a tax Act to the stated facts and circumstances;

**‘binding private ruling’** means a written statement issued by SARS regarding the application of a tax Act to one or more parties to a ‘proposed transaction’, in respect of the ‘transaction’;

An estimated twenty three percent (23%) of the 224 Binding Private Rulings (referred to as BPR) issued by the South African Revenue Service (referred to as SARS) relate to transactions by corporate groups to date (SARS, 2017). Relevant to the argument put forward in this thesis, the high incidence of taxpayers needing to obtain a BPR for group tax purposes is considered to confirm the complexity of tax rules of corporate groups in South Africa. The complexity experienced by the corporate taxpayer was echoed in a submission to the Davis Tax Committee (2018:63) where it was stated that the CFO Forum explained that “the fragmented nature of the anti-avoidance measures” was a risk for business in complying with the tax laws:

The fragmentation of the provisions increases the risks to business in completing income tax returns accurately as it adds complexity and requires deep professional knowledge and understanding of the law to identify the potential provisions that may find application to the income derived by the business.

The maxim theorized by Adam Smith of the need for the imposition of tax to be cost effective is clearly not achieved, considering the cost of applying for a BPR. In the *Comprehensive Guide to Advance Tax Rulings* (SARS, 2013:1-10), it is stated that it is advisable for a taxpayer to request the assistance of “an accountant, lawyer or other tax professional” when applying for a BPR. A fee structure is provided depending on the type of application. Small, medium, and micro-sized enterprises pay R2 500 as a non-refundable application fee and for all other applicants the fee is R14 000. A standard case may vary from R10 000 – R35 000 at an hourly rate of R650. The estimated time of completion is 20 days. A complex case estimate fee range is R70 000 – R105 000 and at an hourly rate of R650. The estimated time to complete a complex case is 60 days. For

extraordinary cases the estimated fee will be determined on a case-by-case basis as well as the estimated time of completion. A cost recovery fee is also payable for example, for travel costs incurred by the SARS official working on the ruling. Costs incurred by SARS to consult an engineer regarding the ruling, is, for example, also billed to the taxpayer. Adding up the costs as well as the value of the time waiting for such ruling, the uncertainty of tax within a corporate group is undeniably involving both the taxpayer and SARS in avoidable expenses.

Providing the taxpayer with a tool such as a BPR to obtain tax certainty for specific transactions is a positive gesture by SARS but it is argued that with a group tax regime in South Africa the volume of BPRs with regard to group taxation will decrease with the certainty such a regime will provide. It appears that the implementation of a group tax regime will potentially increase tax certainty for a taxpayer doing business within a corporate group. Secondly considering the costs involved in the BPR process a decrease in BPR applications will clearly be cost beneficial for both taxpayer and SARS by improving the cost efficiency of the tax system. Adding to that will be the advantage of time saved on the process of obtaining such BPR.

## **1.2 PROBLEM STATEMENT**

It is proposed that an integrated group tax regime in South Africa will convert the group tax legislation into a world class and effective tax model based on the current economic and legal substance of the various forms of business participating in the economy of South Africa. South Africa is in an advantageous position in that there are various countries that have had group tax regimes in place since the early 1900s from which tested practices may be used when designing an appropriate group tax regime.

Ting (2013:5) advises that “the modern commercial world dictates a change in paradigm with respect to the treatment of corporate groups”. Ting (2013:8) warns though that every country must consider internal conditions and adapt its tax system to fall within these constraints. He importantly advises that a country introducing group tax regime must first “get the legislation right”. Strasser and Blumberg (2009:4) echo this warning and state that the outdated model of the legal persona of a company leads to “dysfunctional anachronistic law” and out of harmony of the present day.

Ting (2011: 427-428) explains that various models of group taxation regimes are being applied in the world. The classification of different group taxation regimes is done according to the extent to which a single entity approach is applied in respect of intragroup losses and intragroup asset transfers. The countries with a weaker group taxation regime include South Africa. Australia, for example, provides for the set-off of losses as well as the transfer of assets and it is the group tax regime that is classified at a high level as indicated in appendix A. The UK has a group relief and asset transfer group taxation regime which is also according to Ting, a strong regime.

The current group tax legislation of South Africa, except for a few piecemeal provisions, is founded on the principle of a company being a separate legal entity for tax purposes. The fundamental economic and legal differences between a separate legal entity and a corporate group is not currently provided for in the tax legislation, complicating it for a corporate group to freely transact. The historic origins of the legal person of a company within law and jurisprudence took place in the context of rentiers being the main shareholders in companies. The concept of a corporate group in which the main shareholder, if not the only shareholder, is another entity was not taken into consideration. This thesis argues that applying legislation in which the recognition of a corporate group as a separate legal entity is absent will complicate the application of the legislation to this form of business unit.

This thesis recognises that the history of both the concept of company as well as the development of company law is not limited to only one country or culture. Influences spread across countries and the versatility of cultures, economics, politics, and social environments have a shaping impact, and must not be underestimated.

It is suggested in this thesis that although there are different group taxation regimes from which South Africa can select, the fundamental legal and economic differences between a corporate group and a separate legal entity must be understood and legislation must be amended to accommodate different types of business forms.

### **1.3 GOALS OF THE RESEARCH**

The main purposes of this research are to acquire an understanding of the development of the legal personality of a company and the consequences this has on tax legislation, specifically in relation to the taxation of corporate groups. A historically contextualised analysis will be done of the development of trading through unregulated forms of businesses to the subsequent creation of the company as a regulated business. The development of the legal persona of a company in legislation as well as jurisprudence will be critically analysed as the current tax legislation, as explained above, is based on the principle of a company's having an own legal persona regardless of it being part of a corporate group. This concept, formed by the legal mind over the last hundred years, will be an important characteristic the legislators will have to consider when drafting legislation for a group taxation regime. The main goal will be addressed through the following sub-goals:

1. studying the history of the origin and development of the concept of a company;
2. studying the history of company law and the origins of the legal persona of a company contained in company law and jurisprudence;
3. obtaining an understanding of the fundamental difference between the separate legal entity and a corporate group;
4. illustrating, using a South African case study, the reality of a corporate group as a single economic unit; and
5. based on the arguments presented, arriving at a conclusion regarding the need for legislative recognition of a corporate group as a separate legal entity, thus facilitating the development of a group taxation regime.

### **1.4 METHODS, PROCEDURES, AND TECHNIQUES**

Legal research, into which category the present research falls, can be classified into two typologies, namely, doctrinal or non-doctrinal. McKerchar (2008:18-19) describes non-doctrinal research as “research ‘about law’ rather than ‘in law’”. A doctrinal methodology provides a systematic

exposition of the rules governing a legal category (in the present case the legal rules relating to the taxation of corporate groups), analyses the relationships between the rules, explains areas of difficulty, and is based purely on documentary data. Doctrinal research is further divided into reform-oriented and theoretical research. Research focused on amending law will be reform-oriented, while theoretical research will focus on an understanding of the conceptual bases of legal principles.

A doctrinal research methodology within the reform-orientated category will be employed for the present research. The first part of the thesis will be theoretical research aimed at obtaining an understanding of the origins and development of the legal principles contained in company law. A comprehensive literature survey will be conducted on the topic of the history on the trading form developing into a company and the company law forming from it. Continuing the study will include elucidating the connection between company law and tax law and how the principles contained in company law influence tax law. The literature survey will bring into perspective the reasons why this thesis argues that the principle of a company being separate legal entity must be extended to provide a corporate group with a similar legal right of being considered a legal entity.

## **1.5 ETHICAL CONSIDERATIONS**

No ethical considerations arise as all the data used for the research are publicly available. Interviews will not be conducted; opinions will be considered in their written form. All sources of data will be appropriately acknowledged, and full references provided.

## **1.6 OVERVIEW OF CHAPTERS**

In chapter two the South African history of tax legislation, especially of company tax, will be discussed. A synopsis of the introduction of the first Income Tax Act in South Africa after unification is given. The subsequent development of tax legislation as well as commissions and committees appointed to review tax legislation over the last 100 years are also discussed focusing on group taxation considerations.

The third chapter consists of the history of the development of the concept of a company and subsequent company legislation. This chapter explains the origins of the legal persona of a company within the historical economic circumstances of the years 1700 - 1900.

Chapter four reviews the development of legislation in South Africa focusing on company law. The adoption of legislation as well as legislation processes will be reviewed in order to explain the applicability of the legal persona as discussed in chapter three on company law in South Africa and, concomitant with that, tax law.

In chapter five the structure of a corporate group is explained by means of a case study of Sasol. Sasol provides an appropriate example of the potential economic and strategic unity a corporate group may form. The nature of the shareholder in such a group is compared to the nature of shareholder that existed during the period in which the legal persona of a company was formalised. The chapter demonstrates that the legal persona of a company is still based on historical economic and social conditions, has not adapted to the conditions in the modern world, and is no longer appropriate.

Chapter six concludes the findings of the thesis and, after a brief summary of the findings in the chapters, provides a recommendation regarding the legal recognition of a group of companies as a separate person, thus bringing South Africa into line with a modern legislative approach to company law. This will then lay the foundation for the introduction of a group taxation regime.

## **CHAPTER 2: THE HISTORY OF CORPORATE TAX IN SOUTH AFRICA**

### **2.1 INTRODUCTION**

Chapter one provided the context of this research and explained the problem statement and goals of the research. The problem with the taxation of a corporate group, as explained by Correia (2013:1-2), is due to corporate tax being based on the principle of a company as an entity legally separate from the corporate group for tax purposes. The lack of coherent corporate group tax regimes in a country leads to tax avoidance being counteracted by complicated piece-meal reforms. As advised by Ting (2013) in his comprehensive study on various corporate group tax regimes in countries, for example, Australia, the Netherlands, Spain and the USA, a paradigm shift is needed in the treatment of corporate groups. This shift would lead to an understanding that to ignore a corporate group economic reality would not be conducive to the proper taxation of the corporate group.

South Africa has considered, and still is considering, corporate group tax, but only piece-meal reforms have been implemented, thereby increasing the cost of tax compliance, which is contrary to the cost effectiveness and tax certainty canons formulated by Adam Smith (Smith, 1776:803-806).

Chapter two commences with the history of corporate tax in South Africa, with the aim of contextualising from a South African perspective the tax policy on group taxation in relation to the tax law of the past and the present.

### **2.2 THE HISTORY OF SOUTH AFRICAN INCOME TAX LEGISLATION**

Law is the manifestation of an objective: it is the vehicle used by the state to regulate the behaviour of its subjects. It provides a means to achieve social, economic, cultural and political policies (Burger, 2002:6).

The Income Tax Act No. 28 of 1914 (Income Tax Act of 1914) was the first version of an Income Tax Act in South Africa after unification and was promulgated on 20 July 1914 (Hattingh,

2016b:54). In this chapter it will be explained that even though there have been various amendments, incorporations, and repeals of all the Income Tax Acts in South Africa, certain principles that applied in the original Acts are still to be found in the current Income Tax Act of 1962. It is proposed that in critically evaluating these principles today it is imperative to understand their origins. As explained by Harris (2016:18), British income tax law was based on a law of 1803 which could only be understood in terms of hundreds of years of local British history. Similarly, the current principles contained in the Income Tax Act of South Africa will be explainable in the context of their origins and development in terms of the local history of South Africa and the external influences forming legislation.

The value of understanding the historical origin and the context within what the legislation was designed is important in the interpretation of legislation, as stated by Dobson J in *Minister of Land Affairs of the Republic of South Africa and Another v Slamdien and Others* (LCC107/98) [1999] ZALCC 6 at [14]:

The purposive approach as elucidated in the decisions of the Constitutional Court requires that one must:

- (i) in general terms, ascertain the meaning of the provision to be interpreted by an analysis of its purpose and, in doing so,
- (ii) have regard to the context of the provision on the sense of its historical origins; [emphasis added]
- (iii) have regard to its context in the sense of the statute, the subject matter and broad objects of the statute and the values which underlie it;
- (iv) have regard to its immediate context in the sense of the particular part of the statute in which the provision appears or those provisions with which it is interrelated;
- (v) have regard for the precise wording of the provision...

Botha (2016:18-20), providing some clarity on the “chronologic time-line” of legislation in South Africa, explains that in the Constitution of the Republic of South Africa, 1996, “old order legislation” is defined in item 2 of Schedule 6 as meaning legislation enacted before the previous<sup>1</sup>

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<sup>1</sup> The previous Constitution being referred to is the Constitution of the Republic of South Africa, 1993.

Constitution took effect. This old order legislation is divided into two historical eras with the first being pre-Union legislation of the period 1806 to 1910. The second era stretches from the Union to Democracy, being 1910 to 1994.

In the discussion of the history of tax legislation, a chronological time-line will be applied for the reasons provided. The first period commenced in 1914 with the introduction of the Income Tax Act of 1914 and concluded in 1940. Between 1914 and 1940 there were various amendments to the Income Tax Act which will be explained below, but what is considered by Hattingh (2016a:99-100) to be the amendments that still form the basis of current tax legislation in South Africa occurred in 1940/41 when J.H. Hofmeyr “announced a total overhaul of the tax system” which has not occurred since; “The 1941 Income Tax Act was a substantial piece of work – it still provides the bedrock for much of the South African income tax legislation in operation in 2014”.

According to Correia (2013:2) economy, politics, and ideology influence corporate income tax policies. In South Africa tax policy experiences similar influences (Davis Tax Committee, 2016a:8):

Far from merely being a mechanical, technical exercise in economic analysis, tax policy is inherently political and ideologically contested, moulded by the dynamic interplay among economic and political institutions, interest groups and political values and culture (e.g. the degree of tolerance of inequality or the perceived legitimacy of government).

These influences will be discussed below within the various chronological timelines in the history of tax in South Africa.

### **2.2.1 Unification – 1910**

In 1910, the Republic of South Africa, as now named, consisted of four British colonies, the Transvaal, the Cape, the Orange River, and Natal. On 31 May 1910 the Union of South Africa was proclaimed. Governance as well as jurisprudence were both influenced by British policy. The doctrine of parliamentary sovereignty was used as a model for the constitution of the Union. The legal positivist approach of separating law and morality followed by the British courts was likewise followed by Union courts (Du Plessis, 2017:57-58).

According to Nattrass and Seeking (2010:8-9) after unification in 1910 South Africa followed Britain's move "from the laissez-faire liberalism of the Nineteenth Century to the more interventionist and regulatory mode associated with the 'new liberalism'". In the first ten years after unification, the state played a key role in the economy with nine out of 13 government departments regulating key economic sectors, namely:

Finance, Agriculture, Lands, Mines, Commerce and Industries (merged with Mines as Mines and Industries from 1912 to 1933), Education, Post and Telegraphs, Railways and Harbours and Public Works.

Capital required to finance the functions necessitated the introduction of a "Union-wide progressive income tax".

### **2.2.2 The First Imposition of Income Tax in the Union of South Africa – 1914**

Discussions on the development of income taxation in South Africa often start with an event that took place one hundred years ago – the promulgation of the first comprehensive Income Tax Act in the Union of South Africa (Jansen van Rensburg, 2016:25).

On 13 June 1912 General J.C. Smuts was appointed Minister of Finance by General Botha (Hancock & van der Poel, 1966:99). In a letter dated 29 May 1912 Smuts requested the following literature from H.J Wolstenholme (Hancock & van der Poel, 1966:524):

Please send me the following little books:

1. Withers: *The Meaning of Money* (Methuen).
2. Armitage Smith: *Principles and Methods of Taxation* (Murray).

The taxation discussed in the second book was that being applied in Britain (Hattingh, 2016b:55).

This first Income Tax Act was influenced by internal political and economic conditions in the Union of South Africa, as well as conditions outside the Union, specifically the British Empire and Europe. At first reluctant to introduce tax, Smuts had expressed the opinion in a letter to J. X. Merriman two years earlier in 1912 that the introduction of tax was a strong possibility (Hattingh,

2016b:55); “Although the revenue has improved, we shall certainly have to resort to some taxing measures”.

On 22 May 1914 Smuts placed a resolution before the Senate on the introduction of income tax which was approved on the 26<sup>th</sup> of May 1914 without an official Bill (Hattingh, 2016b:54). Within two months the Income Tax Act No. 28 of 1914 was promulgated and was published in the Government Gazette of 20 July 1914. The Act was 17 pages long and consisted of six chapters (Harris, 2016:15).

Hatting’s’ (2016b:57) quote from Smuts’ 1914 budget speech lists various problems that had a negative influence on the Union and necessitated the need for the introduction of income tax:

The year 1913-1914 has been one of the most terrible years in the history of the country. (Cheers.) We have had three great labour disturbances during the year. We have had an unprecedented drought following another great drought the year before. We have had stock diseases, a very serious setback in the ostrich and tobacco industries, and there are calamities which have come over the country.

Smuts’ solution to improving the economy was to be in new forms of taxation (Hattingh, 2016b: 59) and adding the imposition of tax as a new economic policy of the country:

we are reaching a very important era in our financial history – now we are coming to new forms of taxation, we have to consider very carefully what is the best policy for this country to pursue...we are changing one basis to the other...

....

the Government proposes to do the right and wise thing, and to settle the economic policy of this country on a sound basis without delay, and I think that the best and fairest thing to do would be to go in for an income tax [emphasis added].

The introduction of the Income Tax Act of 1914 and the subsequent inclusion of more types of taxes, for example, Super-Tax in 1916, according to Natrass and Seekings (2010: 9), generated more revenue than the customs duties received prior to the introduction of taxation. After 100 years the “new form of taxation” proposed and introduced by Smuts has grown from a 17-page Income

Tax Act (Hattingh, 2016b:73) to the approximately 497-pages of which the current Income Tax Act of 1962 consists.

In the remaining part of this chapter the taxation of corporates and shareholders will be discussed. In the paper authored by Hattingh (2106a:83) the taxation of corporates and shareholders are divided in “more or less six distinct phases” in what is submitted being an accurate classification of periods that will be applied in the remaining sections.

### **2.2.3 Years 1915 – 1925**

The Income Tax Act of 1914 did not distinguish between the income being earned by a natural person or by a company, and both were taxed at the same progressive tax rates. Tax imposed on income of more than £1000 was at a tax rate of 2, 5% and 7, 5% for income of more than £24 000. Dividends paid to shareholders were exempt provided they were paid from after-tax profits. The question of the double taxation of shareholders was addressed by Smuts during a session of Parliament on the 25<sup>th</sup> of May 1914 in which he explained that: “Anybody who knew the Cape Act and the framework of the income tax would know that that could not happen” (Hattingh, 2016a:84-85).

Super Tax was first enacted by section 4(1) of the Income Tax Act No. 35 of 1916 and was aimed at high income earners, specifically shareholders in the mining industry. Excess Profits Duty was first introduced in South Africa in 1917 and applied to companies and individuals at a rate of 25% on excess profits (Hattingh, 2016a:90-91).

The double taxation of shareholders, contrary to Smuts’ statement, did occur two years later. From 1 July 1916 a Dividend Tax was payable on dividends distributed by companies. Section 35(2) of the Income Tax (Consolidation) Act No. 41 of 1917 imposed the following tax rates (Hattingh, 2016a:88):

The 1917 Dividend Tax had split-rate features and implemented, on a number of levels, the conduit view of a company.

The tax rates were as follows:

- 10% for companies whose principal business was gold mining;

- 7.5% for companies whose principal business was diamond mining; and
- 5% for all other companies.

Within the provisions of Dividend Tax one of the first characteristics of group taxation was inferred. In terms of section 42 of the Income Tax (Consolidated) Act No. 41 of 1917, wholly owned subsidiaries and their parent company that carried on similar types of business had to be treated as one company for the purposes of Dividend Tax (Hattingh, 2016a::

The taxable base had to include all the profits of any wholly owned subsidiaries ‘carrying on the same class of business’ as the parent company, and these companies had to be treated as one single company for purposes of computing Dividends Tax.

According to Ting (2013:3) an essential feature of group taxation is that a corporate group controlled by a parent company is a single entity and section 42 above did lean in that direction. Regrettably the idea of a company as a legal entity with corporate shareholders forming one economic unit was never given significant consideration in subsequent amendments except for specific ‘piece-meal’ provisions.

#### **2.2.4 Years 1925 – 1932**

In 1924 the South African Party under the leadership of Smuts lost the election to the National Party. The third Prime Minister of the Union of South Africa, J.B.M. Hertzog, appointed N.C. Havenga as the Minister of Finance (Van Der Walt, 1976:510). This first transition of power after Unification brought about tax reforms in 1925 when Excess Profits Duty and Dividends Tax were repealed. Section 6 of the Income Tax Act No. 41 of 1925 imposed the following basic income tax rates (Hattingh, 2016a:91- 92):

- 15% for companies whose principal business was gold or diamond mining (5% in 1917);
- 7.5% for companies whose principal business was life insurance or mining (5% in 1917);
- 12.5% for all other companies (5% in 1917); and
- gradual rates of 5% to 10% for individuals (same as in 1917).

The 1916 Super Tax was amended to include private companies (Hattingh, 2016a:92):

This extension evidently incorporated the view that the individual shareholder in a private company formed an economic unit because government was concerned that controlling shareholders could otherwise avoid Super Tax by capturing wealth in a private company.

This was a second time the concept of separate legal persons could in specific circumstances form an economic unit. As in the case of Dividend Tax, this is submitted to be another “piece meal” amendment.

The crash of the US stock market in 1929 impacted on South Africa, and the Hertzog government was faced with a budget indicating a deficit of £200 000. To improve this dire position, Hattingh (2016a: 93-94) explains, Smuts, as “leader of the Opposition”, suggested that South Africa should follow the example of the United Kingdom and abandon the gold standard. The budget put forward by Smuts resulted in a surplus of £750 000. Hertzog did not agree on the abandonment of the gold standard but due to pressure from the mining industry and from farmers his government agreed to abandon the gold standard. Early in 1933 Hertzog and Smuts formed a coalition government and in May 1933 won 136 of the 150 seats in Parliament (Giliomee & Mabenga, 2007: 283). During the coalition period “ad-hoc reforms were adopted” in tax legislation (Hattingh, 2016a: 94).

### **2.2.5 Years 1932 – 1940**

The tax amendments and political influences for the period 1932-1941 (Hattingh, 2016a:96-97) can be summarised as follows: Excess Profit Duty was reintroduced in 1933 as the Gold Mines Excess Profits Duty and was only applicable to profits made by gold mines. Between 1935 and-1936 the imbalances caused by changes made to the tax system in 1925 by the Hertzog government had to be addressed. The Commissioner of Taxes, A.F. Corbett, chaired the Departmental Committee to review the taxation of goldmines, and in 1936 the Gold Mines Excess Profits Duty was replaced with a gold tax formula. The tax system for corporates was a classic system with split-rates for gold mining.

In 1932 the principle of a group of companies forming one economic unit was again a reason for an amendment in the Tax Act as an anti-avoidance measure in respect of Super Tax (Hattingh,

2016a:94). In terms of section 9(1) of the Income Tax Act No. 28 of 1932 (Income Tax Act of 1932):

Where it appears to the commissioner [Commissioner] that any one person other than a public company controls more than one private company, the commissioner [Commissioner] shall assess such private companies for super tax jointly as a single company.

By 1940, the tax system, which remained stable, was again in the spotlight with the commencement of World War II.

### **2.3 OVERHAUL OF THE SOUTH AFRICAN INCOME TAX ACT**

Quite simply, one cannot make sense of a hundred years of history without understanding the geo-and social-political context and, often critical, the personalities involved (Hattingh *et al*, 2016: xiv).

What is considered by Hattingh (2016a:98-99) to be a redrafting of the Income Tax Act took place in 1940/1. When war was declared by Britain and France on 3 September 1939 the task of building a war chest was given to the newly appointed Minister of Finance and Education, J.H. Hofmeyr, under Smuts, the newly re-appointed Prime Minister. From a vastly different background of being the Minister of the Interior and Education from 1933 to 1939, Hofmeyr proposed a total overhaul of the tax system in his first Budget Speech on 28 February 1940. The proposed amendments were substantial enough to require that the Income Tax Act be re-drafted to be promulgated in 1941 as the Income Tax Act No.31 of 1941 (Income Tax Act of 1941). Over time this Act displayed the lack of experience as well as the characteristic trademark of the Finance Minister as an idealist, particularly regarding corporate and shareholder tax. None the less, according to Hattingh (2016a:100); “The 1941 Income Tax Act was a substantial piece of work – it still provides the bedrock for much of the South African income tax legislation in 2014”.

In the context of this thesis, the amendment of the definition of a private company brought about with the enactment of the Income Tax Act of 1941 is of interest and will be discussed in more detail before concluding this review of the history of company tax in South Africa.

### **2.3.1 An Economic Unit Formed by a Closely Held Company and its Shareholders**

*The Memorandum on the Proposed Consolidated Income Tax Bill and Concessions to the Excess Profits Duty* (Memorandum) (Union of South Africa, 1941a) listed the following reasons for the consolidation of the Income Tax Acts on the first page as:

- (i) a more equitable incidence of rating;
- (ii) a means to restrict legal tax avoidance by company flotation;
- (iii) amendments to the former law;
- (iv) authority for the imposition of two new taxes - The Non-resident Shareholders' Tax and the Undistributed Profits Tax.

One of the proposed amendments related to the notion that a closely held private company and its shareholders form one economic unit. This notion was addressed owing to taxpayers legally being able to avoid tax due to the underlying principles in the existing Income Tax Act of 1932:

Many ingenious methods to avoid taxation were devised which were only possible because of the principles underlying the present Act. Experience has shown that the means of avoidance of tax and the inequity of tax incidence are due to-

- (a) the form of the definition of a private company;
- (b) regarding a private company as a tax entity.

The definition of a private company referred to above is provided in section 27 of the Income Tax Act of 1932 as follows:

For the purposes of this Part the expression 'income subject to super tax' means an amount as determined in section twenty-nine received by or accrued to or in favour of any person other than a company during any year of assessment:

(2) In this section-

'public company' means any company other than a private company;

'private company' means any company wherein -

- (a) shares representing not less than ninety percent of the share capital of the company are held or controlled by not more than any five shareholders; Provided that where shares in a company are registered in the name of a partnership each partner shall be deemed

to be a shareholder having a holding in the company in proportion to his interest in that partnership; or

- (b) shares representing not less than fifty-one per centum of the share capital are held or controlled by one person; or
- (c) not less than seventy-five per centum of the working capital has been supplied by one person:

Provided that a company shall not be deemed to be a private company –

- (i) if shares therein representing not less than eighty per cent of the share capital are held or controlled by a public company; or
- (ii) if it has been distributed as dividends during any year of assessment a sum not less than seventy-five per centum of the amount upon which it otherwise, but for the provisions of this paragraph, be assessed for super tax in respect of such year of assessment.

In 1933, the second proviso to section 27 above was repealed and substituted with a new paragraph:

- (ii) if it has distributed as dividends during the year of assessment a sum not less than seventy-five per centum of the income subject to super tax accrued to or received by it during any year of assessment.

In the Memorandum (Union of South Africa, 1941a:2-3) it was explained that the current definition provides an unintended opportunity for the shareholder to alter the status of a company between its being public or private at will. It was suggested that public companies and all other companies not falling within the definition of private companies should be deemed a public company. The test suggested was based on “the conception of a public company as being one in which the shareholders tend to be investors and not propriety partners”:

Public companies will, subject to certain safeguards, be mainly those whose shares are quoted in a recognized stock exchange.

....

But in the unlikely case of a company continuing to enjoy quotation when the company has assumed the characteristics of a partnership, safeguards will be provided whereby such a company will be treated as a private company for purposes of taxation.

The legal character of the company was not considered to be tainted by the view taken by the tax legislation as explained in the Memorandum (Union of South Africa, 1941a:3):

There will be of course, no interference with its enjoyment of the normal benefits derived from incorporation, save that, except in certain special cases, the company will not be taxed on these assessments for normal or super tax.

It is evident that the legislator was aware that shareholders of a company were able to form an economic unit due to the nature of their relationship. The dogma of the legal personality of a company is however a complication for the legislator who would have to acknowledge the possibly different outcomes for tax purposes. The mere fact that specific mention is made in the Memorandum (Union of South Africa, 1941a) that the legal status of the company is to remain indicates the importance of this concept regardless of whether certain conditions are identified that seem to be different from this legal concept.

## **2.4 COMMISSIONS/COMMITTEES ON TAX REFORMS IN SOUTH AFRICA 1945 – 2017**

On 3 December 1948 Hofmeyr unexpectedly passed away and two years later in September 1950 Smuts died at the age of 78 (Hattingh, 2016a:106). Two prominent figures in the design and development of tax were lost to South Africa.

In 1948 the New Nationalist Party under the leadership of D.F. Malan won the election on a technicality. Hattingh (2016a:106-107) describes this newly appointed Prime Minister as going out “with zeal” to review the laws and in 1949 he appointed R. Steyn as chairperson of a Committee of Enquiry into the Income Tax Act. Four years later, in 1953, a Tax Commission was appointed to consider the recommendations made by the 1949 Committee.

The Commission of Inquiry into Fiscal and Monetary Policy in South Africa, the Franzsen Commission, was appointed on 24 November 1967 by the State President. Under the chairmanship of Dr D.G. Franzsen, the vice-President of the South African Reserve Bank, the terms of reference

included only considering “minor changes in the present system of company taxation” (Van Niekerk,1969:108).

When Wilcocks and Middelmann (2004:39) evaluated the need to introduce group taxation in South Africa they took into consideration the reports of the 1986/7 Commission of Inquiry into the Tax Structure of the Republic of South Africa (the Margo Commission) and the 1995 report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa (the Katz Commission). They concluded that the Margo Commission had considered group taxation and had concluded that such a regime must not be implemented as it would lead to loss in revenue for the fiscus and could prejudice minority shareholders. According to Wilcocks and Middelmann (2004:47-48) the Katz Commission made the following recommendations concerning group taxation. The report presented in December 1995 acknowledged that a closely held group of companies could be formed into an economic unit but ignoring this for tax purposes could result in “economic and business distortions”. The Commission concluded by recommending a gradual approach to group taxation.

In 2001 the Second Revenue Laws Amendment Act No 60 of 2001 introduced Corporate Rules which, as explained in chapter one, provided some relief in the restructuring groups, but merely as “piece-meal” reforms.

The most recent committee appointed was the Davis Tax Committee (2018:8) which agreed that group taxation was to be implemented but stated that current economic conditions were not yet conducive to group taxation.

## **2.5 SUMMARY AND CONCLUSION**

In this chapter the history of tax in South Africa was discussed. Since the introduction of the first Income Tax Act of 1914 it has undergone various amendments, with a major overhaul occurring in 1940/1. This overhaul was initiated by Hofmeyr, under the leadership of Smuts as Prime Minister. The concept of a shareholder and the company forming one economic unit was applied in various provisions in the Income Tax Act, but the implementation of a group tax regime was only officially considered for the first time by the Margo Commission in 1986/7. The Katz

Commission in 1995 and the more recent Davis Tax Committee in 2018 also considered a group tax regime. The Katz Commission did recommend a gradual approach to group taxation with the latest Committee agreeing to the possible advantages of group taxation but expressing doubt whether the current economic conditions will be suitable for such new regime.

The historic provisions in the Income Tax Acts relating to taxpayers potentially forming a group, agrees to the description provided by Correia (2013) as being “piece meal” provisions to prevent tax evasion. Super Tax was amended in 1925 for example, to include private companies with the view that shareholders in a private company can avoid Super Tax by “capturing wealth in a private company” (Hattingh, 2016a:92). In 1932 Super Tax was again amended as to “introduce anti-avoidance measures aimed at treating groups of closely held companies as one unit for purposes of assessing Super Tax” (Hattingh, 2016a:94). In an amendment to the definition of a private company as contained in the Income Tax Act of 1932, the aim was explained as limiting tax-avoidance. The motivation behind this amendment was to prevent a shareholder/s of a private company from altering the status of the company between private and public in order to avoid tax. But even with the realisation that one economic unit can be formed between separate legal taxpayers, in the Memorandum (Union of South Africa, 1941a), the separate legal identity of the company was still protected with a statement made that regardless of the definition, the company will retain its legal personality.

In chapter three the origin of this legal personality of a company will be explored as well as the reason why the legal personality is a doctrine that is difficult to reverse.

## **CHAPTER 3: THE HISTORY OF THE DEVELOPMENT OF THE COMPANY AS A TRADING BODY AND THE DEVELOPMENT OF COMPANY LAW**

### **3.1 INTRODUCTION**

The rational study of law is still to a large extent the study of history. History must be a part of the study, because without it we cannot know the precise scope of rules which it is our business to know. It is a part of the rational study, because it is the first step toward an enlightened scepticism, that is, toward a deliberate reconsideration of the worth of those rules (Holmes, 1897:469).

In chapter two the discussion of the history of tax in South Africa focused on the history of company tax pertaining to the tax imposed on companies or perceived corporate group structures. After the first Tax Act was introduced by Smuts in 1914, there were numerous amendments and tax reforms as new political parties were appointed to government. What is considered one of the most important reforms was administered by Hofmeyr in 1941 with the need for funds due to World War II. This reform concluded with the re-writing of the Tax Act. The resulting Income Tax Act of 1941, according to Hattingh, (2016a:100), has formed the bedrock of South African Tax legislation until today.

The reviews by Commissions and Committees on the possibility of implementing a group tax regime were discussed and it was found that they mostly recommended it, but due to specific reservations it has not been implemented, the Margo Commission considering it would give rise to a possible loss for the *fiscus* and the recent review by the Davis Tax Committee, found the country's current economic and political state not yet ready to introduce such a regime.

The goal of chapter three is to provide a history of the origin of the juristic personality of a company by means of an examination of the history of trading and the development of the trading-regulated bodies into what today is known as companies. The development of the legal framework governing the companies so formed, namely company law, will likewise be discussed to gain an understanding of the origins of the legal persona of a company.

Williston (1888:105-106) finds it anomalous “that different kinds of corporations are treated without distinction, and, with few exceptions, as if the same rules were applicable to all alike”. He

advises that, in order to understand a company and company law, the origin and development of business corporations must be investigated:

To understand how it was that the law of business corporations was so connected with that of other corporations, and how it gradually became distinguished, it is necessary to understand how such corporations grew up, and in what way they were regarded when first they came into existence.

Holmes (1897:469) explains that the rational study of the law must include the study of history in order to comprehend the scope of the rules. Holmes aptly compares old law to a dragon in a cave that possess great strength:

When you get the dragon out of his cave on to the plain and in the daylight, you can count his teeth and claws, and see just what is his strength. But to get him out is only the first step. The next is either to kill him, or to tame him and make him a useful animal.

Holmes continues explaining that law developed based on principles that are not applicable anymore, is “revolting”:

It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past.

This analogy of old law being comparable with a dragon is appropriate for the argument put forward in this thesis. The law and jurisprudence that adheres to the dogma of the legal personality of a company, coupled with the limited liability of shareholders, is based on archaic economic and social conditions. In this thesis it will be explained that owing to the established legal position it is difficult to consider any alternative that would be applicable to the company and its shareholders.

Specific attention will be given to English company law due to it having a significant influence on company law “in the world”, as Suzman claims (1949: iv):

The lead in such reforms comes naturally from the United Kingdom which, beginning with the Companies Clause Act of 1862, settled the main lines of company legislation in the world.

Researching the development of company law in England is for all practical purposes, to research South African company law as Justice H.C. Nel (2001:47) indicates: “The history of the companies

act [Act] of the United Kingdom is therefore largely also the history of the South African Companies Act”.

### 3.2 THE LEGAL PERSONIFICATION OF A COMPANY

A Corporation or Incorporation is a Body framed by Policy or Fiction of Law, and it's therefore called a Body Politick; and it's called an Incorporation or Body Incorporated... (Anon, 1702:1).

Blumberg (1993:4) explains that contemporary company law contains underlying principles attributed to corporates by jurists such as Sir William Blackstone and Stewart Kyd in the late eighteenth century who, according to Blumberg, described the corporation; “as a legal unit with its own legal rights and responsibilities, distinct from those of the individuals who constituted its members or shareholders from time to time”.

The personification of a corporate can be dated back to the early seventeenth century with Sir Edward Coke's (1612, quoted in Blumberg, 1993:4) description of the corporation as “invisible, immortal, and rest[ing] only in intendment and consideration of the law”. Blackstone in response introduced the characterisation of a corporate as an “artificial person”, but Kyd, according to Blumberg (1993:256), cautions against this use of such metaphysical references warning that such metaphysical terms were “bewildering and apt to mislead”. In 1809 the influence of England on this personification of a company was acknowledged in the case of the *Bank of the United States v Deveaux*, 9 U.S (5 Cranch) 61 (1809) in which Marshall CJ, held at [9] that:

As our ideas of a corporation, its privileges, and its disabilities, are derived entirely from the English books, we resort to them for aid in ascertaining its character. It is defined as a mere creature of the law, invisible, intangible, and incorporeal. Yet when we examine the subject further, we find that corporations have been included within terms of description appropriated to real persons.

In 1956 an example of a “metaphysical personification” of a company, against which Kyd cautioned was applied in South Africa. In *CIR v Richmond Estates (Pty) Ltd* 1956 (1) SA 602 (A), 20 SATC 355 Centlivres CJ held; “A company is an artificial person with no body to kick and no

soul to damn and the only way to ascertaining its intention is to find out what its directors acting as such intended”.

Clarity on the terminology used in the remainder of the chapter is essential. In the literature reviewed the word “guild” is spelled by some authors as “gild”. The meaning of “guild” is given as “a medieval association of craftsmen or merchants, often having considerable power” (Oxford Living Dictionary, 2018: Online). The word “gild” used as a noun, is the “archaic spelling of guild” (Oxford Living Dictionary, 2018: Online). For purposes of this thesis, the format of the word used by the author in the specific reference will be used in this thesis.

Clarity is also important for the use of the word “company”. Ireland (1996:42) explains that in the eighteenth and nineteenth centuries “an association of a particular *economic* type [emphasis in original]” would be called a joint-stock company or just company, whereas “‘company’ is usually used as a diminution of ‘incorporated company’, denoting an enterprise of a particular *legal* status [emphasis in original]”. In this thesis the abridged “company” will be used. References to joint-stock company are in accordance with the sources.

### **3.3 FROM GILDS/GUILDS TO AN INCORPORATED COMPANY**

#### **3.3.1 Overview**

In a study by Williams (1985:438) on the derivation of American municipality corporation law from English corporation law, she explains that legal history includes various historical periods as well as various current policies being followed, meaning that no one single event determined the outcome of such a study:

Many historical events, as do many current events, result from a complex interaction of influences and counterinfluences, such that the end results may look more like chemistry among conflicting “causes” than simply but/for causation [emphasis in original].

In this thesis, the research done on the development of a company as a legal entity reveals that there were events, especially between the middle-ages and the early 1800s, which influenced the design and subsequent development of company law, and which are addressed in this thesis.

Blumberg (1993:1) writes that company law derived its roots from Roman law and by the fifteenth century the concept of a corporation already had a legal nature. According to Williston (1888:106), Blackstone credits Noma Pompilius with having originated the idea that a corporation is “a fictitious person, distinct from the actual persons who compose it”; and the opinion of Angell and Ames was that the Romans borrowed the concept from the Greeks. It is, however, in the treatise of Savigny that Williston considers the “best connected account of corporations in the Roman law” is found:

But once established definitely for dependent towns, the institution of the legal person was extended little by little to cases for which one would hardly have thought of introducing it. Thus, it was applied to the old brother-hoods of priests and of artisans; then, by way of abstraction, to the State, which, under the name of *fiscus*, was treated as a person and placed within the jurisdiction of the court. Finally, to subjects of a purely ideal nature, such as gods and temples.

Williston (1888:107) describes how, with the introduction of Christianity, the church applied the doctrines of the corporations to the organisation of the church whereby these doctrines subsequently influenced the laws of England. De Klerk (1977:258) points to the influence of the church which required all public officials had to be baptised members of the Church of England after the passing of the 1661 Test and Corporation Acts. Pollock’s view (1911, in Baars, 2012:48) of the involvement of the church in company law agrees with Williston and De Klerk:

...the idea of the Church as the mystical body of Christ has had an important influence on the growth of the law of corporations; it did much towards fashioning for us the anthropomorphic picture of the many members in one body.

According to Baars (2012:48), as the church evolved the “idea of the *personae fictae* had become accepted in canon law, it started to be applied to the common law bodies such as the boroughs and guilds”. These guilds, considered by Williston (1888:107-108) to be the earliest form of corporate association in England, will be reviewed in the next section as the starting point of understanding the development of the company and company law to what it is today.

### 3.3.2 Gild/Guild to Regulated Company

Writing on the Gild Merchant, Gross (1890:1-2) points to the “gloom enveloping the origin of the law of corporations”, and the need to understand the history of guilds which start with the Norman Conquest (and which was the source of the expansion of trade and industry in England). Gross (1890:8) explains that the establishment of the Gild Merchant originated with the need to protect trade and industry within a borough; the Gild Merchant received a charter that included, for example, the following clause:

We grant a Gild Merchant with a hanse and other customs belonging to the Gild, so that [or ‘and that’] no one who is not of the Gild may merchandise in the said town, except with the consent of the burgesses.

The meaning of the granting of a charter is explained by Cawston and Keane (1896:1-2) as follows:

A Charter, so named from the material on which it is drafted (Lat. *charta*, paper), may be defined as a written instrument by which the State confers certain privileges on corporate bodies, either to protect them in the exercise of their lawful avocations at home, or else to encourage and sustain them in their more hazardous ventures abroad.

The purpose of a charter was, as explained by them, to provide specific privileges to guilds and municipalities:

Charters were first granted to municipalities and guilds of all sorts whose operations were necessarily limited to localities within the State. Such documents were needed to protect the trades and industries of the country in times of almost chronic civil commotion, feudal oppression, and general lawlessness. Under such conditions these concessions were soon found – especially in England – to be as mutually advantageous to the Crown as to the privileged corporations.

Gross (1890:5-6) surmises that one of the earliest references to Gild Merchant was “a charter granted by Robert Fitz-Hamon to the burgesses of Burford (1087-1107)”. In later years under the reign of Henry I (1100-1135)<sup>2</sup> the Gild Merchant appears more often in municipal charters and

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<sup>2</sup> The period of reigns listed in the thesis was obtained from the official web site of the British Royal Family. (Online) available: <https://www.royal.uk/kings-and-queens-1066> [Accessed 16 February 2019].

increasingly so under Henry II (1154-1189) and Richard I (1189-1199). The “technical and metaphorical notion” of the incorporation of a municipality was well known in 1272–1307 during the reign of Edward I (Gross, 1890:95).

Boardman-Weston (2012:8) describe the charter given by Henry III (1216-1272) in 1231 to the University of Cambridge as a right of *ius non trahi extra* (the “right not to be carried away”). The King, according to Boardman-Weston, provided the “‘corporation’ beneath him the ability to formulate and codify their own ‘laws’, to discipline their members and to protect such organisations from outside interference”. Williams (1985:381) explains that “English law came to view the charter grants as grants of corporate status”.

Gross (1890:99) believes the formation of incorporation was influenced by guilds due to some of their characteristics corresponding to those found in guilds:

Their compact organization, the completeness of their unity, might easily suggest a resemblance to a personal entity. Hence formal incorporation of burghal institutions may have begun, as some writers assert, with the guilds; at all events, guilds occur among the earliest examples of express incorporation. Moreover, some towns were governed by social-religious guilds, which seems to correspond to the later technical corporation, though not identical with the latter.

Williston (1888:107-109) lists three kinds of guilds which he considers the earliest corporate associations in England. The first is the peace-guild whose members “pledged to stand by each other for mutual protection”. Secondly municipal corporations developed “on account of proximity of residence”, and lastly craft-guilds developed “on account of similarity of occupation”. The first craft-guilds, Williston explains, provided the kind of trades that supplied the community with such necessities as the weavers. Having been given freedom under Henry I (1100-1135) the weavers received their first charter during the reign of Henry II (1154-1189). Other charters followed, being the goldsmiths in 1327, haberdashers in 1407, and merchant tailors in 1466. Municipal organisations and guilds had similar powers and “guildated” and “incorporated” were synonymous terms as late as the reign of Henry VI (1422-1461; 1470-1471).

The “growth of the commercial spirit” during the sixteenth century triggered the establishment of foreign trading companies known as regulated companies, according to Williston (1888:109). Two

such regulated companies were the Russia Company and Turkey Company. Considering the similarities between a regulated company and a guild, Cawston and Keane (1896:10-12) believe that the regulated company was a conversion of the guild with the purpose of supporting the much larger undertaking of foreign trade; “In fact, they may be regarded as growing out of the trade guilds, modified to meet the requirements of their more enlarged sphere of action”. Comparing the guild to the regulated company they explain that regulated companies were developed for traders who paid for membership to trade in foreign countries under the protection of the Crown. Membership of the guild was secured with the payment of a fee, and members had the right to trade in a specific district within Britain. Members carried the risk of liability similar to that of the members of a regulated company, so that “each member retained his personal independence, and mainly acted on his own account - ‘trade on his own bottom’, as was the phrase...”.

According to Harris (2000: 32-33) membership fees received by a regulated company were utilised to provide members with access to factories and embassies in the foreign countries in which they traded. The infrastructure improved the trading conditions for members and increased profits. Damage or loss to this infrastructure was for the account of the members. With the business of the members being “regulated and disciplined” by the company, Harris recognises that the regulated company had some resemblance to a guild except that the regulated company was more profit-driven than was a guild.

Cawston and Keane (1896:11-12) point out that the rules behind membership in a regulated company were sometimes perceived as overly rigid, and this resulted in the need for other forms of association. For example, the transfer of a membership was allowed only after approval by the whole association, and the same applied to apprenticeship; furthermore, all members of a regulated company were deemed to be responsible for portions of debt incurred by the company. By the end of the eighteenth century nearly all the regulated companies had ceased to exist but not “without leaving a deep mark on the commercial and national records of England”. Harris (2000:33) shares this view arguing: “Wars, foreign competitors, changes in market conditions, interlopers, and the rise of the joint-stock corporations, notably the East India Company, all led to the decline of the regulated company”.

### 3.3.3 The Regulated Company and the Joint-Stock Company

The joint-stock company form, as explained by Harris (2000:24), started appearing around 1553 but “it took another century or so for it to crystalize and become widespread”. During this period the joint-stock company and the regulated company emerged simultaneously with the joint-stock company, which was useful for long-distance trading; the regulated company was used for short-distance trading (Harris, 2000:43):

Though they emerged simultaneously, the two forms diffused into distinct fields of operation. The short-distance trade to nearby Western European ports was organized in regulated companies.

Harris (2000:39-45) divides the period before “the Pre-1720 Business Corporation” into three periods: 1550-1620; 1620-1680; and 1680-1720. Between 1550-1620 the legal framework of the “medieval semipublic corporation” combined “with the more capitalistic-mercantilist aims of contemporary merchants”, and corporations were either regulated or joint-stock; “The corporation was usually regulated, in some instances traded in joint stock, but had no permanent stock”. Harris lists some of the first joint-stock companies: the Russia Company was chartered in 1555 and the Levant Company was formed in 1581. He does not believe that the invention of the joint-stock company was immediately regarded as the better form of corporation. For example, the Levant Company (Turkey Company) was incorporated as a regulated company in 1592 after being a joint-stock company. The Russia Company, according to Harris, was reorganised as a regulated company after its joint-stock form was found not to be suitable for resolving the financial difficulties it was experiencing. Harris considers that the “permanent joint-stock turned out to be problematic and undesirable feature for the early business corporations”.

Harris (2000:51-53), referring to the decline in new corporations, adds that the transformation of corporations from regulated or joint-stock company continued. Some regulated companies “turned into open regulated and eventually into government or ceremonial entities”. The forming and subsequent development of business forms was gradual, and only after the Glorious Revolution, “new beginnings could be seen”. Harris’s view (2000:59) is shared in this thesis, in that corporate structures did not develop much beyond traditional theories; “it took well into the nineteenth

century for the legal framework, economic theory, and collective memory to partly escape this past mercantilist burden”.

To understand the role of the Glorious Revolution in company structure and legislation, one needs to understand the power shift that occurred between the Crown and Parliament. De Klerk (1977:262-264) describes the Glorious Revolution’s responsibility for overthrowing James II, who was replaced by his Protestant daughter Mary II and her husband William III, as having brought about the dominance of Parliament over the Crown.

After the Glorious Revolution incorporation was by an “act [Act] of Parliament, or a charter coupled with an act [Act]”, and the number of incorporations by charter decreased (Harris, 2000:53). Between 1688 to around 1720 the use of corporations of any sort increased but based on traditional legal and economic theory (Harris, 2000:59):

The new enterprises that were being formed in growing numbers, and in a variety of sectors, in the period 1688–1720 utilized an institution that had been shaped several generations earlier in a different and by now forever lost context.

Williston (1888:111-113) claims that in the early eighteenth century, around two hundred companies were formed and by 1720 the minimum number of these companies were incorporated. With the need for canals and water-works increasing, the importance of companies increased, but it was with the introduction of gas-lightning and railways that, similar to Harrison, he considers that the development of business corporations was gradual and was based on historical institutions:

The outline sketch just given of the growth of business corporations shows that they are not a spontaneous product, but are rather the result of a gradual development of earlier institutions, running back farther than can be traced.

Oosthuizen (2017:30-32) describes the period 1750-1862 as “the rise of classic liberalism and the *laissez-faire* economic ideology”. He explains that, with the first stage of the Industrial Revolution Oosthuizen in the textiles and iron sectors, the firms growing due to the revolutionised technology, were in the “form of family firms and partnerships”. The railway companies demanded more capital investment and registered as joint-stock companies. In the second phase of the Industrial Revolution, the public railway in Britain grew to carrying around 322 million passengers annually

by 1870. Oosthuizen considers that the “Chartered joint stock companies were designed to facilitate cooperation between outside passive investors and the insiders”.

This section on the development of the regulated company and joint-stock company concludes with the following summary by Williston (1888:113). This analysis is apt as an introduction to the next section which discusses the introduction of company law and the reasoning behind limited liability:

It would be strange if signs of this development were not found in the history of the law relating to them. The natural expectation would be, and such is in fact the case, that as to the points which modern business corporations have in common with the early guilds and municipalities, the law relating to them dates back farther than almost any other branch of the law, while as to the points which belong exclusively to the conception of the business corporation, the law has been formed very largely since 1800. And not only had a body of new law to be thus formed, but old doctrines laid down by early judges as true of all corporations, though in reality suited only to the kinds of corporations then existing, had to be discarded or adapted to changed conditions.

### **3.4 THE INTRODUCTION OF COMPANY LAW AND LIMITED LIABILITY**

The nature of the shareholder of a company during the period when company law and limited liability was first introduced is explained in this thesis to have changed in such a manner that the law based on the historical nature of a shareholder is no longer applicable. In this discussion of the development of company law, therefore, specific attention will be given to the nature of the shareholder at this time as well as the intention of the legislator in relation to limited liability.

#### **3.4.1 The nature of the shareholder in the eighteenth century**

The capital of the joint-stock company’s being divided into shares was a financial invention and not a legal one (Harris, 2000:117), and was a financial device that brought together the “savers and entrepreneurs”. Harris (2000:124) explains that the trading of these stocks was done in a primary market and a secondary market and offered to natural persons:

The inner circle of the primary market comprised a small group of entrepreneurs with personal associations and common business interests who were the initiators of a joint-stock corporation and who would offer shares in their proposed undertaking to a second circle of friends and relatives. If this was not sufficient, they would market their promotion to outsiders, by printing and distributing a prospectus, appointing agents and bankers outside their immediate vicinity, putting advertisements in local or other newspapers, and arranging for meetings in coffee houses or pubs. Public offerings could be made during this period without prior approval of the Stock Exchange and outside its realm.

The need for capital increased the total of rentier investors which, according to Ireland (2008:842), led to a “developed market in JSC shares” and causing the JSC share to be “judicially redefined”. This redefinition re-characterised shareholders as well. Ireland explains that the shares had “previously been deemed an equitable interest in the assets of a company”. Now a share “was legally reconceptualised as a right to profit”. This process influenced the character of the shareholder who was now being considered passive and not active:

No longer were they legally conceptualised as industrial capitalists, as active, asset-owning partners; they were, rather, conceptualised as passive, money-providing ‘investors’, as money capitalists, owners of income rights external to ‘the company’ and the process of production.

Harris (2000:196-197) points out that the joint-stock company became a preferable form of business not only for entrepreneurs but for individuals who were employees or officers of the company. The larger group of shareholders are considered by Harris as “competitors, adversaries, and consumers” and are to be found everywhere:

Shareholders were found in a wide variety of social classes and groups, from peers and gentlemen, through high financiers, merchants, and lawyers, manufacturers and inventors, mariners and tradesmen, widows and minors, down to the miners of the cost book partnerships and the poor of Birmingham who owned the Union Flour Company. Quite a few of the above were more than passive investors, and at one point or another held offices in the companies in which they owned shares. Thus, individuals all over England, from all classes, acquired first-hand experience as owners and managers of joint-stock undertakings.

Harris (2000:127) acknowledges that shares were not the only form of finance and that both short-term and long-term borrowings from “banks, merchants and kin were common”. The use of shares

for financing did increase during the 1800s, rendering the joint-stock company an attractive form of business and increasing the “number of petitions for incorporation in which the stated need to raise huge sums of money served as both motivation and justification for incorporation”.

### **3.4.2 The Joint-Stock Companies Act**

The traditional forms of business organisation, by the 1800s, were, according to Turner (2017:15-17): partnerships; unincorporated businesses; and businesses incorporated either by Royal Charter or by a private Act of Parliament. He explains that unincorporated businesses could be undermined by the arbitrary nature of their legal status arising from the uncertainty of their knowing whether they could be judged in fact to be either legal or illegal. Expanding on the reason for reform, Harris (2000:216) explains that the growth of the economy in England required traditional forms of business organisations to adjust to financial, technological, and managerial advances. Businesses “with an element of joint stock, had spread considerably. They were now found in the canal sector, in insurance, in water supply, dock building, and other utilities, and had begun to appear in manufacturing”. Harris adds that; “The legal and economic advantages of the business corporation over the partnership and the unincorporated joint-stock company become clearer than ever.”

The joint-stock companies not only increased in number, but also in “weight in the whole English economy” (Harris, 2000:194). Harris calculated that 13.9% of “Great Britain’s net reproducible fixed stock in 1810” (2000:196) comprised of the capital of the joint-stock companies, increasing to 24.5% in 1840. Harris (2000:223) explains that: “One by one, new sectors were conquered by the joint-stock business company, which became a more familiar and integral component of England’s economic success and identified with it”. The joint-stock company, being a “new creature”, its legal status had to be examined by the State (Harris, 2000:223). The “dominantly conservative judiciary” did not consider the joint-stock company in a favourable light but the “split between the economic reality and the legal framework reached a critical point”, which according to Harris (2000:250) forced Parliament in 1824-1825 to address this concern for the first time. But it was only in 1844 that Parliament addressed the “common-law limitation on the formation of joint-stock companies” (Harris 2000:268).

The Joint Stock Companies Act of 1844 was enacted on recommendations made by the Gladstone Committee (Oosthuizen, 2017:54-55). Gladstone was appointed vice-president of the Board of Trade in 1843 despite his being a Protectionist and reluctant to join the Board (Harris, 2000:280-281). By the time he took over the Select Committee on joint-stock companies Gladstone “had developed a fascination with the details of administration and a growing interest in economic policy”. On 15 March 1844 the first and final report was submitted to Parliament containing twenty-three resolutions, the first of which typifies the general spirit of the report:

That in order to prevent the establishment of fraudulent companies, and to protect the interests of the shareholders and of the public, it is expedient that all joint stock companies (other than banking companies) for commercial purposes, whether future or already formed, be registered in an office to be appointed for that purpose (Parliamentary Papers 1844, quoted in Harris, 2000:281).

During a debate in the House of Commons in 1844 (Hansard HC Debate, 1844<sup>3</sup>) on the Joint-Stock Companies Registration and Regulation Bill, Sir William Clay expressed the view that “if there was anything on which the public mind was made up, it was on the necessity of some changes in the mode of forming Joint-Stock Companies”. Gladstone expanded on this argument by explaining that the people must have the power to pursue commercial pursuits without interference:

Joint Stock Companies at present could not be formed with any privilege such as that of suing and being sued, except by coming to Her Majesty in Council, or by applying to Parliament. What was one of the main principles of this Bill? That under it they could be formed entirely irrespective of the Board of Trade, and they would be subject to that department only as to certain forms of construction and regulation. Under this Bill, there would be a power, for the first time, for persons to associate themselves in companies, for the purpose of commercial pursuits, without the fear of interference from any human being whatever.

The legislative reform recommendations suggested by Gladstone were received without much debate. The Joint Stock Companies Act of 1844 provided for the registration, incorporation, and regulation of joint-stock companies. A second Act also brought about by Gladstone was the Joint Stock Companies Winding-Up Act of 1844. The lack of debates on these Bills is not surprising

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<sup>3</sup> vol. 76, cc 273-83

due to the tactics Gladstone applied. With the aim of minimising opposition, he removed the matter of limited liability in the Act. A second advantage for Gladstone was that the concept of registration was not unfamiliar or untested (Harris, 2000:281-283). The Registration Act of 1786, according to Harris (2000:275), was the starting point of the “historic evolution of the concept” of registration; the Act established the procedure of “recording information about shareholders and the transferring of shares in each ship under English flag”.

It was only in 1855 that limited liability was addressed, which will be discussed in the next section.

### **3.4.3 Limited Liability**

The advantages of limited liability, according to Harris (2000:130-131), are understood by explaining the danger of doing business in the eighteenth and early nineteenth centuries without limited liability. A creditor could for example have a debtor arrested for a debt as small as £10, before trial, and without evidence; with approximately 10 000 individuals imprisoned annually the protection of shareholders was becoming a pressing concern. By 1825 a clause providing limitation of debt to shareholders was commonly included in the incorporation statute when an incorporation was granted by Parliament. This clause limited the shareholder to the amount contributed and “only if further calls were authorised”. With the importance of limited liability increasing, entrepreneurs motivated in Parliament for a recognition that “limited liability was essential for the success of their undertaking”.

In a House of Lords debate on the Limited Liability Bill, Lord Stanley of Alderley point out to the urgent need for limited liability (Hansard HL Debate, 1855c<sup>4</sup>):

To show that the general feeling of the public was in favour of the Bill, he might mention that when a deputation of Gentlemen did him the honour a short time since to wait upon him and express a wish to have the measure postponed, he asked them how, if the Bill were so mischievous, the almost universal opinion of the country, as indicated by the public Press, was in its favour; and they candidly admitted that, with the exception of the Leeds Mercury, there was no journal in the kingdom which would admit an article against the principle of limited

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<sup>4</sup> vol. 139, cc 1895 - 1918

liability. To show the peculiar urgency of this measure, he need only to state the principle of the existing law: — the principle was, that whoever shared in the profits should bear also the risk of all the losses.

Not all shared the view, however, that limited liability was necessary. During a Commons Sitting (Hansard HC Debates, 1855a<sup>5</sup>) Mr. Muntz described the Bill as “one of the most objectionable Bills he had ever seen”, unnecessary and of no use to society:

Besides, the very object of the Bill—that of affording additional facilities for obtaining capital to be employed in trade—was a necessity that did not exist; for there was an ample supply of capital for all legitimate purposes of trade.

....

He objected to the Bill, because it was not founded on a sound principle, and because he believed that, instead of serving the working man and persons of small capital, it would mislead them, and would deceive society itself.

Mr. Cardwell in return explained that limited liability would enable persons of not great means to have the advantage of investing funds (Hansard HC Debates, 1855b<sup>6</sup>):

He had always understood that the object of those who were friendly to the Bill was to establish a new system and wed together labour and capital, in order; that persons of small income might have the power of combining their capital for the purpose of carrying on useful branches of trade. The Solicitor General, however, said that the Bill was only contemplated for undertakings of great magnitude. On the contrary, the object of the Bill was to enable small capitalists to aggregate themselves for all useful purposes.

A reading of the debates in both Houses shows no consideration of the effect the Limited Liability Bill would have in circumstances in which shares were not held by an individual but by a company. The discussion focused on protecting the individual investing in a company and not the company investing in a company leading to a corporate group structure.

On 14 August 1855 the Limited Liability Act was enacted, being repealed shortly afterwards, and re-enacted in 1856 as “An Act for the Incorporation and Regulation of Joint Stock Companies, and

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<sup>5</sup> vol. 139, cc 1378 - 1397

<sup>6</sup> vol. 139, cc 1445 - 1458

other Associations”. This Act allowed corporations to be incorporated as limited liability companies (Turner, 2017:19). Turner (2017:22) explains that the idea that the liberalisation of company law would accommodate larger enterprises in order to obtain capital for business purposes was found to be incorrect. Smaller companies used incorporation, not to obtain capital, “but to avoid the costs associated with untimely dissolution and facilitate the intergenerational inheritance of businesses”. Smaller companies can overcome the minimum shareholder requirement of seven, as provided for in this 1855 Act, by using “six nominal shareholders”. Turner concludes that the legality of such a ‘created’ company was addressed in the now famous case of *Salomon v Salomon & Co Ltd* [1897] AC 22 (*Salomon v Salomon*). This case “put the new company law to the test” (Baars, 2012:69) and quoting Hicks (2008), Baars expresses that the question faced by the court was to “interpret the law literally or whether to consider more its presumed spirit and intention”.

The details of this case are as follows: after years of carrying on a business on his own account, Mr. Salomon transferred his business to a joint stock company. His wife and five children each held one share and Salomon held six shares. As sole trader, he effectively sold his business to himself and six other members. Shortly thereafter the company experienced financial problems and Mr. Salomon sold the debentures held by him to a Mr. Broderip. The company could not resolve its financial difficulties and was liquidated. The debenture, providing the holder thereof first right to the assets of the company before other creditors, was in the case of Mr. Salomon’s company of no worth due to the company not having enough assets to honour the debentures presented by Mr. Broderip. Mr. Broderip sought Mr. Salomon personally to be held liable for the debt of the company by challenging the legitimacy of the company’s having the status of limited liability. After an unsatisfactory finding by Vaughan Williams J both parties appealed to the Court of Appeal. In the Chancery and Court of Appeal in *Broderip v Salomon* [1895] 2 Ch. 323, Kay LJ held that limited liability was not to be used as a scheme for legalising a company which was only pretending to carry on business and therefore Mr. Salomon must be held personally liable for the debt. Mr. Salomon appealed to the House of Lords who overturned the ruling of the Court of Appeal. Lord Halsbury [at 30-31] explained that the intent and meaning of the Act was to provide a legal existence to a company:

I will for the sake of argument assume the proposition that [1897] A.C. 22 the Court of Appeal lays down - that the formation of the company was a mere scheme to enable Aaron Salomon to carry on business in the name of the company. I am wholly unable to follow the proposition that this was contrary to the true intent and meaning of the Companies Act. I can only find the true intent and meaning of the Act from the Act itself; and the Act appears to me to give a company a legal existence with, as I have said, rights and liabilities of its own, whatever may have been the ideas or schemes of those who brought it into existence.

The influence of *Salomon v Salomon*<sup>7</sup> in South Africa was soon followed in *Dadoo Ltd & others v Krugersdorp Municipal Council* 1920 AD 530 (*Dadoo v Krugersdorp*). Innes J considered the juristic personality of the company to be separate from members and quoted from the *Salomon v Salomon*<sup>8</sup> case [at 550]:

A registered company is a legal persona distinct from the members who compose it. In the words of Lord Macnaghten (*Salomon v Salomon & Co.*, 1897 AC at p 51), "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".

Nearly sixty years later, in *Banco de Mozambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 (3) SA 330 (T), at [345] Goldstone J confirmed that the importance of the principle of a company as having a legal personality was "enshrined" by the Appellate Division in the *Dadoo v Krugersdorp*<sup>9</sup>:

In the present case no single reason has been advanced for creating a new category of case where corporate personality should be ignored. In *Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530 the Appellate Division enshrined the inviolability of corporate personality.

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<sup>7</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>8</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>9</sup> *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530

According to Daehnert (2007, in Boardman-Weston: 64) the principle of separation between the legal entity and shareholder determined in *Salomon v Salomon*<sup>10</sup> is a dogma to which the courts strictly adhere:

In Salomon, the House of Lords explicitly imposed the dogma of separation between legal entity and shareholder. It may also be remarked that this decision has cast a very long shadow on English company and group law. Indeed, Salomon is the starting point for each court when considering the question of whether the corporate veil should be lifted... The way courts do this is quite often described as “robust”, thus strictly upholding the Salomon principle.

The importance of the *Salomon v Solomon*<sup>11</sup> case is not only evident in the literature studies of this research but a reference to the number of times this case has been cited since 1901 indicates its importance. According to the South African Legal Information Institute (<http://www.saflii.org/>, 2019) this case was cited in approximately 647 court cases across the world. As recent as two years ago, in the Supreme Court of Appeal of South Africa, *City Capital SA Property Holdings Ltd v Chavonnes Badenhorst St Clair Cooper No and Others* (85/2017) [2017] ZASCA 177 (*City Capital v Chavonnes*), Schippers AJA held at [27] with reference to *Salomon vs Salomon*<sup>12</sup> that:

It is trite that a company is a legal entity distinct from its shareholders. It has rights and liabilities of its own, separate from those of its shareholders. Its property is its own and not that of its shareholders.

Concomitant to the legal personality of a company is that which has been metaphorically described as ‘piercing the corporate veil’. In *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others* 1995 (4) SA 790 Smalberger JA explained at [11-12] that this concept is referred to either as piercing or lifting the veil:

... to disregard the separate corporate personalities of LCI and GLI in order to give effect to the judgment in the original action for delivery of the Findon shares to the appellant (what is commonly referred to as "lifting" or "piercing" the corporate veil).

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<sup>10</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>11</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>12</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

Veil piercing was, according to Lord Neuberger [at 122] in *VTB Capital plc v Nutritek International Corp* [2013] UKSC 5, [2013] 2 AC 337 (*VTB Capital v Nutritek*), unsuccessfully attempted in the *Salomon v Salomon*<sup>13</sup> case:

There is great force in the argument that that case represented an early attempt to pierce the veil of incorporation, and it failed, pursuant to a unanimous decision of the House of Lords, not on the facts, but as a matter of principle. Thus, at 30-31, Lord Halsbury LC said that a “legally incorporated” company “must be treated like any other independent person with its rights and liabilities appropriate to itself . . . , whatever may have been the ideas or schemes of those who brought it into existence”. He added that it was “impossible to say at the same time that there is a company and there is not” [emphasis added].

It is proposed that the doctrine of the legal personality of a company has evolved into a matter of principle being reinforced by various attempts by courts when unsuccessfully seeking to pierce the corporate veil. This effectively complicates the paradigm shift needed to understand and accept that a corporate group is an economic and legal unit, with the courts consistently confirming the separate personality of a company.

### 3.5 SUMMARY AND CONCLUSION

In this chapter the origin and development of the corporate form as well as company law was discussed in the context of English law, due to the notion shared by academics that England laid the foundation for company law in the world. It argues that trading started in the guilds/guilds of boroughs where membership was limited to citizens of boroughs; these guilds were provided with legal identity through charters from the Crown. With the growth of the economy and the extension of trade into other countries, the need for an accommodating business vehicle led to the gradual development of the regulated company and the joint-stock company, both of which were either incorporated by charter or by an Act of Parliament. Later the industrial revolution required increased capital to fund new business ventures. The nature of the investor in companies transformed from active to passive. The development of business forms brought about the need to

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<sup>13</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

develop new laws to regulate companies so the Joint Stock Companies Act of 1844 was introduced. Shareholder investors would be protected against company debt by the introduction of the Limited Liability Act of 1855.

In the case of *Salomon v Salomon*<sup>14</sup> the new company law was put to the test according to Baars (2012:69), and this led to the form in which company law still provides the company with the protection of its separate legal personality.

It is inferred that the separate personality of a company that developed over time, and with the establishment of company law, has been retained in legal doctrine. Development of the business form into new complicated corporate structures did not alter this legal doctrine so set in the company law.

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<sup>14</sup>Salomon v Salomon & Co Ltd [1897] AC 22

## **CHAPTER 4: THE HISTORY OF COMPANY LEGISLATION IN SOUTH AFRICA**

### **4.1 INTRODUCTION**

Chapter three studied the development of the company and the introduction of company law in England through the history of the guilds followed by the development of the regulated company as well as the joint-stock company. During the Industrial Revolution, England experienced economic growth and the need for capital from rentier investors increased. The enactment of the Joint Stock Companies Act 1844 was integral to the structure of modern company law (Labuschagne, 2014:69). The Limited Liability Act of 1855 introduced the legal separation of shareholders and company, and with the ruling in *Salomon v Salomon*<sup>15</sup> the legal separation between the shareholder and the company become a doctrine to which courts still adhere today.

The legal personification of the company has a universal resonance as English company law “settled the main lines of company legislation in the world” (Suzman, 1949: iv) and as explained by Justice H.C. Nel in section 3.1, company law in South Africa as well.

Chapter four will focus on the specific factors that shaped company law in South Africa by reviewing the various external influences on legislation for the years prior to 1910 and the period after the establishment of the Union of South Africa.

### **4.2 WHY STUDY THE HISTORY OF LAW**

Burger (2002:6) describes the law as a tool that the state can utilise to achieve specific outcomes or to prevent mischief:

Law is the manifestation of an objective: it is the vehicle used by the state to regulate the behaviour of its subjects. It provides a means to achieve social, economic, cultural and political policies.

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<sup>15</sup>*Salomon v Salomon* [1879] AC 22

Considering that if law is the manifestation of the objective of social, economic, cultural, and political policies then an understanding of those conditions prevalent in the period in which the law was drafted, assists not only in the interpretation of the law but also in considering whether current conditions are similar enough for the objective of the law still to be functional.

Reviewing the origin of law in South Africa is not a simple task in view of South Africa's having a rich history of influences on its legal system manifesting in a multi-layered legal system, according to Lenel (2002:7):

1. Tribal law and Islamic [Islamic] law (sharia).
2. Statute law.
3. English law.
4. Roman-Dutch law as common law.
5. Roman law (Corpus Juris Civilis)

An example of the various systems that have influenced South African courts is illustrated in a case decided in the Supreme Court of the Cape of Good Hope in 1876. In *Beatty vs Donnelly* (1876) 6 Buch 51, the plaintiff sued the defendant for damages sustained after the defendant's monkey bit the plaintiff. After the Magistrate "gave judgment of absolution from the instance" the plaintiff appealed. De Villiers, CJ [at 52] referred to three different law systems in his judgment: the law of England; Roman-Dutch law; and Roman law:

There is no doubt that by the law of England, where injuries are committed by domesticated animals, such as dogs, the knowledge by the owner of vicious propensity must be proved; but even by the English law I doubt whether this would be the case regarding animals like monkeys. Under the Roman-Dutch law I am not aware that in the case of direct injury done by any animal any such knowledge on the part of the owner is required. The Roman law referred only to quadrupeds, though I suppose it would extend also to monkeys, which belong to the category *ferae naturae*. The Magistrate ought not to have given absolution on this ground, and the case must be remitted back for hearing on the merits.

The historical perspective is important for clarity regarding the context of company law. According to Baars (2012:40) the sixth edition (1997) of Gower's and Davies's *Principles of Modern*

*Company Law*<sup>16</sup> spends two chapters<sup>17</sup> in the introductory section on the history of the concept of a company. Davies (2003, quoted in Baars 2012:40) explains the need for an historical review as follows:

...this book is concerned with modern company law, but there are some branches of modern English Law which cannot be properly understood without reference to their historical background, and company law is one of them; indeed, of all branches of law it is perhaps the one least readily understood except in relation to its historical development, a somewhat extended account of which is therefore essential.

### **4.3 A BRIEF VIEW OF THE HISTORY OF LEGISLATION IN SOUTH AFRICA**

The establishment of the trade route between Western Europe and the East and the subsequent colonisation of the Cape of Good Hope led to the introduction of various systems of law into South Africa, resulting in the current combination of Roman-Dutch law, English law, and African law (Lenel, 2002; Du Plessis, 2017). The arrival of Jan van Riebeeck led to the introduction in the Cape of a legal system originating in Holland known as *Roomsche-Hollandsche Reg* (Schreiner, 1967:5), which, as explained by Du Plessis (2017: 24), is an amalgamation of medieval Dutch law of mainly Germanic origins and the Roman law of Justinian.

The English practice in terms of a current rule in English law, as explained by Du Plessis (2017:31), was that colonised territories would retain the law that was in place at the time of conquest. Roman-Dutch law consequently remained. The introduction of English law in the early 1800s with the British occupation of the Cape, was not immediate but, according to Schreiner (1967:6-11), progressed “by degrees of certain portions”. He explains that the appointment of judges from Britain was one way of introducing English law; furthermore, South African

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<sup>16</sup> Textbook for teaching law in various parts of the world (Baars, 2012:40).

<sup>17</sup> Later editions of the textbook exclude the historical review which is unfortunate since the approach taken in this thesis is that an understanding of the economic, social, and political conditions during the development of legislation assists in understanding the intention of the legislator when drafting the law. This will assist in evaluating the effectiveness of the legislation in current conditions.

advocates recruited for the Bench were required to be members of the English Bar. Some of the English laws were directly imported, as for example the Law of Evidence, whereas the Law of Procedure was modified before being introduced in South Africa. In the case of company law, it was directly copied from English law by the South African legislature. Schreiner proposes that the application of English case law in deciding cases heard in courts was indicative of the infiltration of English law and brought about the principle of binding precedent:

But of far greater importance than legislative copying has been the use made of English case law and legal writings by South African judges in deciding cases where the South African law had not already been settled by authoritative decision.

Du Plessis (2017:36) has a similar argument that the legal certainty to which English law aspired was introduced into the “flexible Roman-Dutch” law not by “the enactment of legislation but by the judges of the Supreme Court who were trained in English law”.

The importance of case law can be traced back to the training of lawyers in England that was since the thirteenth century, done by case law (Van Niekerk, 2013:107). When England colonised the Cape of Good Hope, law reports, an established part of English law, were adopted in South Africa. According to Van Niekerk (2013:116-117), Buchanan’s Reports of Supreme Court cases, covering the period 1868 to 1878 and consisting of eight volumes, were, well into the early twentieth century, still considered to be “a reliable source of judicial decisions”. Judicial decisions play a pivotal role as a source of law in “any legal system that applies the doctrine of precedent” (Van Niekerk, 2013:145).

It is inferred that legal precedent is one of the factors influencing the difficulty in the paradigm shift of recognising the corporate group as an entity. In the context of this thesis, understanding the binding precedent principle is important and before continuing with the history of legislation in South Africa, more needs to be said on that.

### 4.3.1 Legal Precedent

According to Schreiner (1967:11), despite of the fact that the courts of Netherlands did respect prior decisions made by their courts, it was the English law treatment of *rationes decidendi* that had the greatest influence on the South African law.

To understand the meaning of *rationes decidendi*<sup>18</sup> historical legal writing will have to be consulted. In the Croke's Reports, dating back to around 1584, the explanation of *ratio decidendi* given is "very accurate and condensed" according to Burns (1893:1-2): "Wherefore, upon the first argument it was adjudged for the defendant, for they said that those things which have been so often adjudicated ought to rest in peace". Burns continues explaining that the origin of *stare decisis* is found in the Latin maxim: "*Stare decisis et non quieta movere*", which translated, means "To stand by precedent and not to disturb what is settled." Burns reasons that *stare decisis* "may be called the doctrine of precedent or of authority". He explains that for a court to follow a decision to avoid "confusion worse confused", prior milestone court decisions must be available to follow:

Of necessity there must be certain fixed land-marks approaching correctness, though not infallibly perfect; and courts should be guided by these even though a rigorous adherence to them might at times work individual hardship. These land-marks are, of course, prior decisions serving as precedents not lightly to be changed.

The prominence this doctrine of precedent still has in South Africa today, is confirmed by the endorsement of this principle as being a deep-rooted feature of the rule of law in *True Motives v Mahdi* (543/07) [2009] ZASCA (*True Motives v Mahdi*) as stated by Cameron JA [at100]:

The doctrine of precedent, which requires courts to follow the decisions of coordinated and higher courts in the judicial hierarchy, is an intrinsic feature of the rule of law, which is in turn foundational to our Constitution. Without precedent there would be no certainty, no predictability and no coherence. The courts would operate in a tangle of unknowable considerations, which all too soon would become vulnerable to whim and fancy. Law would not rule. The operation of precedent, and its proper implementation, are therefore vital constitutional questions.

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<sup>18</sup> Latin plural for *ratio decidendi*. (Merriam-Webster Dictionary, 2019: Online)

The impact of the doctrine of precedent on the application thereof on circumstances where a group of companies could be considered as being one entity by law, will be discussed in chapter five.

#### **4.3.2 The period 1652 – 1806**

The intention of the board of the Dutch East India Company (Vereenigde Oost-Indische Compagnie, or VOC), referred to as the Here XVII, in sending van Riebeeck to the Cape in 1652 was to provide a stopover for their fleet for fresh food and water supplied through barter transactions with the local people. This policy was not successful and by 1657 nine of the VOC employees and their families (who had arrived with Jan van Riebeeck) were permitted to move to specific allocated plots on which they could cultivate vegetables and tobacco to sell to the VOC (Fourie, 2012:15). Corporate activity during this period was limited due the VOC having a low tolerance for commercial activity with or by the local people (Oosthuizen, 2017 & Fourie, 2012). By 1702 the number of so-called Vryburgers (free citizens) increased from 14 to 1 368 (De Villiers, 2012:43-44). By 1795 when Britain occupied the Cape the area inhabited by Europeans covered approximately 110 000 square miles and the settler population had increased to around 50 000 (Fourie, 2012:17).

In 1803 the Batavian Republic occupied the Cape for a period of three years and by 1806 the Cape was again annexed by Britain. Only on 13 August 1814 did the Cape become a formal colony of Britain in terms of the Convention of London (Du Plessis, 2017:30). Harris (2016:3) confirms that the British retained the Dutch regime with their proclamation in 1795: “the Payment of any taxes or contribution which for the present must continue on the same footing as formerly...”.

The introduction of legal precedent into Roman-Dutch law, not by enactment, but by English-trained judges was not unexpected (Kotze (1917 in Du Plessis, 2017:37) :

When we come to the common law of England we note that one of its leading characteristics is the weight attached to judicial precedent. In no country is such great authority or respect shown for previous judicial decisions as in England ... This view is apparently based on the balance of convenience, it being considered that the unsettling of what has been once

established and acted on outweighs the advantage to be derived from the introduction of the correct rule.

An example of this can be found in the case of *De Villiers v Cape Divisional Council* (1875) 5 Buch 50. Chief Justice De Villiers's decision was that the approach to the interpretation of statutory law was to be in accordance with the rules of interpretation in English law. De Villiers C.J at [64] stated:

But in construing statutes made in this Colony after the cession to the British Crown, this Court should, in my opinion, be guided by the decisions of the English Courts, and not by the Roman Dutch authorities. It is, no doubt, quite true that the Proclamation of 6th August, 1813, is more like an edict of a Roman Emperor than a modern Act of Parliament, and that it bears evident traces of having been originally drawn by a Dutch lawyer in the Dutch language; but as it officially issued from an English Governor in the English language, it must be subject to the rules of construction laid down for English statutes by the decisions of English Courts of Law.

According to Botha (2016:92) text-based approaches to English law began to overtake the Roman-Dutch rules of the functional approach to statutory interpretation.

### **4.3.3 The period 1806 – 1910**

Lenel (2002:5) explains that during both the first and second British invasions of the Cape, Roman-Dutch law applied but, for example, cruel punishment was abolished in 1795. By 1823 the Colebrooke-Bigge commission had proposed that the existing legal system should be replaced with the English system which, according to Schreiner (1967:6-7), was “done designedly, as a policy measure, or casually in the ordinary course of the administration of justice...” as instanced by the requirement that practitioners on the bench or at the bar were also members of the English bar (Lenel: 2002, Schreiner, 1967).

During the 1830s and 1840s the Voortrekkers moved out of the Cape to the North and North East of the country, which would be referred to in time as the Great Trek (Visagie, 2012:117-119). By the end of 1838, Visagie continues, the Republic of Natalia was established, but by May 1844 it had become an official district of the Cape Colony and therefore fell under the rule of Britain. In

1852, with the signing of the Sand River Convention, Britain recognised the independence of the Voortrekkers north of the Vaal River, and this led to the establishment of the Zuid-Afrikaansche Republic (ZAR). Two years later, on 23 February 1854, with the signing of the Bloemfontein Convention, the Republic of the Orange Free State was formed. South Africa now consisted of two British colonies, Natal and the Cape, and two republics, the Republic of the Orange Free State and the Zuid-Afrikaansche Republic.

Under the direction of Lord Carnarvon, Britain's aspiration was to have the two Republics fall under British rule, and in 1877 the ZAR was annexed; but by 1884, except for Britain having a say in the policy of external relations, the ZAR was independent of Britain. After the Anglo-Boer war (1899-1902), in May 1902, the Treaty of Vereeniging was signed in Pretoria overthrowing the dependence of the two Republics (Pretorius, 2012:235-244).

#### **4.4 COMPANY LAW IN SOUTH AFRICA**

The influence of English law in South Africa via the application of indirect methods was not applicable to all branches of the law. Company law, except for some amendments to accommodate local conditions, was, however in principle copied from English Companies Acts (Schreiner, 1967:10). The next section will focus on the development of company law in South Africa. It will become apparent from this discussion that company law in South Africa was largely influenced by the English Company Law even into the twentieth century.

##### **4.4.1 Company Law before 1910**

Oosthuizen (2017:80-82) provides a detailed explanation of various Companies Acts based on English law that were adopted in South Africa. Company law was first promulgated in 1861 in the Cape Colony as the Joint Stock Companies Limited Liability Act No. 23 of 1861 (Companies Act 23 of 1861) based on the English Joint Stock Companies Act 1844 and the Limited Liability Act 1855. According to Cilliers (2000, quoted in Labuschagne, 2014:80) the Companies Act 23 of 1861 "was almost verbatim an adaptation" of the two Acts. The Companies Act of 1861 was

applied in formulating subsequent Companies Acts of the Natal Colony and the two Republics. This, according to Oosthuizen, initiated the “practice of extensive borrowing from English legislation”. In Natal the Joint Stock Companies Limited Law No. 10 of 1864 remained an important source of company law in Natal until 1926. In the ZAR the De Acte van Maatscappijen met Beperkte Verantwoordelijkheid No. 5 of 1874 was enacted and De Wet over Beperkte Verantwoordelijkheid van Naamloze Vennootschappen of 1891 was enacted in the Republic of the Orange Free State. After Unification in 1910 the Cape, Natal, and Orange Free State maintained the status quo, keeping to their own Companies Acts, until the Companies Act No. 46 of 1926 was enacted, which was based on the Transvaal Companies Act No. 31 of 1909 and which was, except for a few differences, based on the English Companies (Consolidation) Act 1908. The Companies Act No. 46 of 1926 was indirectly based on English company law with some slight differences, as for example, the South African Act “provided for a system of judicial management” which was contrary to the English Act.

#### **4.4.2 Company Law after 1910**

The influence of English company legislation in South Africa persisted with historic amendments to the Companies Act of South Africa being based on amendments to the English Companies Act. In the section below comprehensive amendments made to the South African Companies Acts and based on “earlier major English legislative changes” (Oosthuizen, 2017:82) will be discussed.

##### The Millin Commission – South Africa

The Millin Commission was appointed in 1947 to review the Report of the Cohen Committee on Company Law amendments, which had been published in the United Kingdom in 1945 (Suzman, 1949: IV). The aim of this Commission was to consider the need to study the new Consolidating Companies Act of 1948 (Companies Act of 1948) of the United Kingdom to determine whether English legislation amendments should be adopted in the Union. The Act was, except for selected amendments, based on recommendations made by the Cohen Committee.

### The Cohen Committee - Britain

The purpose of the Cohen Committee, chaired by Mr. Justice Cohen, was as explained by Sir Stafford Cripps (Hansard, HC debate, 1947<sup>19</sup>):

...to consider and report what major amendments are desirable in the Companies Act, 1929, and, in particular, to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest [emphasis in quote].

Attention will be given now to references made to corporate groups made during this House of Commons debate.

According to Sir Stafford the main reason to amend legislation was to clarify the “relationship between management and ownership” (Hansard, HC debate, 1947<sup>20</sup>):

Perhaps the main reason why amendment is now so urgently necessary is that the relationship between management and ownership in limited liability companies has tended progressively to be more and more shadowy. Even before the war, apprehension was expressed on this point, and remedies were then suggested, and, with the great growth in the size of companies, the old relationship, which really grew out of the idea of partnership, where individual owners were closely concerned themselves with the management, has largely disappeared in modern company structure. The growth of groups or chains of companies, which make the true economic entity rather than the company itself, where we get a whole complex of companies operating together—that factor has still further divorced management from ownership. This now well-developed tendency is, in fact, practically ignored by the company law as it exists today, and that is another reason why amendment is required [emphasis added].

A company group structure forming an economic unit is acknowledged, but only to the extent that it impacts on, for example, reporting to shareholders. Sir Stafford continuing, explains that for the shareholders to be made aware of the accounts of the company, clause 13 of the Bill proposes that:

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<sup>19</sup> vol. 438, cc 585 - 671

<sup>20</sup> vol. 438, cc 585 - 671

Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

The following remark from Mr. Bracken on the consolidation of group accounts by the holding company, was regrettably only aimed at enhancing disclosure for the benefit of shareholders (Hansard HC Debate, 1947<sup>21</sup>):

Legislation requiring consolidated accounts from holding companies is long overdue. Those responsible for the last Companies Act—and I think that Lord Greene, Master of the Rolls, was Chairman of the Committee—did a little to insist on the disclosure of essential information about subsidiaries. During the last 20 years, a great number of companies have formed subsidiaries to operate departments of their business. This is often a wise and necessary arrangement. Many of these subsidiaries are private companies. A great gulf often exists between a holding company's disclosed profits and the profits of the whole group. Shareholders often know nothing of the tangible assets behind the investments in subsidiaries; nor need they know the debts of the subsidiaries, or if they are greatly indebted to the bank. This tendency to operate the departments of a business through subsidiaries, although entirely legitimate, is capable of very great abuses, which can best be checked by this Bill's insistence that holding companies must publish group balance sheets and group profit and loss accounts [emphasis added].

In the same debate the principle of limited liability is lauded by Sir Stafford quoting from the Cohen Committee Report in which the limited liability principle is pointed out as important for the growth of the economy (Hansard HC Debate, 1947<sup>22</sup>):

They say in paragraph 5: “We are satisfied by the evidence that the great 'majority of limited companies, both public and private, are honestly and conscientiously managed. We believe that the system of limited liability companies has been and is beneficial to the trade and industry of the country and essential to the prosperity of the nation as a whole. The Companies Acts have been amended from time to time to bring them into accord with changing conditions, but if there is to be any flexibility opportunities for abuse will inevitably exist. We consider that the

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<sup>21</sup> vol. 438, cc 585 - 671

<sup>22</sup> vol. 438, cc 585 - 671

fullest practicable disclosure of information concerning the activities of companies will lessen such opportunities and accord with a wakening social consciousness” [emphasis added].

In chapter one of the present thesis, Ting (2013:6) was quoted as saying that “the modern commercial world dictates a change in paradigm with respect to the treatment of corporate groups”. By analysing the comments made in the debate above it can be said that this paradigm shift is not easy to achieve. The economic unit formed by the corporate group is acknowledged by Sir Stafford above as “groups or chains of companies, which make the true economic entity rather than the company itself” yet there is no consideration of whether this economic unit should be recognised as a separate legal entity.

With the introduction of limited liability, the focus was on the protection of natural shareholders. In the debate on the influence of the growth of corporate groups, the focus remains on the shareholder. Yet the fact that some shareholders in the group are not rentiers but corporate shareholders is ignored. Additionally, the important role that limited liability plays in the economy is inferred to complicate any amendments that might involve the application of limited liability. It is unfortunate that the seemingly obvious differences between a company and a corporate group are identified yet are not applied in law. The changing conditions that brought about the amendments to the Companies Acts, as mentioned by Sir Stafford, does unfortunately not include re-thinking the change in the nature of the shareholders that could and arguably should influence the application of the separate legal status of a company within a closely held corporate group.

The doctrine of the separate legal personality of a company remains seemingly entrenched in the legal mind.

#### The Van Wyk De Vries Commission

In 1963 the Van Wyk De Vries Commission was appointed in South Africa to review and consider the Jenkins Committee report that had been released in England. The report by the Van Wyk Commission formed the basis of the Companies Act No. 61 of 1973 (Companies Act of 1973) (Oosthuizen, 2017:82). This Act widened the gap between the South African Companies Act and the English Companies Act, according to Oosthuizen (2017:90), but was nonetheless considered to be based on the principles of English company law, according to a report by the Department of Trade and Industry (2004:3).

### The Department of Trade and Industry review

In 2004 the Department of Trade and Industry started a review process to update company law with modern principles based both on national conditions and international trends (Department of Trade and Industry, 2004:3). The aim was to amend the Companies Act of 1973 in being consistent with the new constitution and contain the principles of equity and fairness (Department of Trade and Industry, 2004:14). The Companies Bill 2007 was published after two years during which time the Department of Trade and Industry engaged with, *inter alia*, academics; NEDLAC; international experts; and “commonwealth jurisdictions, which share many of our company law traditions” (Companies Bill, 2007: 4). According to Labuschagne (2014:86) the resulting Companies Act No. 71 of 2008 (Companies Act of 2008) was “drafted with reference to the principles, *inter alia*, of Canadian company law” but still included principles from English Companies law (Department of Trade and Industry, 2004:3) and due to “the presence of several United States based consultants” American influences as well (Labuschagne,2014:95).

## **4.5 LEGAL DEFINITIONS OF A COMPANY AND CORPORATE GROUPS**

Until now the present discussion was comprised of a view on the historical journey of the origin and development of a company as a legal trading business form. In the following section the integration of the legal and jurisprudential meaning of a company as provided for in the context of company law with tax law will be elucidated. This will entail providing the various definitions of the meaning of company and corporate groups in both the Companies Act of 2008 and the Income Tax Act of 1962. It is cumbersome working through the definitions but the connection of the Companies Act of 2008 to the Income Tax Act of 1962 is found within the definitions. It will become clear that the dogma determines that a company has a separate legal personality and directly influences the taxation of such a company, especially within a “group of companies” as defined in the Income Tax Act of 1962.

#### 4.5.1 Company Law

Commencing with the provisions of the Companies Act of 2008, a company is provided with a legal status as a juristic person with the capacity of an individual, in terms of section 19:

##### **Legal status of companies**

**19.** (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; [emphasis added]
- (b) has all of the legal powers and capacity of an individual, except to the extent that [emphasis added]
  - (i) a juristic person is incapable of exercising any such power, or having any such capacity; or
  - (ii) the company's Memorandum of Incorporation provides otherwise;

...

Section 19(2) of the Companies Act of 2008 provides for the limitation of liability for a shareholder:

- (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, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

The Companies Act of 2008 does provide for the definition of a holding company and a subsidiary, but does not provide a juristic personality for the group formed by the holding company and its subsidiaries:

**“group of companies”** means a holding company and all of its subsidiaries;

**“holding company”**, in relation to a subsidiary, means a juristic person that controls that subsidiary as a result of any circumstances contemplated in section 2(2)(a) or 3(1)(a);

Section 3 of the Companies Act of 2008 provides the conditions under which a company will be considered a subsidiary:

(1) A company is-

(a) a subsidiary of another juristic person if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in any combination-

(i) is or are directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholder agreement or otherwise; or

(ii) has or have the right to appoint or elect, or control the appointment or election of directors of that company who control a majority of the votes at a meeting of the board; or

(b) a wholly-owned subsidiary of another juristic person if all the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by persons contemplated in paragraph (a).

(2) For the purpose of determining whether a person controls all or a majority of the general voting rights associated with issued securities of a company-

(a) voting rights that are exercisable only in certain circumstances are to be taken into account only-

(i) when those circumstances have arisen, and for so long as they continue; or

(ii) when those circumstances are under the control of the person holding the voting rights;

(b) voting rights that are exercisable only on the instructions or with the consent or concurrence of another person are to be treated as being held by a nominee for that other person; and

(c) voting rights held by-

(i) a person as nominee for another person are to be treated as held by that other person; or

(ii) a person in a fiduciary capacity is to be treated as held by the beneficiary of those voting rights.

(3) For the purposes of subsection (2), “hold”, or any derivative of it, refers to the registered or direct or indirect beneficial holder of securities conferring a right to vote.

The definition of a subsidiary commences by stating that a subsidiary is firstly a company, which by implication legally separates the subsidiary from the holding company regardless of the control the holding company has over the subsidiary. This is consistent with the viewpoint, as explained in chapter two, in 1941 that the closely held private company and its shareholders being considered as forming one economic unit does not taint the legal status of the private company.

In summary, the primary definition of a company in terms of the Companies Act of 2008 is:

“**company**” means a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person .....

#### **4.5.2           Income Tax Act of 1962**

The Companies Act of 2008 influences the tax imposed on a company due to the Income Tax Act of 1962 directly referring to the Companies Act with regards to determining the status of a company:

“**Companies Act**” means the Companies Act, 2008 (Act No. 71 of 2008);

...and subsequently defines a company in section 1 of the Income Tax Act 1962 where it refers to the law under which a company has been incorporated according to the Companies Act, 2008:

For companies registered under foreign company law, the question must be posed what impact will it have on South African tax law if foreign law recognises a corporate group as a legal entity? With section (b) of the definition of “company” in section 1 of the Income Tax Act of 1962 including that if the Companies Act of 2008 recognises a company incorporated under foreign law as a company, a corporate group recognised as a company in foreign law might fall within the definition of a company in South Africa for tax purposes. In chapter one it was demonstrated that

South Africa must ensure that tax legislation is in line with international practices. This is one example of how important that, in fact, might prove to be.

In terms of section 5(1)(d) of the Income Tax Act of 1962, tax and rates are imposed on a company for the financial year of the company:

**5. Levy of normal tax and rates thereof.** - (1) Subject to the provision of the Fourth Schedule there shall be paid annually for the benefit of the National Revenue Fund, an income tax (in this Act referred to as the normal tax) in respect of the taxable income received by or accrued to or in favour of-

...

(d) any company during every financial year of such company.

The definition of a company referred to in section 5(1)(d) of the Income Tax Act of 1962 is as follows:

**"company"** includes -

- (a) any association, corporation or company (other than a closed corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or
- (b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; . . .

As explained in chapter one, the Income Tax Act of 1962 does include certain provisions relating to corporate groups, but the application thereof is seemingly complex and costly, as indicated by the numerous binding rulings being applied for by corporate taxpayers. From the various definitions of “group companies” provided for in the Income Tax Act of 1962, it is inferred that this alone adds to the complexity of the concept of a corporate group in the Income Tax Act. Botha (2016:119) describes the definition section in an Act as the “dictionary for the Act”. He explains that the definition of a word is conclusive but, as held in *Kanhym Bpk v Oudtshoorn Municipality* 1990 (3) SA 252 (C), that “a deviation from the meaning in the definition clause will be justified only if the defined meaning is not the correct interpretation within the context of the particular provision”.

The first definition, considered to be a wider definition of a group of companies is provided for in section 1(1):

**“group of companies”** means two or more companies in which one company (hereinafter referred to as the **“controlling group company”**) directly or indirectly holds shares in at least one other company (hereinafter referred to as the **“controlled group company”**), to the extent that-

(a) at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

(b) the controlling group company directly holds 70 per cent or more of the equity shares in at least one controlled group company;

Specific to the provisions in the Income Tax Act of 1962, which accommodate certain intercompany transactions within the corporate group, namely sections 41 - 47, an additional narrower definition of a group of companies has been provided. This definition refers firstly to the definition of a group of companies in section 1, as provided above, and secondly to additional provisions to be applied in terms of sections 41-47:

**“group of companies”** means a group of companies as defined in section 1: Provided that for the purposes of this definition –

(i) any company that would, but for the provisions of this definition, form part of a group of companies shall not form part of that group of companies if –

(aa) that company is a company contemplated in paragraph (c), (d) or (e) of the definition of “company”;

(bb) that company is a non-profit company as defined in section 1 of the Companies Act;

(cc) any amount constituting gross income of whatever nature would be exempt from tax in terms of section 10 were it to be received by or to accrue to that company;(dd) that company is a public benefit organisation or recreational club that has been approved by the Commissioner in terms of section 30 or 30A;

(ee) that company is a company contemplated in paragraph (b) of the definition of “company”, unless that company has its place of effective management in the Republic;

or

(ff) that company has its place of effective management outside the Republic; and

...

It is considered that the need to provide two different definitions as being symptomatic of the lack of acknowledgment that the corporate group is a separate legal entity. This is deemed to add a layer of complexity to the taxation of a group of companies. A corporate group is, as will be discussed in more detail in chapter five, a strategic economic unit regardless of the legal context within in group.

#### **4.5.3 The Constitution of the Republic of South Africa, 1996**

The supreme law (*lex fundamentalis*) of South Africa is the Constitution of the Republic of South Africa, 1996. Chapter two, section 7(1) of the Constitution provides that the Bill of Rights is the cornerstone of the democracy of South Africa. The section further provides that the Bill of Rights “applies to all law, and binds the legislature, the executive, the judiciary and all organs of state”. Section 4(1) provides that: “A juristic person is entitled to the rights in the Bill of Rights to the extent required by the nature of the rights and the nature of the juristic person”. By implication, the company, being considered as a juristic person in terms of law, is in terms of the Constitution of South Africa, protected by the Bill of Rights.

It is surmised that the legal personality of a company is, in the context of South Africa, embedded in the law and jurisprudence and protected in the Bill of Rights, a formidable legal creation. Attempting to make inroads into the argument that a company within a corporate group must surrender its legal personality in favour of forming part of the “legal corporate group entity” is not going to be easy.

In chapter four, commencing with the arrival of van Riebeeck in the Cape, the history of the legislation in South Africa was discussed. The legal system in South Africa, being influenced by different legal systems, has (Oosthuizen, 2017) according to Lenel (2002:7) developed into a layered system. Through various court cases and legislation containing features of these different legal systems, company law on the other hand was for all practical purposes a direct copy of English company law.

After unification, South Africa continued to follow the amendments made to English company law, except for some minor adjustments to fit into the South African context. Various committees or commissions were appointed from time to time to review company law. The Cohen Committee appointed in Britain specifically addressed the implications of the increase in the number of corporate groups. The debates held on the recommendations of the Cohen Committee acknowledged that the importance of corporate groups forming an economic unit must be addressed and so it was determined that these corporate groups should consolidate their results for the benefit of the shareholder. It is deemed unfortunate that the Cohen Committee did not apply its mind to considering the possibility of recognising the corporate group as a legal entity.

The final sections of this chapter shifted the focus to the current status of the corporate group in South African legislation, specifically company law and tax law. The connection between company law and tax law was explained is found in the definition of a company in the Income Tax Act of 1962 being based on the definition of company in the Companies Act of 2008. It was further discussed that the tax law, in providing two definitions for a corporate group, added to the complexity of the taxation thereof in South African tax law.

The chapter concluded by referring to the Constitution of South Africa in which the company being considered a juristic person has protection within the ambit of the Bill of Rights, thus adding to the difficulty in initiating the paradigm shift to which Ting (2013:5) refers.

In chapter five a case study is presented using the Sasol Corporate Group. By comparing the historical conditions as explained in previous chapters with the current conditions within the Sasol

Corporate Group it will be shown that the separate legal personalities of the subsidiaries in the Sasol Group do not comply with the original intent the legal principle of separate legal identity.

## **CHAPTER 5: CORPORATE GROUPS – A CASE STUDY**

### **5.1 INTRODUCTION**

The concept of trading through an unregulated form, which developed into a regulated legal form and then became a company, was discussed in chapter three. The legislation regulating this form of trading, as well as the principles enshrined in the legislation, was explained. The subsequent development of the legislation, company law, was considered first in the context of its origins in England, and thereafter in its South African context.

An essential principle embedded in company law is that of the separate legal personality attained by a company once it is registered in terms of the Companies Act of 2008. The shareholders of such a company will have limited liability due to the company being registered. This limited liability is applicable in the context of a corporate group in which each of the various companies forming the group has limited liability even though a corporate group forms one economic unit. This is, arguably, problematic because in substance a corporate group and a company should be treated similarly in law. In this chapter the corporate group structure will be discussed. A case study will be included of the Sasol Limited that has always been considered to have as its main strategy, since its establishment in 1950 (Hodge, 2000:2), the perspective of the group as one economic unit.

This chapter aims to illustrate by way of the case study why the concept of a legal personality as developed through history is questionable when applied to companies which form a corporate structure over a hundred years later.

### **5.2 THE BUSINESS DESCRIPTION OF A CORPORATE GROUP**

Chapter four provided a legal definition of a corporate group in terms of company law, whereas this chapter considers a more appropriate “definition” for a corporate group to be founded in the economic structure formed by the corporate group.

According to Ho (2012:885-886) defining a corporate group in view of a company being a legally defined entity in terms of company law is a “complicated exercise” in that she considers that the “key defining characteristic of a corporate group is typically common ownership”. The classic structure of a group of companies will be a holding company with direct and indirect subsidiaries. The various types of subsidiaries will be regarded as separate legal entities with rights and obligations legally separated from the holding company. In such a structure, Ho states, the economic boundaries of a group of companies do not correspond with its legal boundaries.

Adolf and Berle (1947:343-344) describe a corporate group as “a constellation of corporations controlled by a central holding company”. The corporate group concept was brought about by the increase in the size and diversity of business enterprises that complicated proper management and acceptance of liability by the management team. A way of overcoming this challenge, according to Adolf and Berle, was by means of a “process of sub-division” of the company into a holding company with subsidiaries. One large business organisation is thus conducted through various smaller companies.

Strasser and Blumberg (2009:3-4) provide an example of a corporate group that expands globally, and which is referred to as a “multinational organisation”. A worldwide recognised logo, colour scheme, and rental terms that are similar, means that a person renting a car from Hertz<sup>23</sup> in Amsterdam will not be aware that s/he is in effect dealing with a subsidiary of a much larger company located in another country. Strasser and Blumberg acknowledge that even though the local company may have some freedom to apply their own strategy, it will be based on the strategic direction set by the parent company.

One such example of a multinational company in South Africa is Sasol Limited. Applying the theory as explained above of the structure of the company that consists of various subsidiaries located globally but with its strategy originating from the holding company, Sasol Limited

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<sup>23</sup>Hertz Global Holdings, Inc. (Hertz Global), incorporated on August 28, 2015, is a holding company. The Company owns Rental Car Intermediate Holdings, LLC, which owns Hertz Corporation (Hertz), Hertz Global's primary operating company. The Company operates through three segments: U.S. Car Rental (U.S. RAC), International Car Rental (International RAC) and All Other Operations. As of December 31, 2016, the Company operated its vehicle rental business globally through the Hertz, Dollar and Thrifty brands from approximately 9,700 corporate and franchisee locations in North America, Europe, Latin America, Africa, Asia, Australia, The Caribbean, the Middle East and New Zealand. The Company's brands maintain separate airport counters, reservations and reservation systems, marketing and all other customer contact activities (<https://www.reuters.com/finance/stocks/companyProfile/HTZ>). [Accessed 26 November 2018].

provides a good case study. This discussion will focus on two concepts, the formation of an economic unit and the nature of the shareholder within the group.

### **5.3 SOUTH AFRICAN COAL, OIL AND GAS CORPORATION (SASOL)**

#### **5.3.1 Background**

Hodge (2000:2-4) authored a working paper on Sasol in which he provides detail of the origin and development of Sasol. For the purposes of this chapter the following facts have been taken from Hodge's working paper.

In 1950 Sasol was registered as an independent company funded by the Industrial Development Corporation with the State as the sole shareholder. In the 1970s the sanctions against South Africa due to apartheid policies and increases in crude oil prices led to a decision by the government to increase Sasol's synfuel (synthetic fuel) operations by building Sasol 2 which in size would be ten times larger than Sasol 1. The capital needed for the project was obtained by restructuring Sasol and listing it on the Johannesburg Stock Exchange in 1979. By then the Sasol 3 development was also approved. The listed company, being Sasol Limited, owned 100% of Sasol 1 and 50% of Sasol 2 and 3. The remaining 50% of Sasol 2 and 3 was owned by the government and the Industrial Development Corporation. Sasol was committed to buy back all the shares and by December 1983 all the shares held by the government and the Industrial Development Corporation in Sasol 2 had been bought back and the shares held in Sasol 3 were bought back in 1991.

#### **5.3.2 An economic unit**

A corporate group forming an economic unit has been discussed in previous chapters. Using the current structure, the strategy and management of the Sasol Group will provide an example of a corporate group based in South Africa forming just such an economic unit.

It was observed in the introduction that the strategy of Sasol, after restructuring and listing the Holding Company on the Johannesburg Stock Exchange, was to avoid shares in subsidiaries being held by outside parties, so shares were strategically bought back from outside shareholders.

In 1990 the investment strategy “was to be in chemicals with a balance between upstream and downstream chemicals”. With the domestic market having insufficient demand, Sasol ventured into the international market (Hodge, 2000:5):

Recognising that the local market promised limited demand, Sasol concentrated immediately on the export market and even opened up a European Division of Sasol Chemicals to develop the customer base.

Sasol is an example of the management and strategy of a group originating from a central holding company. Hodge (2002:6) summarises the expansion strategy of Sasol thus:

An important aspect of Sasol’s expansion is that it has not been based on buying existing firms using financial reserves but based on gradual diversification around core technological competencies. Sasol has made a couple of small international acquisitions but in the same product markets and designed to reinforce its own technologies and product lines.

It is inferred that since 1991 the strategy of Sasol has not altered much. In the Annual Review of Sasol Limited for 30 June 2003 the fact that the strategy of the companies in the group originates from the holding company is clearly disclosed (Sasol, 2003:10):”The Sasol head office at Johannesburg, South Africa, co-ordinates group activities and provides certain specialised services to group companies”.

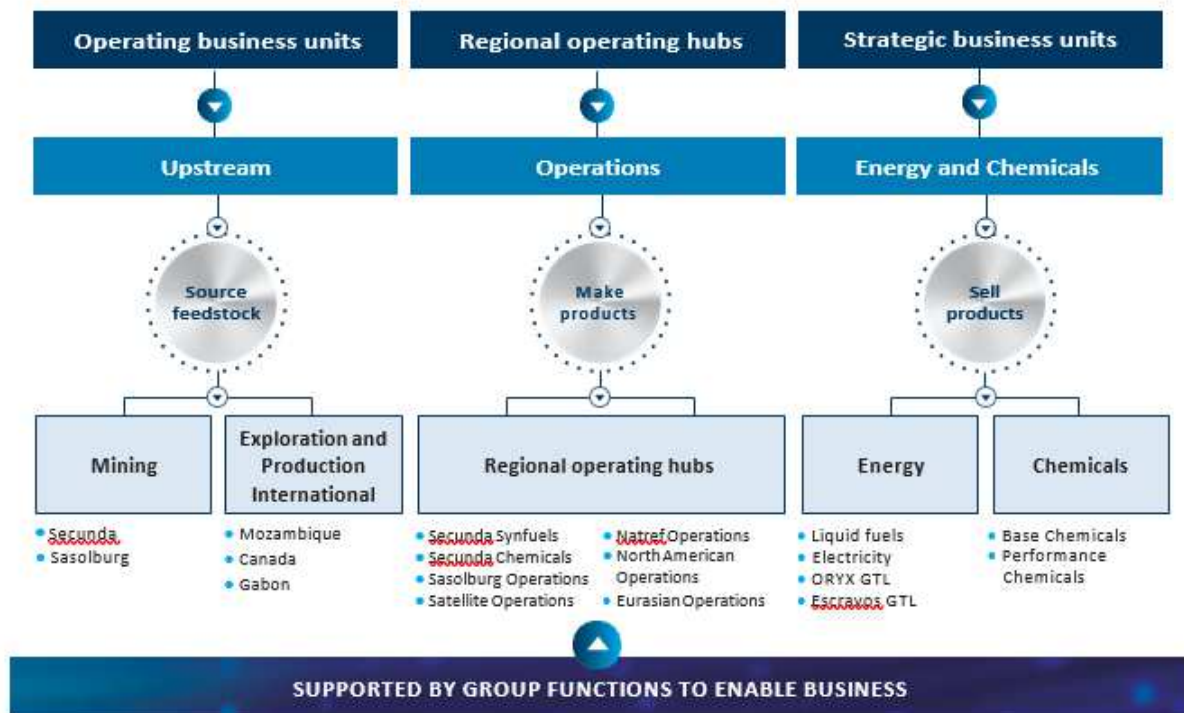
In 2018 the structure of Sasol is still designed to obtain results through a chain of subsidiaries which in principle forms one economic unit. The subsidiaries held by Sasol comprised “strategic business units, operating business units, regional operating hubs and Group functions” (Sasol, 2018b:74). The Sasol Group forming one economic unit is confirmed by the statement in the Integrated Report (Sasol, 2018b:75) which states that Sasol policies and processes apply to all companies in the Sasol Group:

We have the necessary policies and processes in place to ensure that all entities in the Sasol Group adhere to essential Group requirements and governance standards. As a direct or indirect shareholder, Sasol exercises its rights and is involved in the decision-making of its subsidiaries

on material matters and the Board is satisfied that its delegation of authority framework contributes to role clarity and effective exercise of authority and responsibilities [emphasis added].

It is not only policy and processes that bind the various entities together but its value stream as well, observable in the diagram below from the Integrated Report (Sasol, 2018b:3) of Sasol for the 2018 financial year. The key aspect of the diagram is that it is an example indicating that the companies in the group are focused on achieving the best outcomes for the Sasol group as if it were in truth one business entity. Support for the different value streams is achieved by the group functions being “arranged along an integrated value chain that draws on each business’s unique capabilities and areas of specialisation to enable integrated thinking and decision-making in the organisation”.

**Table 1 – Sasol value creation structure**



Source: Sasol (2018b:3)

### 5.3.3 Nature of the shareholders in Sasol

In chapter three it was explained that limited liability was introduced in order to protect the rentier shareholder. This shareholder, as was explained, was typically a natural person with the need to invest money in a business venture without being actively part of the management of the company.

Blumberg (1993:23) explains that with the forming of a corporate group, one corporation could be the main shareholder of another without a natural person holding shares in the company. In this corporate group there could be various companies registered with no natural person being a direct shareholder. Also, the shareholding in the holding company will “represent the aspirations and interest of human beings with the ultimate equity ownership”. This viewpoint is supported in this thesis but noticeable the closeness or direct contact a shareholder has with a company has changed significantly. In the case study of Sasol, the “human being” as ultimate shareholder is removed from the actual business functions in a layered structure of first corporate shareholders with the human being only being found in a third or even fourth layer as will be explained below.

In the case of Sasol, the company structure has as an ultimate parent company Sasol Limited which owns various subsidiaries either wholly or partially. Regardless of the shareholding percentage the management and control exercised over these subsidiaries gives Sasol Limited authority over all the subsidiary companies. Sasol Limited holds 100% of the shares in Sasol Investment Company (Pty) Ltd which owns the shares in the subsidiaries located outside South Africa but, through the 100% shareholding, Sasol Limited therefore also controls the subsidiaries held by Sasol Investment Company Ltd (See Appendix B and C for shareholding details). Up and until this point whether the shareholders are natural persons is not very clear. To find the ultimate “human being” shareholders one must review the shareholding of the ultimate parent company. In Table 2 below the majority shareholders are not “natural persons” but are, for example, companies, unit trusts, and pension and provident funds. Private investors (“human beings”) holding a direct interest in Sasol Limited hold only 4.2% of the total ordinary shares.

**Table 2 – Major categories of shareholders in Sasol Limited**

Major categories of shareholders	Number of shares	% of ordinary shares	% of total issued securities
<b>Category</b>			
Unit trusts	205 446 312	33,0	31,8
Pension and provident funds	164 649 071	26,4	25,5
Government of South Africa	53 266 887	8,5	8,3
Other managed funds	30 189 353	4,8	4,7
Insurance companies	26 531 451	4,3	4,1
Private investors	26 233 846	4,2	4,1
Sovereign wealth funds	23 652 430	3,8	3,7
Trading position	19 497 918	3,1	3,0

### Major shareholders

Pursuant to section 56(7) of the South African Companies Act, 2008, the following beneficial shareholdings equal to or exceeding 5% as at 30 June 2018 were disclosed or established from enquiries:

	Number of shares	% of ordinary shares	% of total issued securities
Government Employees Pension Fund	84 392 139	13,5	13,1
Industrial Development Corporation of South Africa Limited	53 266 887	8,5	8,3

Source: Sasol (2018a: 22)

In order to find the ultimate shareholders who are natural persons, the nature of shareholders in the various categories of those listed above must in turn be reviewed. Due to limitations of scope, this subject will not be pursued in more detail here. The salient point taken from the given shareholding description is that the nature of the shareholders in the companies forming the Sasol Group is different from the nature of the ultimate shareholder. Shareholding in Sasol originating through other institutional investors adds another layer of opacity between the natural person holding a share and the actual company in which the shareholder indirectly holds share.

#### **5.4 RELATIONSHIP BETWEEN SHAREHOLDERS AND A COMPANY**

In order to set the issue of the nature of the shareholder into a South African context a research report by the National Treasury will be discussed in this section. But before discussing the current conditions a step-back will be taken to 1855 when limited liability was introduced. The policy rationale, as explained in chapter three, of limited liability was to obtain investments from investors who wanted the risk attached to their investment limited to the funds they invested.

The nature of the shareholder has developed significantly and, according to Blumberg (1993:232), the nineteenth-century jurisprudence that focused on the disconnectedness between shareholders (parent corporation shareholders) and the corporation is outdated. In the corporate group structure, the parent corporation shareholder is the dominant shareholder of the subsidiaries. The parent company as shareholder in a corporate structure is not the investor but is a participator in the business of the group. This holding company will, in collaboration with the subsidiaries, participate in and control the business. This explanation given by Blumberg is illustrated in the Sasol case study above wherein Sasol as a Group explicitly indicates that a joint strategy is implemented across all the companies in the Group.

As to the shareholder nature, the current structure of shareholders in the companies in South Africa today, provides a different picture from that which was envisaged when limited liability was introduced. By the end of 2016 there were 379 listed companies trading on the Johannesburg Stock Exchange and the largest class of equity instruments was the ordinary share of the listed companies (National Treasury, 2017: 3). According to the report (National Treasury, 2017:10-11) ordinary

South Africans' retirement savings as well as discretionary savings are managed by retirement funds, long-term insurance companies, and collective investment schemes. These institutions play an important role in directing the funds received from individuals, companies and even government when capital is required. The funds so obtained are invested over a wide range of assets including bonds, debt securities, cash, and, significant for this thesis, in equity.

Institutional investors invest across various asset classes, including shares (equities), bonds and other debt securities, property and cash; both in South Africa and in international markets. They are a crucial component of the local equity market, providing capital to listed companies and a liquid market for the trading of shares and other financial instruments.

Table 3 below indicates that private individuals (rentier investors) holding a direct interest in the top 25 companies<sup>24</sup> in South Africa only forms 1% of the total shareholding.

**Table 3 – Major shareholders by type: Top 25 South African companies**

	Estimated value in R million <sup>2</sup>	% of Top 25 market capitalisati
Foreign companies, direct and indirectly via SA companies <sup>3</sup>	435 688	11%
GEPF and PIC <sup>4</sup>	429 166	11%
South African companies, excluding BEE companies	203 700	5%
South African institutional investors, excluding GEPF and PIC	49 188	1%
South African BEE companies and trusts <sup>5</sup>	44 719	1%
Private individuals	41 986	1%
Foreign institutional investors	37 656	1%
South African Government	27 903	1%
<b>Total estimated value of major shareholdings</b>	<b>1 270 006</b>	<b>33%</b>
<b>Total market capitalisation of Top 25 companies</b>	<b>3 810 608</b>	

*Source: Major shareholders information from Annual Reports, Annual Financial Statements and corporate websites. Market capitalisation provided by JSE.*

*Notes: 1. Major shareholders that own 5 percent or more of the shares of the company.*

*2. Estimated value based on market capitalisation at end 2016. Reporting dates vary across companies and the size of major shareholdings in any one company may differ over time. The estimate applies the most recent reported shareholdings to the market capitalisation of the*

<sup>24</sup> “The top 25 companies accounted for two-thirds of total market capitalisation of South African listed companies in 2016” (National Treasury, 2017: 15).

company at the end of 2016.

3. Includes both direct shareholdings of foreign companies and indirect holdings through South African holding companies.

4. Government Employees Pension Fund and the Public Investment Corporation. The PIC primarily manages funds on behalf of the GEPPF, as well as a smaller amount of other government funds.

5. Major shareholders identified as black-owned based on information on corporate websites.

Source: National Treasury (2017:16)

The rentier shareholder for whom limited liability was intended, still enjoys the advantages thereof, but within the corporate group, a new type of shareholder, other than the rentier, has now gained the advantages even though the nature of the shareholders is fundamentally different.

## 5.5 SECTION 20(9) OF THE COMPANIES ACT OF 2008 – PIERCING THE CORPORATE VEIL

In chapter four the authority of legal precedent being an “intrinsic feature of the rule of law, which is in turn foundational to our Constitution” as held by Cameron in *True Motives v Mahdi*<sup>25</sup> was explained as problematic in allowing the paradigm shift to take place that is needed to identify the separate legal entity a corporate group is for all practical purposes forming. In justifying this comment, the next section will discuss section 20(9) of the Companies Act of 2008 and the first interpretation thereof by a court.

In South Africa, section 20(9) of the Companies Act of 2008 now allows the courts a wider discretion to ‘pierce the corporate veil’. The next case study will illustrate the interpretation of section 20(9) of the Companies Act 2008 in *Ex parte Gore and Others* NNO 2013(3) SA 382 (WCC) (ex parte Gore). This case, according to Cassim (2014:307-308), “delivered the first judgment on section 20(9)” which is the first “statutory provision permitting inroads to be made into” the separate legal personality of a company. Historically disregarding the separate legal personality was according to Cassim is only possible “under the common-law remedy of piercing the corporate veil”. Section 20(9) of the Companies Act 2008 provides that the courts may disregard the legal personality of a company under specific conditions:

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<sup>25</sup> True Motives Mahdi 543/07 [2009] ZASCA

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).

In the *ex parte Gore*<sup>26</sup> application, Binns-Ward J [at 3] explains that the description given on the court roll was one of ‘piercing the corporate veil’. Continuing, Binns-Ward J explained that ‘piercing the corporate veil’ was “a familiar term in this context, locally and in the English common law jurisdictions.” Binns-Ward J’s reference to English common law again suggests that the influence of English law on South Africa company law is still an important factor to consider. As a matter of fact, in *ex parte Gore*<sup>27</sup>, Binns-Ward J delayed providing the reasons for the order due to waiting for a judgement of the UK Supreme Court (Footnote 2):

One of the causes for delaying the provision of the reasons was to enable me to update the description of the English jurisprudence on ‘piercing the corporate veil’ in the draft judgment I had prepared, with appropriate reference to the then awaited judgment of the UK Supreme Court in *VTB Capital Plc v Nutritek International Corp &Ors*[2013] UKSC 5\_(in which judgment had been reserved on 14 November 2012).

Section 20(9) of the Companies Act 2008 does provide for the disregarding of the separate legal personality of a company, but the doctrine of legal precedent is proposed notwithstanding to influence the decision of the court as to the ‘piercing of the veil’. In *ex parte Gore*<sup>28</sup> the interpretation of section 20(9) was done with consideration by Binns-Ward J of the common law

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<sup>26</sup> Ex parte Gore and Others NNO NNO 2013(3) SA 382 (WCC)

<sup>27</sup> Ex parte Gore and Others NNO NNO 2013(3) SA 382 (WCC)

<sup>28</sup> Ex parte Gore and Others NNO NNO 2013(3) SA 382 (WCC)

remedy of ‘piercing the corporate veil’. Cassim (2014:308) as a matter of fact, warns against the courts’ application of this provision without due consideration:

in the light of the extensive powers given to courts to pierce the corporate veil under section 20(9) of the Companies Act, in applying the section it is of fundamental importance that courts do not disregard the separate legal personality of a company too easily, and that they ensure that the correct balance is struck between piercing the corporate veil and upholding the overarching principle of the separate legal personality of a company enshrined in section 19(1) of the Companies Act.

From the judgment explained above it is submitted that doctrine of the legal personality of a company even after the codification<sup>29</sup> of a provision allowing the piercing the corporate veil in South African company law, is problematic. The legal mind codified the common law principle of a company being a separate entity removed from the members / shareholders. Adding the authority of legal precedent forming an inherent part of the rule of law, the paradigm shift needed to be made in order to codify a legal personality for a corporate group is proving to be problematic.

## **5.6 SUMMARY AND CONCLUSION**

Considering the development of the nature of shareholders between 1855 and 2018 into two different models, it is proposed that limited liability of the rentier shareholder is not incorrect but that the limited liability that is extended to the companies that are fully owned by another company is not within the original aim of the limited liability doctrine. Adding to the argument is that the economic reality of the Sasol group, as explained, does not fall within the legal form of the group. The argument to acknowledge that a group of companies, as for example in the case of Sasol, is in fact “one company” and to treat the components thereof as separate legal entities does not represent the actual economic reality of the group.

Historical economic and legal conditions were applied in designing the principles contained in company law and the interpretation thereof. The subsequent development and changes in the business world have not, in all circumstances, been acknowledged in company law. In previous

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<sup>29</sup> Codification is the “statutory compilations of all legal principles” (Botha, 2016:3).

chapters the history of the development of trading form of a company was explored as well as the company law governing this trading form. In chapter six the conclusion will be provided.

## CHAPTER 6: CONCLUSION

### 6.1 INTRODUCTION

In every discipline it is axiomatic that nothing secure can be built on shaky or uncertain foundations; that is to say, where fundamental questions have not been asked and securely answered. If it be assumed that the earth lies as the centre of the universe, few astronomic truths will survive intact. The need for certainty in fundamentals is as true for income tax as of any other branch of learning (Williams, 2016: 211).

This thesis explores the origins of the legal personality of a company within the concomitant doctrine of limited liability. The aim is to convey the argument that South African company law and tax law have not kept pace with challenges posed by the development of the trading form over the last few centuries. The trading forms studied in this thesis, commencing with guilds/gilds, gradually developed into regulated companies or joint-stock companies. The advantages of the joint-stock company form lead to its being the dominant form of business. With the increase in the number of joint-stock companies, the need legally to regulate business arose. The legal personification endowed by statute (*Salomon v Salomon*<sup>30</sup>) created the doctrine of the separate legal person of a company. This legal personality created a position in which corporate groups can structure companies in the group in order to obtain the best tax benefits. Various tax authorities have moved to prevent the consequent tax loss, but the results have been piecemeal reforms of the tax legislation which merely inspired companies to create more complex structures in order legally to circumvent the rules. The failure of company law to extend the doctrine of legal personality to include corporate groups is considered in this thesis to be a potential stumbling block to the implementation of a group tax regime that is fair, transparent, and cost effective.

This concluding chapter offers a précis of the thesis in order to re-state and clarify its findings and it concludes with a final recommendation and suggestions for possible future research projects.

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<sup>30</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

## 6.2 THE GOALS OF THE RESEARCH

Chapter one provides background on historical as well as current policy on the taxation of corporate groups in South Africa. In 2001 the Finance Standing Committee (National Treasury, 2001: slide 4) explained that South Africa should aim to keep the tax system competitive with the international tax system by implementing a policy that would streamline corporate restructuring rules. Currently various provisions are included in the Income Tax Act of 1962, to accommodate transactions in a corporate group as, for example, the group restructuring rules contained in sections 41-47 of the Act. This “piece-meal” type of provision, as argued by Correia (2013:1-2), is a motivation for corporate groups to create complex transactions in order legally to outsmart the *fiscus*. In South Africa the level of complication experienced by corporate groups is visible in that by 2017 an estimate of 23% of the binding private rulings that businesses applied for related to transactions within a corporate group (SARS, 2017).

This thesis argues that the reasons for such complicated group tax provisions are due to tax legislation being based on the doctrine of the company as a legal entity, regardless of its being part of a corporate group that for all practical purposes forms an economic unity (Correia,2013:1-2). To overcome this, Ting (2013:6) suggests that the modern commercial world requires a paradigm shift as to the acceptance of a legal status of a corporate group. It is proposed that for such a paradigm shift to occur, firstly an understanding must be obtained as to the origins of this legal personality of the company. Understanding the conditions and reasoning behind the development of this legal entity principle will provide the evidence that the company within a corporate group cannot be considered on the same grounds as is the original company for which the legal identity and limited liability was provided in legislation, as well as in jurisprudence through the concept of the binding precedent.

In chapter one the following sub-goals were identified through which the main goal would be addressed:

1. studying the history of the origin and development of the concept of a company;
2. studying the history of company law and the origins of the legal persona of a company contained in company law and jurisprudence;

3. obtaining an understanding of the fundamental difference between the separate legal entity and a corporate group;
4. illustrating, using a South African case study, the reality of a corporate group as a single economic unit; and
5. based on the arguments presented, arriving at a conclusion pertaining to the need for legislative recognition of a corporate group as a separate legal entity, thus facilitating the development of a group taxation regime.

### **6.2.1 History of the origin and development of the concept of a company**

The legal personification of a company was cautioned against as far back as the seventeenth century by Kyd who described it as “bewildering and apt to mislead” (Blumberg, 1993:256). In chapter three the aim was to place the true words spoken by Kyd into perspective by providing a history of what led to this personification.

The history of the origins of the legal concept of a company commenced with the guilds (or guilds) chartered in England. The first Guild Merchant was granted a charter around 1087 by the Crown to provide a specific group of people with certain rights in protecting their trade. Other examples were peace-guilds and municipal co-operations (Gross, 1890:5-6). Baars (2012:48) explains that the notion of the fictitious person initiated in common law was then applied to guilds.

The commercial spirit of the English led to growth in foreign trading, but the form of the guild was not conducive to foreign trade, so they were gradually replaced by regulated companies (Williston, 1888:109). The regulated company shared similarities with guilds: for example, membership had to be purchased and a member could only trade within a specific area; risk and reward were for members’ own accounts for both guilds and regulated companies. Even though the regulated company lost favour by the close of the eighteenth century, it did play an important role in the commercial growth of England (Cawston & Keane, 1896:10-11).

The joint-stock company appeared around 1553 and developed simultaneously with the regulated company. Joint-stock companies were suited to long-distance trading and regulated companies for

short distance trading (Harris, 2000:43). It was only after the Glorious Revolution that “new beginnings could be seen” (Harris, 2000:53). The Glorious Revolution secured dominance by Parliament of the King, which meant that corporations no longer received charters from the Crown, but were incorporated by Acts of Parliament (De Klerk, 1977, Harris, 2000). With the need to develop water canals, the need for corporations also increased, and the introduction of gas-lighting and later that of railways increased the need for capital (Williston, 1888:112-113). Railway companies registered as joint-stock companies to obtain capital via passive investors and the selling of shares became increasingly popular (Oosthuizen, 2017:30-32).

The concept of a trading form developed over centuries within the context of the economic, social and political conditions of the various periods. Commencing with the guilds, common law recognition of the fictitious personality of a guild extended to newly developed forms of trading, namely the regulated company and the joint-stock company. The development of guilds into regulated companies or joint-stock companies, is considered to have been influenced, *inter alia*, by the need of members of firstly the guild for a different trading form in advancing the economic and financial needs of the members. Subsequently, the nature of the members developed into shareholders which again brought about a change in the trading form utilised for business purposes. The joint-stock form of business became prominent and replaced both the guild and regulated company to today being one of the prime forms of businesses to be used. The company form as we know today, originating from guilds, has experienced tremendous changes and is far removed from the principles on which the guilds were created.

### **6.2.2 History of company law and the origins of the legal persona of a company**

Based on the assumption that England is considered to be the leader in company law (Suzman, 1949: iv), as well as the role England played in the introduction and subsequent amendments of company law in South Africa, chapter three undertakes a study of the history of the development of trading bodies in England and the principle that was developed of the company being a separate legal entity and separate from its shareholders. In the context of South African company law, and considering the historical review offered by this thesis, the saying “all roads lead to Rome” may be amended to “all roads lead to England”.

As discussed in section 6.2.1 above, the number of joint-stock companies increased as economic, social and political conditions transformed. The increase in the number of joint-stock companies forced Parliament to appoint a Committee, the Gladstone Committee, to address the “common-law limitation on the formation of joint-stock companies” (Harris, 2000:268). The recommended legislative reform resulted in the Joint Stock Companies Act of 1844 which provided for the registration, incorporation, and regulation of joint-stock companies (Oosthuizen, 2017:54-55).

A person was no longer considered a member of a business but a shareholder. The “transferable joint stock”, being a financial device, brought together the entrepreneur and the investor (Harris, 2000:117) and increased the risk for individual investors to be held accountable for any debt incurred by a company. In a House of Commons debate on limited liability, the view was offered by Mr. Cardwell that limited liability would prove to be advantageous to low income individuals who want to invest in shares (Hansard HC Debate, 1855a<sup>31</sup>).

To protect shareholders, the Act for the Incorporation and Regulation of Joint Stock Companies and other Associations was passed in 1856, which allowed companies to be incorporated as limited liability companies. Subsequent to the joint-stock company being incorporated by law so that shareholders would be limited in any liability that was incurred by the company in which they held shares, the legal disconnection between a shareholder and a company was tested in a British case, *Salomon v Salomon*<sup>32</sup>. This case was, according to Baars (2012:69), a test of the interpretation of the new company law. The finding of the court, that members of the company were to be considered as separate from the company, created a dogma which, according to Daehnert (2007, in Boardman-Weston: 64), persists as a principle to which the courts adhere today. This dogma was the legal personality now bestowed upon the company and the personification of a company was now a legal fact. The *Salomon v Salomon*<sup>33</sup> case testing the new company law was, according to Lord Neuberger in *VTB Capital v Nutritek*<sup>34</sup>, an attempt to pierce the corporate veil which it failed to achieve. The difficulty of the court in piercing the corporate veil is inferred to be concomitant with legally not allowing corporate groups to be recognised as legal entities. From the perspective specifically of South Africa, this is demonstrated in the application of section 20(9) of the

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<sup>31</sup> vol. 139, cc 1378 - 1397

<sup>32</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>33</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22

<sup>34</sup> *VTB Capital plc v Nutritek International Corp* [2013] UKSC 5, [2013] AC 377

Companies Act of 2008, whereby the piercing of the corporate veil is allowed under specific circumstances. In *ex parte Gore*<sup>35</sup>, the first case in which this section was interpreted, Binss-Ward J delayed his findings while waiting for an updated judgment to be made in the UK Supreme Court as to the description of English jurisprudence on “piercing the corporate veil”. Despite of the Companies Act of 2008 allowing for the piercing of the corporate veil, the common law principle laid down in *Salomon v Salomon*<sup>36</sup> is perceived still to influence the courts’ decisions. The Latin maxim *stare decisis et non quieta movere* is an appropriate explanation of the courts’ unwillingness to contemplate that “piercing the corporate veil” of a company is not to disturb what has been settled.

In South Africa, the case of *Dadoo v Krugersdorp*<sup>37</sup> established the legal personality of a company in the context of South Africa, applying the principles of *Salomon v Salomon*<sup>38</sup>. This principle is still referred to today as was held in 2017 when Schippers AJA in *City Capital v Chavonnes*<sup>39</sup> stated: “It is trite that a company is a legal entity distinct from its shareholders”.

After Britain colonised South Africa, the influence of English law was, as described by Schreiner (1967:6-7), “done designedly, as a policy measure, or casually in the ordinary course of the administration of justice...” even though the rule applied that British-occupied territories must retain indigenous law. The fact that only barristers who had been trained in England were allowed to plea in South African courts and the adherence to the principle of case law was, for example, used subtly to introduce English law into South Africa (Schreiner, 1967, Du Plessis, 2017). The use of judicial decisions, as explained by Van Niekerk (2013:145), is important in a legal system that applies the doctrine of legal precedent. It is therefore inevitable that the use of case law by English trained judges contributed to the introduction of legal precedent into the law of South Africa. Abiding by precedent (Burns, 1886:745), Innes J in *Dadoo v Krugersdorp*<sup>40</sup> followed suit and the separate legal personality of a company was firmly introduced into the jurisprudence of South Africa.

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<sup>35</sup> Ex parte Gore and Others NNO 2013(3) SA 382

<sup>36</sup> Salomon v Salomon & Co Ltd [1897] AC 22

<sup>37</sup> Dadoo Ltd & others v Krugersdorp Municipal Council 1920 AD 530

<sup>38</sup> Salomon v Salomon & Co Ltd [1897] AC 22

<sup>39</sup> City Capital SA Property Holdings Ltd v Chavonnes Badenhorst St Clair Cooper No and Others (85/2017) [2017] ZASCA 177

<sup>40</sup> Dadoo Ltd & others v Krugersdorp Municipal Council 1920 AD 530

Company law in South Africa before the unification of South Africa “was almost verbatim an adaptation” of English company law according to Cilliers (2000, quoted in Labuschagne, 2014:80). The “practice of extensive borrowing from English legislation” was so established (Oosthuizen, 2017: 80) and after unification amendments in English company law were applied in South Africa, except for some small local amendments to suit South African conditions. Principles were thus also adapted one being the principle of the legal personality. This principle originating centuries ago and contained in the English company law is clearly found to be firmly enshrined in the company law of South Africa.

In section 6.2.1 above it was concluded that the company form originating from guilds has experienced tremendous changes and is long removed from the principles on which the guilds were formed. Company law developed due to and during the various phases of the development of the concept of a company, has regrettably not kept abreast with new developments. The archaic principle of a company seemingly having an impenetrable veil is deeply cherished within company law and jurisprudence to the detriment of the proper legal recognition of a corporate group.

### **6.2.3 Fundamental difference between a separate legal entity and a corporate group**

In section 6.2.1 above it was explained that guilds, consisting of members, were over a few centuries replaced by joint-stock companies consisting of shareholders. Shareholders, as explained by Ireland (2008: 842), became a mix of either passive shareholders or active shareholders. Harris (2000:130) explains that the shareholders' vulnerability of shareholders to be responsible for the debt of the company was a motivation for Parliament to introduce limited liability to protect shareholders against prosecution. In debating the introduction of the Limited Liability Bill, Mr. Cardwell for one considered the advantage of limited liability would be the ability of people with low means to participate in the economy by investing in shares (Hansard HC Debate, 1855b<sup>41</sup>). It is on this point of motivation that the argument of this thesis stands that the limited liability being applied to shareholders regardless of their nature, falls foul of the intent with which it was first introduced.

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<sup>41</sup> vol. 139, cc 1445 - 1458

In 1947 the Cohen Committee review on company law in England discussed the concept of the corporate group. The fact that a corporate group does form an economic entity was not lost on the Cohen Committee as explained by Sir Stafford (Hansard HC Debate, 1947<sup>42</sup>): “The growth of groups or chains of companies, which make the true economic entity rather than the company itself”.

A separate legal entity as explained in section 6.2.1 and 6.2.2 originated in common law brought about by the church and codified into company law during the late 1800s. This legal entity, called a company, consisted of shareholders, being natural persons at first. The nature of the shareholder developed to also include companies holding shares in other companies. This eventually led to what Ho (2012:886) describes as forming the classic structure of a corporate group, being a holding company with direct and indirect subsidiaries. In such structure, Ho explains, the economic boundaries do not correspond with the legal boundaries. Another apt description of a corporate group is given by Adolf and Berle (1947:343) as the process of adapting the structure of the business to assist in the management of an increasing business enterprise. One business in principle is operated with the use of smaller companies.

In this thesis it is inferred that the legal personality of a company originated from the idea to separate the shareholder from the economic entity, the company, the shareholder being a natural person and the company a juristic person. A corporate group is considered to form an economic entity with shareholders being both natural persons and juristic persons. In some instances, as explained in the Sasol Group case study, the natural person as shareholder in the company is not directly linked but can be found within a few structures of shareholding removed from the companies forming the group. Yet company law does not recognise the corporate group as a legal entity even if structurally, a corporate group is an economic unit comparable to the single company.

The corporate group strategy and management being applied across all companies within the group makes it difficult to argue that a company within a corporate group is comparable a separate company. Both companies will have been registered in terms of the Companies Act of 2008, yet the management, economic positions and nature of shareholder of the two companies are fundamentally different. In legally considering both as similar is problematic.

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<sup>42</sup> vol. 438, cc 585 - 671

#### **6.2.4 Case study of a corporate group**

Chapter five firstly provided a description of the corporate group. The provision of a definition is explained by Ho (2012:885) as a “complicated exercise”. According to Adolf’s and Berle’s (1947: 343) description of the corporate group as “a constellation of corporations controlled by a central holding company”. Strasser and Blumberg (2009:3-4) provides the example of the Hertz Company with its worldwide footprint as being an appropriate example of a so-called constellation of companies. Hertz is found all over the world and operates under one name and yet consisting of various companies that will from a legal perspective be considered detached from the group.

Closer to home, a case study was conducted on the corporate group Sasol Limited with the aim of demonstrating the reality of a multinational corporate group forming one economic unit that has been strategically planned and managed since its incorporation in 1950 (Hodge, 2000:2-6). Providing a brief summary of the history and the development of the company, Hodge explains that while external funding was obtained by the selling of shares during the project to develop Sasol 2 and 3, the intention was to buy back the shares in order to contain its management within the group. Sasol, an example of a corporate group that forms one economic unit, has a growth strategy of enhancing and reinforcing technology and products in-house. The philosophy of its group strategy has remained consistent since 1950, and its economic unity is not only one of the boardroom but of its manner of support for different business value streams achieved in its functioning as a group, as is reflected in the Sasol Annual Integrated Report (2018b:75):

Sasol exercises its rights and is involved in the decision-making of its subsidiaries on material matters and the Board is satisfied that its delegation of authority framework contributes to role clarity and effective exercise of authority and responsibilities.

A second motivation for conducting the case study on Sasol was to show that the nature of the shareholder, being an individual (as it was when the original company personality was created), has changed and now includes a company as a shareholder. In the Sasol Group, the subsidiaries forming the group have shares that are held by companies and not by individuals. Even the shares of the Holding Company are mostly owned by other types of shareholders and individual shareholders only hold around 4.2% of the shares as indicated in Table 3 in chapter five.

The Sasol Group, as an example of the structure of a corporate group, illustrates the difference between companies as separate entities, as opposed to various companies within a group that ultimately forms one economic entity. Protecting the company as the shareholder *within* the group is considered to deviate from the original intention of protecting the shareholders as individuals, and this again emphasises the need for the recognition of a group of companies as one economic unit.

### 6.3 CONCLUSION

The Income Tax Act of 1962 relies on the Companies Act of 2008 to define a company. Additionally, the doctrine of precedent is “an intrinsic feature of the rule of law”<sup>43</sup> of South Africa, entrenching the recognition of a company as a separate legal person. Although company law does not provide for the legal personality of a corporate group, tax law recognises a corporate group as a taxpayer when a group tax regime is implemented. The complicated application of group tax relief measures in tax law is proving to be an obstacle to the full recognition of a group of companies as a legal unit. It is surmised that having two primary Acts which define the corporate group differently will in all probability add a new set of complications.

Having illustrated the need for and impediments to the recognition of a corporate group as both a legal entity and a *tax persona* in this thesis, the recommendation that flows from the research is that this is a matter that requires the urgent attention of the legislature in South Africa. Once the status of a group of companies is recognised in both company and tax legislation, the design of a group tax regime can be undertaken.

Bearing in mind that there is already a large body of research on the design of group tax systems, two further related topics could provide grounds for further study:

- That company law lacks a clear definition of a corporate group as a legal entity must not be considered only from the perspective of tax; other laws, for example environmental law,

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<sup>43</sup>True Motives v Mahdi (543/07) [2009] ZASCA

within which a corporate group could, potentially, hide behind the corporate veil in order to avoid costs of the rehabilitation of land used for mining, also needs to be borne in mind.

- Legislation is needed to regulate specific areas of business and to address areas of mischief. The drafters of legislation should in practice remain objective. In this study the drafting of two important statutes was shown to have been initiated by two persons, the first being Goldstone in the drafting of company law and the second Hofmeyr in the overhaul of the Tax Act. A study of these two men and how they influenced the legislation for which they were responsible would be both significant and valuable.
- The concept of limited liability was formed in a political and economic period different to today. Research relating to the extent to which this concept should also be amended to fall within the political and economic conditions of today may also be warranted.
- The OECD is in a consultation process of investigating the taxation of the digital economy. A public consultation document was published in which the challenges in the approach to the nexus and profit allocation arising from digitalisation is being considered. The profit allocation of multi-national entities (“MNEs”) for tax purposes is one of the key features being discussed. South Africa, by not considering a corporate group as a legal entity, could fail to adopt a new internationally accepted tax policy for taxing MNEs in the digital economy. This could impact on potential tax revenue being raised. It would be of value to understand the differences in various countries’ approach to the concept that a corporate group is a legal entity, and the potential to raise additional tax revenue from these MNEs.

## 6.4 FINAL REMARKS

The final comment of illumination for this thesis will be given to Sir James Rose Innes; Sir James, according to Schreiner (1967:13), was one of the three judges who “set out high standards after Union”<sup>1</sup>. In 1909, Schreiner (1967:13-14) records, Sir James’s judgment of *Blower v Van Noorden* 1909 TS 890 at [905], was couched in these considered terms:

There come times in the growth of every living system of law when old doctrine and ancient formulae must be modified in order to keep in touch with the expansion of legal ideas, and to keep pace with the requirements of changing conditions. And it is for the Courts to decide when the modifications, which time has proved to be desirable, are of a nature to be affected by judicial decision, and when they are so important or so radical that they should be left to the Legislature.

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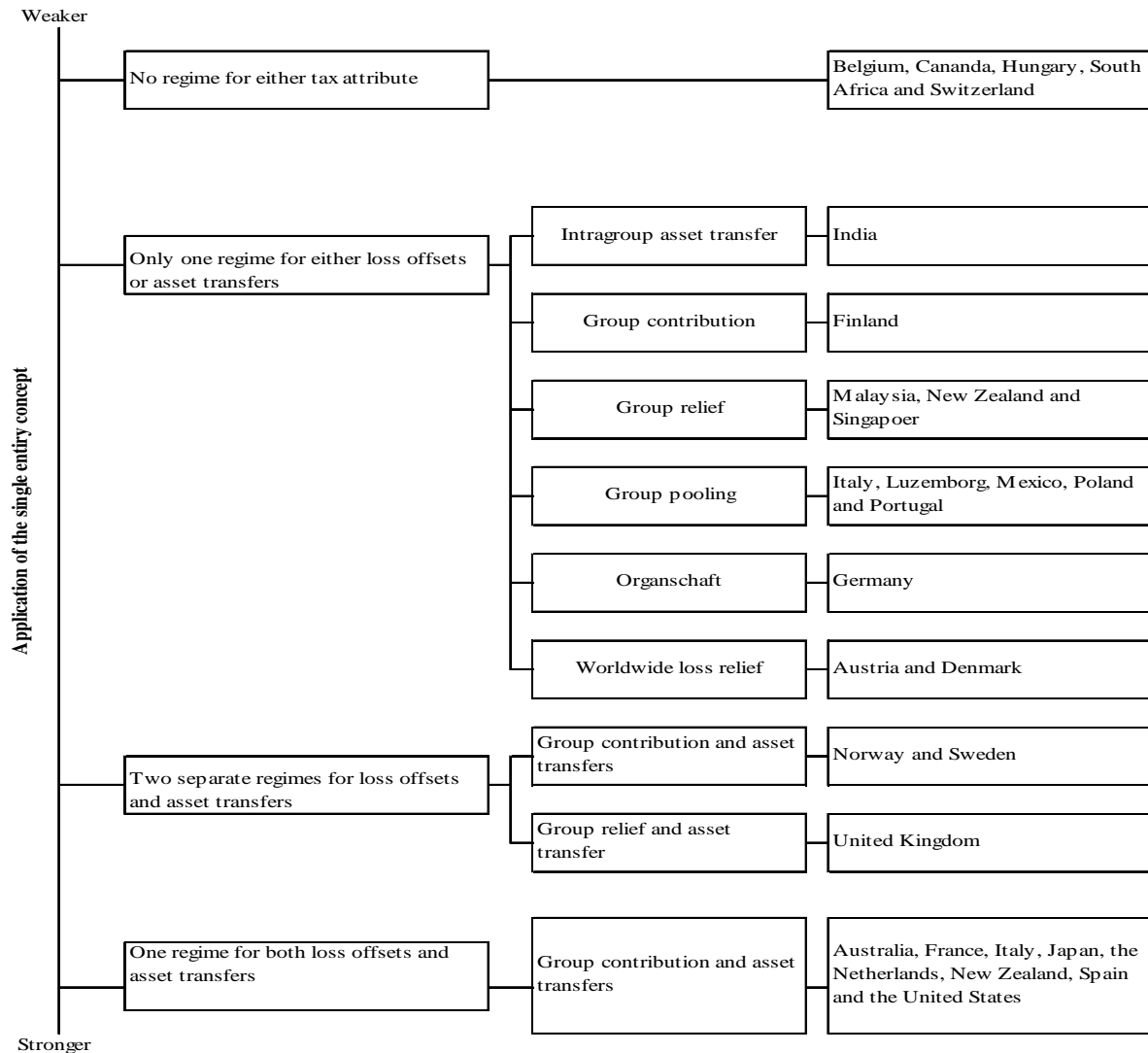
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## Appendix A



Source: Ting (2011:428)

## Appendix B

Name	Country of incorporation	Nature of activities	2018
<b>Significant operating subsidiaries</b>			
<b>Direct</b>			
Sasol Mining Holdings (Pty) Ltd	South Africa	Holding company of the group's mining interests	100
Sasol Technology (Pty) Ltd	South Africa	Engineering services, research and development and technology transfer	100
Sasol Financing Ltd	South Africa	Management of cash resources, investments and procurement of loans (for South African operations)	100
Sasol Investment Company (Pty) Ltd	South Africa	Holding company for foreign investments	100
Sasol South Africa Ltd	South Africa	Integrated petrochemicals and energy company	100
Sasol Middle East and India (Pty) Ltd	South Africa	Develop and implement international GTL and CTL ventures	100
Sasol Africa (Pty) Ltd	South Africa	Exploration, development, production, marketing and distribution of natural oil and gas and associated products	100
Sasol Oil (Pty) Ltd	South Africa	Marketing of fuels and lubricants	75
Sasol New Energy Holdings (Pty) Ltd	South Africa	Developing lower-carbon energy solutions	100

Source: Sasol (2018a:93)

## Appendix C

Name	Country of incorporation	Nature of activities	2018
<b>Significant operating subsidiaries</b>			
<b>Indirect</b>			
The Republic of Mozambique Pipeline Investment Company (Pty) Ltd (Rompcoc)*	South Africa	Owning and operating of the natural gas transmission pipeline between Temane in Mozambique and Secunda in South Africa for the transportation of natural gas produced in Mozambique to markets in Mozambique and South Africa	<b>50</b>
Sasol Financing International Limited	South Africa	Management of cash resources, investment and procurement of loans (for our foreign operations)	<b>100</b>
Sasol Germany GmbH	Germany	Production, marketing and distribution of chemical products	<b>100</b>
Sasol Italy SpA	Italy	Trading and transportation of oil products, petrochemicals and chemical products and derivatives	<b>100</b>
Sasol Mining (Pty) Ltd	South Africa	Coal mining activities	<b>90</b>
Sasol Canada Holdings Limited	Canada	Exploration, development, production, marketing and distribution of natural oil and gas and associated products in Canada	<b>100</b>
Sasol Chemicals (USA) LLC	United States of America	Production, marketing and distribution of chemical products	<b>100</b>

Source: Sasol (2018a:94)