

CORPORATE LAW, PARTNERSHIPS AND TRUSTS

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ABSTRACT

The following issues are discussed in this *Sibergramme*:

- The legal consequences where trustees make an award of trust income or capital to a person who is not a beneficiary of the trust
- During the subsistence of a partnership, no partner can lay claim to particular partnership assets as being his sole property, for they are owned by the partners as co-owners in undivided shares
- Greater clarity as to meaning of business terms in common currency: ‘*business*’, ‘*association*’, ‘*voluntary association*’, ‘*unincorporated association*’, ‘*universitas*’, ‘*firm*’
- An aggrieved minority shareholder must choose his remedy carefully

1. TRUSTS

The legal consequences where trustees make an award of trust income or capital to a person who is not a beneficiary of the trust

One of the most important clauses in a trust deed is that which defines who the *beneficiaries* of the trust are to be – that is to say, the person, persons or class of persons to whom the trustees are empowered to make distributions of trust income or capital.

In **ITC 1840 (2010) 72 SATC 79**, the Gauteng Tax Court had to pronounce on the income tax consequences where trustees had made an award of trust capital to certain entities in the bona fide but mistaken belief that the latter were ‘beneficiaries’ – in other words, that they fell within the scope of the beneficiary clause of the trust deed.

The answer given by the court was unequivocal – the award was not one made ‘under and in pursuance of any trust’ and was therefore not exempt from donations tax in terms of section 56(1)(l) of the Income Tax Act 58 of 1962. Instead, it was a donation that fell outside of that statutory exemption and it was therefore subject to donations tax – which in this case amounted (together with interest due to the tax authorities) to some R180 million.

Aside from the disastrous tax consequences (for the donations tax could have been easily and legitimately saved by the simple expedient of amending and expanding the beneficiary clause in the trust deed), what does this decision tell us of the general legal

consequences where trustees award trust income or capital to persons who are not beneficiaries of the trust?

The award was held to be *ultra vires*

The decision in this case tells us that such an award by the trustees is *ultra vires* – a somewhat unhelpful, or at least ambiguous term.

Ultra vires is a term of art that can either refer to an act that is beyond the *capacity* of the legal entity in question, or it can mean an act that is beyond the *authority* of the individuals, acting as agents for the entity.

In terms of the Companies Act 61 of 1973, a company has limited capacity in that it can only do such things as fall within the scope of the objects clause in its memorandum of association, although section 36(1) of that Act allows outsiders to hold the company to *ultra vires* acts.

A trust, on the other hand, is not a legal *persona* in its own right, save where a particular statute (such as the Income Tax Act) provides otherwise. Outside of these statutory exceptions, a trust is merely an aggregation of assets, held by the trustees in their capacity as such.

Consequently, it is doubtful whether a trust (as distinct from a company) can act ‘beyond its capacity’. Thus, when the court, in ITC1840 said that the trustees had acted *ultra vires*, it presumably meant that the trustees were acting beyond their *authority*, as trustees.

The consequences where an agent acts without authority

In that event, the consequences of the trustees’ so doing would be the ordinary consequences which ensue where an agent acts without or beyond his authority, namely that the principal is not bound by the act unless there is a later ratification or unless the act fell within the agent’s *ostensible* authority or unless (in the case of a company) the *Turquand rule* applies.

The *Turquand rule* or indoor management rule provides that there is an irrebuttable legal presumption that all acts of a company’s internal management have been duly carried out. In circumstances where the *Turquand rule* applies, the act in question is binding on the company, despite the irregularity.

The Supreme Court of Appeal has not to date determined whether the *Turquand rule* applies to trusts (but see the affirmative conclusion in this regard in *Vrystaat Mielies (Edms) (Bpk) v Nieuwoudt* 2003 (2) SA 262 (O)), and in ITC 1840 the tax court found it unnecessary to make a finding on this point.

2. PARTNERSHIPS

During the subsistence of a partnership, no partner can lay claim to particular partnership assets as being his sole property

The meaning of the term ‘partnership’ is well-established, even though South Africa has no Partnership Act and there is thus no statutory definition of the term.

A ‘joint venture’ is an expression of a less clear meaning. It seems that a joint venture may – or it may not – be a partnership.

It is a matter of importance to know whether the parties to an undertaking are ‘partners’ or merely ‘joint venturers’. Most obviously, if they are ordinary partners (as distinct from anonymous partners or partners *en commandite*), they will be jointly and severally liable for partnership debts.

Other important consequences flow from whether they are or are not partners.

The rights of partners vis-à-vis partnership property

Thus, for example (as was recently affirmed by the Supreme Court of Appeal in *Botha v Coetzee* [2010] ZASCA 90), in a partnership, the partners are, during the subsistence of the partnership, co-owners in undivided shares of partnership property.

From this it follows that, during the subsistence of the partnership, no partner may lay claim to any particular partnership asset as being his sole property. At best (see para [5] of the judgement), he can secure ‘an order declaring him to be a partner and no more’.

If, on the other hand, the joint venture falls short of being a partnership, then a party to the venture may (depending on the terms of the agreement) be entitled to an order declaring that he is the sole owner of particular property that is the subject of the venture, and be entitled to have that property transferred to him.

In *Botha v Coetzee*, the applicant was asking the court for an order declaring him to be the beneficial owner of 50% of the shares in a certain company, and for an order that those shares be transferred to him.

On the version put forward by the applicant, Botha, in his affidavit, he and one Coetzee had agreed that they would acquire properties, that they would use a company as the vehicle for doing so, that Coetzee would initially and as a matter of convenience hold all the shares in the company; and that Coetzee would, on request, transfer 50% of those shares to Botha.

The court held that, on these facts, the agreement between Botha and Coetzee was not a partnership, ‘but rather, something akin to one – probably a joint venture if a label is necessary’.

The court pointed out (at para [6]) that if the undertaking had been a joint venture, then Botha's cause of action (for an order declaring him to be the owner of 50% of the shares and for transfer of those shares to him) would have disclosed a cause of action.

However, Botha had sought relief on the basis that his cause of action was a partnership agreement.

It was held that if the undertaking were indeed a partnership which still subsisted, then, as a partner, the applicant, Botha, was not entitled to the relief that he claimed, namely, an order declaring him to be the sole owner of 50% of the shares of the company in question (being partnership assets); nor was he entitled to an order that those shares be transferred to him.

This is so because, as was noted above, during the subsistence of a partnership, no partner can lay claim to particular partnership assets as being his sole property.

What was important was not the label attached to the agreement, but its terms

However, the Supreme Court of Appeal held (at paras [6] – [7]) that the critical issue was not what label the applicant had attached to the agreement (namely, that it was a partnership) but what the terms of the agreement were, and whether those terms could provide a cause of action, albeit not one based on partnership.

The court ruled that the matter should be referred to trial.

3. COMPANIES

Greater clarity as to meaning of business terms in common currency

The lexicon of business in South Africa is replete with words in common colloquial usage whose precise meaning is often obscure as regards the various forms of trading organisation.

The meanings of ‘company’, ‘close corporation’, and ‘partnership’ are clear – but what about ‘business’, ‘association’, ‘voluntary association’, ‘unincorporated association’, ‘universitas’ and ‘firm’?

Once litigation by or against such entities is contemplated, the question of the *locus standi* or otherwise of the organisation comes into sharp focus, as do the rights and liabilities of their members.

The thorough judgment of Van Zyl J in *Ex-TRTC United Workers Front v Premier, Eastern Cape Province* 2010 (2) SA 114 (ECB) is illuminating in this regard.

The judgment points out (some footnotes edited or omitted) that–

[10] Similar to a partnership, a firm¹ does not possess legal personality. It does not acquire any rights or duties separate from the person or legal entity that owns it. A firm is, simply put, a business carried on by the sole proprietor thereof under a trade name. The firm name is therefore in reality nothing more than the alias of its sole proprietor.² That being the position, legal proceedings cannot be instituted in the name of the firm. The owner must be cited in his/her personal capacity or, in the case of a company, in the registered name thereof. Under our law no juristic person is capable of being divided into a number of separate juristic personalities.³

[11] Turning to associations, they are described in *The Shorter Oxford English Dictionary* as “A body of people organised for a common purpose; a society”. Claasen provides the following description: “An organised body of persons who have joined together under some contract, statute, regulations or Rules, for the purpose of carrying out some common object.” A distinction must be drawn between, on the one hand, corporate associations which are by virtue of legislation (statutory associations) or under the common law (*universitas personarum*) legal entities distinct from their members,⁴ and what are referred to as unincorporated associations, on the other. For present purposes it is only necessary to deal with a *universitas* and an unincorporated association. The distinction between these two entities has been explained as follows in *Webb & Co Ltd v Northern Rifles; Hobson & Sons v Northern Rifles*⁵:

“A *universitas personarum* in Roman-Dutch law is a legal fiction, an aggregation of individuals forming a *persona* or entity, having the capacity of acquiring rights and incurring obligations to a great extent as a human being. An *universitas* is distinguished from a mere association of individuals by the fact that it is an entity distinct from the individuals forming it, that its capacity to acquire rights or incur obligations is distinct from that of its members, which are acquired or incurred for the body as a whole, and not for the individual members.”

[12] A *universitas* is therefore a separate legal entity that has perpetual succession with rights and duties independent from the rights and duties of its members. One of the most important rights of a *universitas* is the capacity to own property. Being a legal persona, a *universitas* may sue or be sued in its own name. It derives these characteristics from the common law and it is not necessary for it to be created by or registered in terms of a statute.⁶

¹ Rule 14 of the High Court rules defines a firm as ‘a business, including a business carried on by a body corporate, carried on by the sole proprietor thereof under a name other than his own’.

² *Simpson’s Motors v Flamingo Motors* 1989 (4) SA 797 (W) at 798F; *Ahmed v Belmont Supermarket* 1991 (3) SA 809 (N) at 811H; *PK Stores (Pty) Ltd t/a Eric’s Spar v Mike’s Kitchen* 1994 (2) SA 322 (O) at 324E.

³ Per Leveson J in *Two Sixty Four Investments (Pty) Ltd v Trust Bank* 1993 (3) SA 384 (W) at 385F.

⁴ Associations which can be classified as statutory associations include, inter alia, banks (Banks Act 94 of 1990), building societies (Mutual Banks Act 124 of 1993) and those registered as companies under s 21 of the Companies Act 61 of 1973. See also *Shillings CC v Cronje and Others* 1988 (2) SA 402 (A) at 420F–G.

⁵ 1908 TS 462 at 464–5.

⁶ *Ex parte Johannesburg Congregation of the Apostolic Church* 1968 (3) SA 377 (W) at 377E.

[13] By contrast, an unincorporated association refers to an association “which does not have a legal persona separate from its constituent members”.⁷ “Corporate” has a correspondingly opposite meaning. An unincorporated association is regarded as merely an aggregation or collection (a body) of natural persons. Accordingly, if the term “unincorporated association” is used, it refers to nothing more than a collection of individuals who ... are bound to one another by contract and who act jointly in pursuit of a common purpose. It has no existence on its own. It consequently cannot own property⁸ and has no *locus standi* to sue or be sued in its own name.⁹ In legal proceedings by or against the association, every member must as a result be cited as a plaintiff or a defendant, as the case may be.¹⁰

[14] Accordingly, the feature that a partnership, a firm and an unincorporated association have in common is that they have no legal personality of their own and do not exist apart from the individuals of whom they are composed.’

The nature and qualities of a *universitas*

As a business structure, a *universitas* is rare in South Africa, inter alia because of the statutory numerical limit on the members of an unincorporated profit-making organisation imposed by section 30(1) of the Companies Act 61 of 1973.

Section 30(1) provides that (except for the organized professions that have been exempted from this provision)–

‘No company, association, syndicate or partnership consisting of more than twenty persons shall be permitted or formed in the Republic for the purpose of carrying on any business that has for its object the acquisition of gain by the company, association, syndicate or partnership, or by the individual members thereof, unless it is registered as a company under this Act ...’

This provision is not as restrictive as it may seem at first reading, for it does not apply to an organisation of more than twenty persons merely because it makes an incidental profit, but only where the organisation was formed for the purpose of carrying on business for gain. (See *Huey Extreme Club V Mcdonald t/a Sport Helicopters* 2005 (1) SA 485 (C).)

Universitates are prolific in South Africa outside the commercial sphere, since many non-profit organisations choose to establish themselves as a *universitas*, rather than incur

⁷ Per Ogilvie Thompson JA in *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 (3) SA 291 (A) at 302A - B. See also *Shillings CC v Cronje and Others* 1988 (2) SA 402 (A) at 419F.

⁸ Although immovable property may be registered in the name of the association, the individual members are limited co-owners thereof. See LAWSA op cit in para 623; and Bamford, *The Law of Partnership and Voluntary Association in South Africa* at pp 185–6.

⁹ *Levin v Transvaal Miners Association* 1912 WLD 144; and *Congregation of Oblates of Mary Immaculate in the Transvaal v Moluele and Others* 1949 (3) SA 885 (T).

¹⁰ *Graham v Milnerton Turf Club* 1921 CPD 688; and *Leschin v Kovno Sick Benefit and Benevolent Society* 1936 WLD 9.

the expense, complexity and on-going compliance burden of registering themselves as a company.

Indeed, the Non-Profit Organisations Act 71 of 1997 mandates in section 12(1) that, in order to be registered under the Act, the constitution of a non-profit organisation must–

‘make provision for the organisation to be a body corporate and have an identity and existence distinct from its members or office-bearers [and] make provision for the organisation’s continued existence notwithstanding changes in the composition of its membership or office-bearers’.

Consequently, many (perhaps most) registered non-profit organisations are established as *universitates*.

The plaintiff was held not to be a *universitas*

The court pointed out (at [19]) that the primary source for determining the characteristics of an association is its constitution, and that this does not necessarily have to be in writing.¹¹

It was held (at para [19]) that the primary source for determining the characteristics of an association is its constitution, for this provides evidence of the intention of the members who contracted to form that association (*Ex-TRTC United Workers Front v Premier, Eastern Cape Province* 2010 (2) SA 114 (ECB) at 127F). Where the constitution is equivocal, or where there is no written constitution, the question whether a particular organisation is a *universitas* has to be determined by having regard to its nature, objects and activities (*Ex-TRTC United Workers Front v Premier, Eastern Cape Province* 2010 (2) SA 114 (ECB) at 128A).

In the present case, the court held (at para [20]) that the plaintiff organisation lacked the requisites of a *universitas* because it was formed for very limited purposes and, once that purpose was served, there would be no further need for it and it would cease to exist.

The latter dictum should be born in mind when drafting the constitution of an organisation with a view to its being a *universitas*.

An aggrieved minority shareholder must choose his remedy carefully

For all its brevity, the decision of the Durban High Court in *Molokoane v Diversified Power & Systems Integration (Pty) Ltd* [2009] JOL 24674 (KZD) holds valuable lessons for aggrieved minority shareholders in private companies and their professional advisers.

¹¹ To the same effect, see *CIR v Witwatersrand Association of Racing Clubs* 1960 (3) SA 291 (A) at 304G–305B.

The applicant, who was a director and a 26% shareholder in the respondent company, had applied in terms of section 344(h) of the Companies Act 61 of 1973 for the winding up of the company on the grounds that such an order was just and equitable.

The grounds on which the applicant relied were, inter alia, that the three other director/shareholders of the company had prevented him from participating in the management of the company and also that–

‘it has become impossible ... to carry on business due to the deadlock in the management arising from the internal disputes between myself and the other directors’.

The remaining shareholders and directors opposed the application, contending inter alia that, in terms of a shareholders’ agreement, the shareholders in the company were obliged to resolve their disputes by negotiation or arbitration, that the applicant was seldom at work and refused to attend meetings, and that the deadlock in question had been created by the applicant himself.

It was, of course, optimistic of the applicant to think that he could succeed on application, as opposed to action, given the numerous disputes of fact that were bound to arise. He also did his case no good (see the judgment at para [18]) by filing a cursory, four page founding affidavit that lacked supporting detail or documents.

Of interest in the judgment is the court’s view of the relevance of the shareholders’ agreement which provided that any dispute between the parties had to be resolved by negotiation or arbitration.

In this regard, the court held (at para [14]) that the provisions of the shareholders’ agreement–

‘do not expressly prevent a shareholder from launching an application for the winding-up of the respondent [company] even if the dispute arises in terms of or pursuant to the agreement. I am also satisfied that these provisions do not, by implication, have such effect. If the parties had wanted to restrict their rights to approach the court for relief under the Act, they could (and presumably would) have made provision for such restriction in the agreement’.

Consequently, said the court, the dispute-resolution provisions of the shareholders’ agreement did not preclude the applicant from applying for the company’s liquidation in terms of section 344(h).

The company was viable

It was undisputed that the company was ‘alive and well, busy, effective’ and had a number of employees.

In hindsight, the applicant’s strongest argument for a winding-up order was that he had (allegedly) been precluded from participating in the management of the company.

It was common cause that the company in question was a domestic company, or what other decisions have called a *quasi-partnership*, in which there is an agreement or understanding that the company will be operated as though it were a partnership.

Where there is such an understanding, all the members are entitled to participate in management, and if any is precluded from doing so, this is such a fundamental breach of the relationship as to be grounds for a winding up order. (See for example, *Ebrahimi v Westbourne Galleries Ltd.*)¹²

In the present case, however, the applicant chose instead to rely in the main on an alleged ‘deadlock’ in the management of the company.

It is well-established that deadlock (and not necessarily actual or complete deadlock) between the members, coupled with such a state of animosity as precludes all reasonable hope of reconciliation and friendly co-operation, is grounds for a winding-up order.¹³

The difficulty with this ground is that an applicant is not entitled to a winding-up order if he had himself created the deadlock. (See the judgment at para [27].) Not unexpectedly, this is precisely what the other shareholders and directors in the present case averred.

This again, was a dispute of fact that could not be resolved in application proceedings unless the matter was referred to oral evidence – which the court in this case declined to do.

An ulterior motive?

It is difficult to avoid the suspicion (though the judgment makes no explicit observation to this effect) that the application for the winding-up of the company, given its prosperity, may have been brought by the applicant for an ulterior motive, namely, to pressure the other shareholders into buying him out on favourable terms.

It is trite that, if there were such an ulterior motive, the proceedings would be an abuse of the process of the court, and would be liable to struck out on that ground alone.

For example, in *Tsenelo Media Solutions (Pty) Ltd v Brand IQ (Pty) Ltd* [2009] JOL 23506 (GNP), the court held that the applicant for the liquidation of the company in question was not really seeking liquidation, but was disputing the valuation of shares.

In the present case, the court hinted at its suspicion in this regard in suggesting that the applicant’s most appropriate remedy, in the circumstances, lay in an application in terms of section 252(1) of the Companies Act which provides that–

‘[a]ny member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable: to him or to some part of the members of the company, may ... make an application to the Court for an order under this section’.

¹² [1973] AC 360 (HL).

¹³ *Apco Africa (Pty) Ltd v Apco Worldwide Inc* 2008 (5) SA 615 (SCA) at [21].

If an applicant successfully invokes this provision, the court can then make any order it sees fit. In the present case, the most obviously order to make would be that the company itself or the other members buy out the applicant's shares at their fair value.

In the result, the court was not persuaded that the applicant had established that it would be just and equitable to wind up the company, and the court dismissed the application.

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