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National Treasury

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**PRETORIA**

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Dear National Treasury

**RE: Personal liability company**

Please find the South African Institute of Tax Professionals' request for a technical correction to section 12E(4)(a) of the Income Tax Act (58 of 1962).

**Problem statement**

Section 12E(4)(a) requires that a company must, in order to be a "small business corporation", be a private company as defined in section 1 of the Companies Act (Act 71 of 2008).

A personal liability company, whilst it must meet the criteria for a private company in order to be a personal liability company, is not a private company as defined in section 1 of the Companies Act.

The means that certain professional practices that are only allowed to render their services through a personal liability company will then not be a small business corporation for purposes of section 12E.

It is our view that these companies should qualify as small business corporations, if the other requirements of section 12E(4) are met.

## Comments

### *Relevant to the meaning of the phrase 'a private company'*

Two types of companies may be formed and incorporated under the Companies Act, 2008, namely profit companies and non-profit companies. A "profit company", as defined in section 1 of the Act, means a company incorporated for the purpose of financial gain for its shareholders.

In terms of the definition in section 1 of the Companies Act, 2008 a "private company" means a profit company that:

- (a) is not a public, personal liability or state-owned company; and
- (b) satisfies the criteria set out in section 8(2)(b).

A "public company" means a profit company that is not a state-owned company, a private company or a personal liability company.

In terms of the criteria set out in section 8(2)(b), a profit company is a private company if:

- (i) it is not a state-owned company; and
- (ii) its Memorandum of Incorporation:
  - (aa) prohibits it from offering any of its securities to the public; and
  - (bb) restricts the transferability of its securities.

In terms of section 8(2)(c) a profit company is a personal liability company if:

- (i) it meets the criteria for a private company; and
- (ii) its Memorandum of Incorporation states that it is a personal liability company.

From this it is clear that a personal liability company is not public company, but it is also not a private company as defined in section 1 of the Companies Act.

The only difference between a private company and a personal liability company is that the personal liability company must, in its Memorandum of Incorporation, state that it is a personal liability company. The problem arises from the fact that, whilst it must meet the criteria for a private company in order to be a personal liability company, it will not mean that it is a private company in terms of the Companies Act.

It is therefore clear that in terms of the Companies Act there are three kinds of profit companies, a public company, a private company or a personal liability company. (We can ignore a state-owned company for the purposes of this submission.) It is then clear that a private company or a personal liability company can't be public company. That would imply that a personal liability company is actually also a private company.

In the Draft Interpretation Note: No. 9 (Issue 6), issued by SARS earlier this year, the following is stated:

“Under the Companies Act No. 61 of 1973 a personal liability company was a private company which was not specifically defined or excluded from being a private company. As a result, it could historically have qualified as an SBC. This situation, however, no longer prevails since a personal liability company is specifically excluded from the definition of “private company”.”

(It is accepted that the reference here to a “personal liability company” is in fact to “a company limited by guarantee”.) The important point is that SARS acknowledges that the old Incorporated's (companies limited by guarantee), qualified under section 12E(4)(a) as a private company, but under the wording in the new Companies Act, it doesn't.

The Draft Interpretation Note also states that:

“A private company is, therefore, generally a juristic person that has been incorporated under the Companies Act for the purposes of making financial gain and whose founding document prohibits the offer of its shares to the public and restricts the transferability of its shares.”

It is clear that a personal liability company is a “a juristic person ... incorporated under the Companies Act for the purposes of making financial gain and whose founding document prohibits the offer of its shares to the public and restricts the transferability of its shares”. Such a company is then, in essence, also a private company.

### *Relevant to a 'personal liability company'*

Many professions, listed in the definition of 'personal service' only allow their practitioners (professionals) to render their services through a company, if the company is a person liability company.

Under the Ethical rules of conduct for practitioners registered under the Health Professions Act, 1974, a "private practice" means "the practice of a health practitioner who practises for his or her own account, either in *solus* practice, or as a partner in a partnership, or as an associate in an association with other practitioners, or as a director of a company established in terms of section 54A (*sic*) of the Act."

The South African Medical Association states that "section 54A (*sic*) gives you (the practitioner) an option to incorporate a company in terms of section 8(2)(c) of the Companies Act." The document can be found at <https://www.samedical.org/images/attachments/forms-of-business-partnership-vs-personal-liability-company.pdf>.

In terms of section 38 the Auditing Profession Act, 2005, the only firms that may become registered auditors are companies which comply with section 38(3) of that Act. Under that sub-section, the Regulatory Board must register a company as a registered auditor, amongst others, if the company has a share capital and its memorandum of incorporation provides that its directors and past directors are liable jointly and severally, together with the company, for its debts and liabilities contracted during their periods of office. Section 38(4) provides that, in its application to a company which is a registered auditor, section 8(2)(c) of the Companies Act, 2008, has effect.

Another example is found in the Geomatics Profession Act, 2013. It provides that a company may practise as and perform the work of a geomatics professional if the company has been incorporated or recognised as a personal liability company in terms of the Companies Act, 2008.

### **Conclusion**

It is our view that a personal liability company is also a company envisaged in section 12E(4).

The services that are typically rendered by professionals trading through a personal liability company are included in the definition of 'personal service' in section 12E(4)(d).

We therefore believe that a technical correction is required to section 12E(4)(a) in order to achieve this.

## Proposal

We propose that the words “... any private company as defined in section 1 of the Companies Act ...” be replaced with “... any private company as defined in section 1 of the Companies Act, but including a personal liability company ...”.

Yours sincerely,

Piet Nel