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Dear Ms Fubbs

COMPANIES AMENDMENT BILL, 2010

1. INTRODUCTION

SARS wishes to thank the Portfolio Committee on Trade and Industry for the opportunity to make submissions on the Companies Amendment Bill, 2010, (the Bill).

SARS and the dti have engaged constructively in the process that led up to the promulgation of the Companies Act, 2008, (the Act) and SARS appreciates the steps that were taken to address its concerns in that process. This engagement continued in the process leading up to the introduction of the Bill. Pressure of time has, however, meant that a number of issues could not be taken up in the Bill and will have to be brought before the committee by the dti and SARS for consideration.

The submissions below are intended to assist the committee in the consideration of these issues.

2. ISSUES FOR CONSIDERATION

2.1. Verification of annual financial statements

Verification of annual financial statements (AFS) is essential to reliance on them by a wide range of stakeholders, including creditors, employees, investors, regulators and shareholders. On the other hand, verification should be appropriate to the impact of a company on the economy, the needs of its stakeholders and other similar factors. SARS, therefore, has no difficulty with differential verification of AFS within an appropriate framework and looks forward to further engagement with the dti with respect to the drafting of the regulations in this regard. Three issues arising from the Act and the Bill with respect to the verification of AFS are as follows.

2.1.1. Audit of public companies (section 30 and clause 19)

The Act requires that public companies and certain other companies have their AFS audited. As a practical matter the auditors will then require that the

financial affairs of their material subsidiaries be audited for consolidation purposes, so that auditors may express an opinion on the holding companies' AFS. A difficulty arises where the ultimate holding company is located offshore, since its AFS may not be subject to the same level of verification as would be the case in South Africa.

SARS suggests that section 30 be amended to require that a company in South Africa have its AFS audited if it is a direct subsidiary of an offshore company that would be required to have its AFS audited were it located in South Africa.

2.1.2. Verification where all issued securities are held by directors (section 30 and clauses 19(c) and (d))

As noted above, SARS is of the view that the verification of AFS is essential to reliance on them by a wide range of stakeholders, who require varying degrees of assurance that the AFS comply with the required reporting standards. The exclusion of companies, all the issued securities of which are held by persons who are directors, from verification is therefore of concern in view of the increased risk that collusive dealings against other stakeholders or inadequate record keeping in such companies may go undiscovered for a longer period.

SARS supports the proposed amendment to section 30(2)(*b*)(ii)(*bb*) but on the basis that the exemption in terms of the proposed section 30(2A) be restricted to the requirement of section 30(3)(*d*) that the AFS be presented to the first shareholders' meeting after approval by the board.

2.1.3. Reportable irregularities (section 30 and clause 19(g))

Sections 44(1) and 45 of the Auditing Profession Act, 2005, provide that if unlawful acts that may cause serious financial loss, amount to fraud or theft, or are a material breach of a fiduciary duty come to an auditor's (or independent reviewer's) attention these "reportable irregularities" must be reported to the Independent Regulatory Board for Auditors (IRBA). If the reportable irregularities are not addressed by the management of the company within 30 days, IRBA reports them to the appropriate regulator or law enforcement agency.

SARS is of the view that this valuable mechanism should be retained to ensure consistent reporting of reportable irregularities, whether an audit or independent review is performed. SARS suggests that either an amendment be introduced to mandate that the Companies and Intellectual Property Commission fulfil a similar role with respect to independent reviews or clause 19(*g*) be amended to ensure that IRBA retains the role. The second option can be achieved by specifying that sections 44(1) and 45 of the Auditing Profession Act, 2005, remain in force with respect to persons carrying on independent reviews, with the necessary changes required by the context.

2.2. Persons allowed to act as directors (section 69(12) and clause 43(*b*))

A person who has been removed from an office of trust on the grounds of misconduct involving dishonesty or has been convicted and imprisoned without the option of a fine or fined more than a prescribed amount for an offence involving theft, forgery, fraud, misrepresentation, dishonesty or other

similar offences may not, as a general rule, act as a company director. This disqualification remains in force for at least five years after the removal from office or the completion of the sentence imposed for the relevant offence

However, section 69(12) of the Act provides that a person disqualified on one of the above grounds will be entitled to act as a director of a private company if all its issued securities are held by that person or by persons related to that person and they have consented in writing. This dispensation contrasts with that currently applying in respect of close corporations where such a person would be barred from taking part in the management of such corporation save under authority of a court.

Although clause 43(*b*) proposes that the exclusion be limited to a single removal from office or conviction, it remains a concern. Companies with only one shareholder or shareholders who are related need not necessarily be small companies. As things stand at the moment a company could be owned and run by a convicted fraudster while being exempt from preparing verified AFS. The potential prejudice to company stakeholders, other than the shareholders, is clear.

SARS suggests that clause 43(*b*) be amended to delete the exclusion provided in terms of section 69(12) or restrict it to only the smallest companies.

2.3. Conversion of par value shares into non-par value shares (item 6(3) of Schedule 5 and clause 118(5)(*c*))

Item 6(3) of Schedule 5 to the Act contemplates a change in the rights of shares on conversion from par value shares to non-par value shares. Combining a change in rights with a conversion creates considerable tax compliance difficulties for both taxpayers and SARS.

A change in shareholders' rights will trigger a capital gains tax (CGT) event in terms of the Eighth Schedule to the Income Tax Act, 1962, and may have other tax consequences. This means that all companies that are active or hold assets will have to consider the tax consequences of the conversion. SARS will also have to verify that the approximately 1.1 million private and public companies concerned have correctly disclosed the tax consequences.

The combination of a change in rights with a conversion does not appear to be necessary given the powers granted to a company to amend its Memorandum by way of special resolution in terms of sections 16(1)(*c*) and 36(2) to change the rights attaching to issued shares, as well as the protections afforded dissenting shareholders in terms of section 37(8), i.e. the appraisal rights in terms of section 164.

Although clause 118(5)(*c*) proposes the exclusion of a shareholder's appraisal rights in the case of a conversion of par value to non-par value shares this does not ameliorate the difficulties discussed above.

SARS supports National Treasury's proposal for the removal of the forced conversion of par value to non-par value shares. Alternatively SARS suggests that item 6(3) be amended to provide that a conversion from par to non-par value shares not be permitted to vary the rights of shareholders immediately prior to the conversion.

2.4. Business rescue

2.4.1. Moratorium on legal proceedings, including enforcement action (section 133(1) and clause 80)

Legal proceedings, including enforcement action, against a company under business rescue may only be undertaken with the written consent of the appointed business rescue practitioner or by leave of the court. SARS will thus not be able to proceed to collect current taxes payable, even where those taxes are collected by the company from employees (employees' tax and UIF), customers (VAT) and others (withholding tax on royalties, dividends, etc) under colour of law.

SARS supports National Treasury's proposal that business rescue not prevent regulators, including SARS, from initiating or continuing regulatory action. Alternatively, SARS suggests that clause 133(1) be amended to provide that employees' tax, UIF, other withholding taxes and VAT be specifically excluded from the moratorium in line with the provisions of section 133(1)(*e*).

2.4.2. Retention of books or records (section 142(4) and clause 86)

Section 142(4) provides that no person is entitled to retain possession of any books or records of a company or to claim a lien over them if a business rescue practitioner requires them. An accountant or auditor who holds the books or records must, therefore, turn them over even if they are held pending payment of professional fees.

On the other hand, SARS may seize books or records for purposes of the administration of a tax Act. Other regulators and law enforcement agencies may similarly seize books or records. Section 142(4) would appear to require the return of the books or records on demand by a business rescue practitioner, despite any relevance they may have to an ongoing investigation.

SARS suggests that section 142(4) be amended to exclude records held in terms of a search warrant or other statutory authority.

2.5. Appraisal rights (section 164(19) and clause 97)

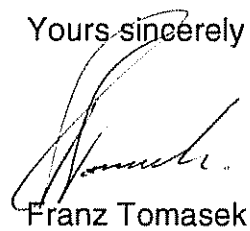
The solvency and liquidity test is one of the cornerstones of the Act. Section 164(19), however, specifically excludes payments to a shareholder exercising appraisal rights under section 164 from the solvency and liquidity tests. This approach may prejudice the other stakeholders in the company who would otherwise be protected by the test. Section 164 (17) goes some way to addressing this issue by providing that a company *may* approach a court for an appropriate order if it foresees a shareholder exercising appraisal rights will lead to liquidity difficulties.

SARS suggests that section 164(17) be amended to provide that a company *must* approach a court for an appropriate order if it foresees that a shareholder exercising appraisal rights will lead to the solvency and liquidity test being failed.

3. CONCLUSION

It is hoped that the above summary will assist the committee in its deliberations. Should the committee require any further information, please do not hesitate to contact the writer.

Yours sincerely



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