



COMPANIES AND CLOSE CORPORATIONS

South Africa

Adams & Adams

Companies and Close Corporations

CAPE TOWN

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DURBAN

Companies Act no. 61 of 1973
Close Corporations Act no. 69 of 1984

Companies as business forms

The forms of enterprise most often used in business in South Africa are

- the sole proprietorship
- the partnership
- the company, and
- the close corporation.

The sole proprietorship is usually suitable for a relatively small enterprise in which the capital of only one person, the proprietor, is invested. In a partnership, two or more partners pool their ability and capital to increase the available business and human capital. In both a sole proprietorship and in a partnership those who contribute the capital - the sole proprietor or the partners - normally constitute the management. In both cases, the business does not become a separate legal entity or persona, and it does not have independent legal status. As proprietors of the undertaking, the sole proprietor or the partners carry the full risk of failure which may result in the sequestration of their personal estates.

In the case of both a company and a close corporation, a separate legal entity is created. A close corporation has a limited number of members who can contribute towards the capital of the business. A company, on the other hand, may be structured to have share capital contributed by many shareholders; this enables a greater amount of business capital to be made available. In both cases, the fact that a separate legal entity has been created entails business advantages, and also means that the shareholders (in the case of a company) and the members (in the case of a close corporation) do not always face the risk of sequestration of their personal estates in the event of failure of the undertaking. However, in certain circumstances the shareholders or members will be at risk.

Advantages of a company

The most common type of company, a company with a share capital, is characterised by the fact that the risk carried by contributors of share capital extends no further than the amount paid for their shares. An incidental advantage of the company is its regulated structure; the functions of a company are logically divided between the directors who are charged with the management of the undertaking, and the shareholders who have contributed

the share capital and 'own' the company, and who can exercise in a general meeting the ultimate control over the company.

In particular the advantages of limitation of risk, perpetual succession and a regulated structure make the **public** company with a share capital the most efficient means for mobilising the capital of the investing public. On a more modest level, the **private** company offers an attractive alternative for individuals or smaller groups, who would otherwise have to associate in a partnership, to reap the benefits of incorporation. In the case of charitable organisations and other associations not for gain, the same advantages of incorporation may be obtained by registration as a company under section 21 of the Companies Act.

Companies: Companies Act no. 61 of 1973

In section 1 of the Companies Act, a company is defined as a company incorporated in terms of the relevant provisions of the Act (Chapter IV) or any body which was a company in terms of any law which preceded the present Act. A company can be adequately described in general terms as an association of persons for the common object of the acquisition of gain; and though this description does not hold good for all companies, it holds good for most.

X Corporate entity

Although the corporate entity as such lacks tangible substance, it is a legal person. It enters into transactions by means of its directors, managers, employees and representatives acting on its behalf.

X Legal personality

Whether any particular entity can acquire legal personality must be determined in the light of the laws in force in the relevant legal system. An incorporated company is recognised in our law as a legal person whereas a partnership is not; and while a foundation has legal personality, a trust does not.

Types and forms of Companies

Formal classification

Only two basic **types** of companies can be formed in terms of the Act:

- a company having a share capital, and
- a company not having a share capital but with the liability of its members limited by the Memorandum of Association.

The latter type is in the Act termed 'a company limited by guarantee'. A special kind of company obliged to use this company type, is the so-called section 21 company or the incorporated association not for gain.

The company having a share capital may take one of two **forms**:

- a public, or
- a private company.

Further variants of these forms with different characteristic features may be distinguished. Thus, for example, a share block company may be seen as a particular kind of public or private company, whereas section 53(b) makes provision for a particular kind of private company with unlimited joint and several liability of its directors, which is mainly aimed at the needs of the professions. In addition the Act provides for the registration of an external company, but **not** of an **unlimited** company, although companies of the latter type which were registered in terms of the Companies Act of 1926 may continue to exist.

Company having a share capital

By far the more common of the two types of companies which according to section 19 may be formed and incorporated under the Act, is the company having a share capital. It obtains its capital by issuing shares and normally its members stand to lose no more than the amount paid by them for their shares. The fundamental difference between this type of company and one limited by guarantee, is precisely that it has a share capital, ie. the law assumes that its funds will be, to some extent at any rate, contributed by the members. Its share capital may consist of shares having par value or of shares having no par value. As indicated above, this type of company may take one of two forms, ie. a public or private company.

Public company

Members

At least seven persons associated for a lawful purpose are required for the formation and incorporation of a public company. Its name ends with the word 'Limited'. A public company may be defined as a company having a share capital and which is not a private company. It can raise capital from the general public. The Act does not place a limitation on the maximum number of members of a public company. The transferability of shares and interest in the company enables its members to dispose of their investments freely:

- Offers for subscription whereby the investing public is invited to take up **unissued** shares in the company may *inter alia* be used to raise capital to finance the company.
- A shareholder may offer his shares in the company for sale to the general public by way of an offer for sale, thus inviting them to purchase **issued** shares of the company to realise his shareholding.

In general, the company is therefore 'open' or 'public' in the sense that members of the public may hold or may acquire an interest in the company. Normally the articles of a public company do not contain provisions restricting the number of its members or excluding generally the offer or transfer of its shares or debentures to the public.

Shares and debentures of a public company may be **listed** and dealt in on a stock exchange. This will only be permitted if the provisions of the Stock Exchanges Control Act no. 7 of 1947 and the rules and requirements of the committee of the stock exchange concerned, have been complied with. The public company is in law the entity best suited for obtaining finance for large enterprises in the private sector. As a consequence of the widely spread shareholding in the case of a large listed company, an impersonal relationship exists between the mass of small shareholders *inter se* and between them and

the management. The typical shareholder is, in economic reality, merely an investor who obtained his shares with a view primarily to secure capital growth.

Private company

The number of members of a private company is prescribed in the Act, and a restriction is required to be placed on the transfer of shares.

Multiple members

For the formation and incorporation of a private company traditionally at least two persons were required to associate for a lawful purpose. However, it is now also possible for a private company to be formed with a single member, the so-called one man company (see below). The name of a private company ends with the words '(Proprietary) Limited'. Its existence is to satisfy the need for a form of company which would be suitable for the operation of an enterprise by a limited number of persons capable of providing the capital needs of the enterprise themselves. The same degree of disclosure as in the case of a public company, whose shares may be widely spread among the public, is not necessary.

Restrictions on private companies

According to section 20(1) a private company is a company with a share capital which is subject to certain restrictions:

- it must restrict the right to transfer its shares
- it must limit its membership to 50 (with exceptions in favour of employees and former employees), and
- it must prohibit any offer of its shares or debentures to the public.

Should a private company fail to comply with these restrictions, it becomes liable to lodge annual financial statements with the Registrar as if it were a public company.

Single member

The private company with a single member was recognised by the Act as it appeared that in practice many private companies were in reality so-called one man companies in that the second member was no more than the nominee of the first. The Act now accepts the reality that a single individual is able to incorporate a company. The emphasis falls on the concept of the creation of a separate legal body by incorporation, and not on the incidental aspect that its members should be a plurality. Thus the necessity of making use of a nominee merely to comply formally with legal requirements no longer exists.

Unlimited liability companies

A special kind of private company with unlimited concurrent joint and several liability of the directors was introduced to make it possible for professions practising in partnership to become incorporated. The last word in the name of such a company must be 'Incorporated'. At present section 53(b) of the Act makes provision for a private company to provide for unlimited liability of its directors (although in principle nothing prevents a public company from making the same provision). The section permits a private company to incorporate a provision in its memorandum that directors and former directors shall be liable jointly and severally for the debts of the company which are or were contracted during their periods of office. The directors of the company are then liable *singuli in solidum* for the debts of the company. In contrast, partners of a partnership may in practice usually not be sued individually during the subsistence of the partnership.

The provision creating joint and several liability may be included in the memorandum at any time by way of special resolution and with the written consent of the directors concerned, but it may only be amended or removed by special resolution if the court is satisfied that it is just and equitable.

Such a private company is mainly intended for professional association. However this does not mean that only members of professions may make use of this special kind of private company. Members of professions permitting such incorporation (eg attorneys, stock brokers, quantity surveyors and architects), find this an acceptable form in which to be associated, notably for the advantages of corporate existence and perpetual succession. This so-called 'professional company' in fact displays so many particular characteristics that it may also be classified to as a special kind of private company.

Company limited by guarantee

At least seven persons associated for a lawful purpose are required for the formation and incorporation of a company limited by guarantee. The last word in its name is 'Limited'. The statement '(Limited by Guarantee)' must be subjoined to its name to distinguish it from the ordinary public company. The company does not have a share capital, but the liability of its members is limited by the memorandum to the amount (not being less than one Rand per member) which the members undertake to contribute in the event of the company being wound up. A member is only liable to contribute to the assets of the company in the event of it being wound up while he is a member or within one year thereafter, if at that stage there are insufficient company assets for payment of the debts and liabilities of the company contracted before he ceased to be a member, and of other costs and expenses of the

winding-up. Any provision in the memorandum or articles or any resolution of the company purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void. Similarly any provision purporting to divide the undertaking of the company into shares or interests shall be void.

Previously this type of company could be a public or private company. In terms of section 19(3) all companies limited by guarantee, including those incorporated before the commencement of the Act, are at present deemed to be public companies for the purposes of the Act. Such a company is therefore obliged to lodge its annual financial statements with the registrar, although it is exempted from the obligation to lodge interim reports and provisional annual financial statements. Since the company may not have a share capital, it does not obtain its initial working capital from its members. This type of company is therefore only suitable if no initial working funds are required, or if those funds are obtained from other sources, for example endowments, fees, charges, donations, subscriptions or loans. This company type is thus hardly suitable for business purposes and is used almost exclusively in cases where the object is not one for gain, eg. mutual benefit societies, research associations etc.

Company not for profit

A special kind of company not for profit and which may under the Act only be incorporated as a company limited by guarantee, is the so-called **section 21 company** or **association not for gain**. Unlike the ordinary company limited by guarantee, the last word of the company's name need not be 'Limited' but the statement 'Association incorporated under section 21' must be subjoined to its name, or if incorporated before 25 June 1980 it may instead subjoin to its name the statement 'Incorporated association not for gain'. Essentially this kind of company is suitable for an association with the main object of promoting religion, arts, sciences, education, charity, recreation, or any other cultural or social activity or communal or group interests. As such an association may not be one for gain, it must apply its profits in promoting its main object and it may not divide its profits or assets amongst its members.

Unlimited company

There are a small number of unlimited companies which were registered in terms of the Companies Act of 1926 and which continue to exist. Most of them have come into being as a result of the formation of consortiums of professional men connected with large engineering projects. If such a company does not convert itself into another type of company, the provisions of the Companies Act of 1926 continue to apply to it. This type of company can no longer be registered.

Share block company

In terms of section 1 of the Share Blocks Control Act no. 59 of 1980, a share block company is a company the activities of which comprise or include the operation of a share block scheme, ie. a scheme in terms of which a share of the company in any manner confers a right to or an interest in the use of land including any building erected or to be erected, or any part thereof. If any share of a company confers such a right or interest, it is presumed to be a share block company. In practice a share block company usually signifies a company having a share capital of which a share confers the right on the holder thereof to occupy a specific unit or apartment in the building which is owned or leased by the company. The expression 'share block' must be included in or form part of the name of the company.

External company

The provisions of the Act in respect of external companies become operative as soon as such a company establishes a place of business in the Republic. An external company must register its memorandum within 21 days after it has established a place of business in the Republic. After registration the external company is a juristic person in the Republic subject to the applicable provisions of the Act.

Conversion of one form of company into another

The Act provides for the conversion of-

- a public company into a private company
- a private company into a public company
- a company into an incorporated association not for gain in terms of section 21 or into a company limited by guarantee
- an unlimited company into any other type or form of company.

Formation of a company

The promoters form a company and secure its incorporation by complying with the requirements of the Act in respect of the registration of the memorandum and articles of association. The company comes into existence when the Registrar of Companies issues the certificate of incorporation which offers proof that -

- all the registration requirements of the Act as well as all preliminary and attendant requirements have been satisfied, and
- the company has been duly registered in terms of the Act.

The body corporate

The result is that the subscribers to the memorandum and articles of association and those who become members of the company from time to time, will be in control of a body corporate having its own name, its own legal personality, perpetual succession, the ability to exercise all the functions of an incorporated company, and restricted liability of its members to contribute to the assets of the company. At the same time the memorandum and articles of association constitute a contract between the company and its members and the members *inter se*.

Reservation of name

Before applying for registration of the memorandum and articles of association, the name of the proposed company must be reserved (on Form CM 5) so that the prescribed documents may be prepared in an acceptable name.

Registration requirements

In terms of regulation 19 of the Companies Administrative Regulations the following must be submitted on application for registration and incorporation of a company having a share capital :

- the original and at least one notarially certified copies of the memorandum and of the articles;
- particulars of the name reserved for the company, by means of a copy of Form CM 5 as approved by the Registrar, together with particulars, if any, of the translation of the name of the company and short form of the name of the company also by means of a copy of Form CM 5 as approved by the Registrar;
- application for registration of the translated form of the company's name, if any, on Form CM 7;
- application for registration of the shortened form of the company's name, if any, on Form CM 7;
- notice of the situation of the company's registered office and its postal address on Form CM 22;

- a power of attorney signed by each of the subscribers to the memorandum in favour of the person lodging the documents;
- the written consent by a person to his appointment as auditor on his printed letterhead or the printed letterhead of his firm (in practice this consent is lodged in conjunction with the application for the certificate to commence business); and
- proof of payment of the registration fee and of the annual duty which must be affixed to the memorandum.

If it is desired to commence business immediately upon incorporation, the requirements for obtaining a certificate to commence business must be complied with simultaneously.

Close corporations: Close Corporations Act no. 69 of 1984

The concept

The Act provides for the formation of a close corporation, which will have its own legal personality and perpetual succession. A close corporation has the capacity and power of a natural person of full capacity.

Membership

The close corporation (in Afrikaans: 'beslote korporasie') does not have shareholders but has members. The members do not hold shares but have an 'interest' in the close corporation which is expressed as a percentage. Membership is restricted to natural persons. A company cannot be a member of a close corporation. The maximum number of members is 10.

Formation of a close corporation

The formation of a close corporation is very simple. Incorporation merely requires the registration of a single document, known as the founding statement, which sets out certain information. No memorandum or articles need to be submitted. The founding statement is a public document and can be inspected by non-members, but no third parties will be deemed to have knowledge of any information included in that statement.

Size

While there is a limit to the number of members of a close corporation (maximum 10) there is no restriction on-

- turnover;
- value of assets; and
- number of employees.

Thus the close corporation cannot outgrow its legal form.

Fiduciary duties

The Act provides that each member will stand in a fiduciary relationship to the corporation. The Act specifically includes certain duties, for example that members must avoid a conflict of interests, must notify other members of interests in contracts, and must not compete in any way with the corporation in its business activities. Members are therefore in a very different position from that of shareholders in relation to a company. Members of a corporation are in the same position in relation to the corporation as directors in relation to a company.

Members' contributions

If a person acquires an interest in a close corporation-

- upon incorporation; or
- from the corporation itself after incorporation

that member must make a contribution (which can consist of corporeal or incorporeal property or, in some instances, of services) to the close corporation. Such contribution will not necessarily determine the size of the member's interest in the close corporation. If a person acquires an interest from an existing member, that person will not have to make any contribution to the close corporation. There are no detailed rules for the maintenance of members' contributions, as is the case with the maintenance of share capital of a company.

Personal liability

The provisions of the Act are enforced in practice by virtue of the fact that members (and in some cases former members) will become personally liable if certain provisions of the Act are abused or ignored.

Similarly creditor protection is achieved by providing that members will be personally liable for corporation debts in certain circumstances.

Internal management : association agreements

The management of a close corporation where there is more than one member, is based on the principles of partnership. Although it is not a requirement, the members can agree with each other on the management, control, or any other internal matter of the close corporation. This agreement is known as an 'association agreement'.

An association agreement -

- is not lodged with the Registrar; and
- is not a public document. Third parties may not inspect it nor can they be deemed to have knowledge of any particulars in an association agreement.

A court, on application, has very wide powers to regulate relations between members.

Certain rules, set out in the Act and regulating the internal management of a corporation, will automatically apply to a close corporation unless contrary provision is made in an association agreement. For example, every member can, unless agreed otherwise, participate in conducting the business of the corporation.

Acquisition of a member's interest

The following persons may acquire the interest of an existing member:

- other members
- outsiders
- the corporation itself.

The consent of existing members will be necessary before outsiders and the corporation itself can acquire the interest. Alternatively, and preferably, these matters will be spelt out in detail in an association agreement.

Disposal of a member's interest

A member's interest can be disposed of in any of the following ways:

- by the member himself
- by order of court
- by the trustee of an insolvent estate
- by the executor of a deceased member's estate.

Provisions exist which effectively give remaining members first option of acquiring a member's interest prior to its disposal in certain circumstances.

An association agreement should set out the valuation and other procedures which must be followed when a member wishes to dispose of his interest, or when a member retires, dies, etc.

Financial assistance

The close corporation will be able to provide financial assistance for the purchase of a member's interest provided certain formalities are complied with. There is therefore no provision similar to section 38 of the Companies Act, which prohibits the rendering of financial assistance in connection with the purchase of the shares of the company.

Payments to members

There are no complex rules regulating what amounts may be distributed to members of a close corporation. Members can receive a payment (similar to a company 'dividend') if after the payment it can be shown that the corporation is solvent and able to meet its debts when they become due. If this cannot be shown, the members (and in some instances, former members) may become liable to repay to the corporation the amount received. Payments to members include the repayment by the corporation of members' contributions.

When and how payments to members can or should be made ought to be provided for in an association agreement entered into between members.

Accounting aspects

A close corporation will be obliged to keep accounting records and to prepare annual financial statements. No 'auditor' need be appointed, but a close corporation must have an 'accounting officer'. Certain other reporting requirements are set out in the Act.

Conversion from company to close corporation

The Act provides for the conversion of a company to a close corporation if-

- the company has 10 or less shareholders
- all shareholders are natural persons
- every shareholder becomes a member, and
- the auditor of the company issues a certificate.

There is nothing to prevent a company organising its affairs so as to comply with these requirements. The Act also states that a close corporation may convert to a company. The provisions of the Companies Act will regulate such a conversion.

Close corporation and companies

While a company may not be a member of a close corporation, a close corporation may hold shares in a company.

If the close corporation stands in relation to a company in such a manner that the close corporation would have been a holding company if it were a company, then the following matters are regulated:

- the provision of loans by the company to the close corporation
- the provision of loans by the company to the members of the close corporation.

A&A section for companies and close corporations

Adams & Adams has, as part of its Trade Marks department, a section for companies and close corporations, which offers comprehensive services related to-

- registration of companies
- registration of close corporation
- defensive company names
- all forms of special resolutions
- shelf companies
- commercial agreements related to companies and close corporation, such as shareholders agreements, members agreements, joint venture agreements, sale of member interest agreements and sale of business agreements.
- intellectual property agreements, including franchise agreements, licence agreements, distributorship and agency agreements and all forms of computer software and licensing agreements.

Private company or close corporation as a business form

Private company

Close corporation

Similarities

Juristic person
Perpetual succession
Members' liability limited except
in certain circumstances
No annual return
Duty on directors to prepare
annual financial statements

Juristic person
Perpetual succession
Members' liability limited except
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No annual return
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Differences

Directors and shareholders
Shareholders hold shares
Shareholders not more than 50
Shareholders have no duties
towards the company
Companies can be shareholders

Members
Members have a percentage interest
Members not more than 10
Members have certain fiduciary duties
towards the corporation
Companies cannot be members

Register of shareholders	No register of members; details of members in founding statement
Articles of association to be registered	Association agreement not compulsory; no provision for registration
Articles restrict the right to transfer shares	The Act regulates the transfer of members' interests
Rules restricting repayment/reduction of capital	Capital can be repaid or reduced fairly simply
Share capital	Members' contributions
Restriction on company to purchase own shares	Corporation can purchase a member's interest
Prohibition on financial assistance by company for the acquisition of its own shares	Corporation can provide financial assistance for the acquisition of a member's interest
Audited annual financial statements	Annual financial statements
Annual general meeting required	No annual general meeting required.

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