FINANCIAL ASSISTANCE FOR SHARE ACQUISITIONS: LEGAL CONSIDERATIONS IN FINANCING THE FINANCIAL ASSISTANCE LOANS THROUGH DIVIDENDS

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DECLARATION

I, 566464,

declare that this research report is my unaided work. It is submitted in partial fulfillment of the requirements for a Master of Law degree (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination at this or any other university.

I submitted my final research report through TurnItIn and have attached it to my submission.

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ABSTRACT

*In order for a company to successfully exist and carry out its functions, it requires money (capital investment) from investors. A company gets the money that it needs to carry on a business, either from shareholders or lenders of money or, usually, from a combination of the shareholders and money lenders. Accordingly, a company's capital/finances need to be protected from misuse, while allowing the board of directors to make strategic decisions on behalf of the company. The Companies Act 61 of 1973 (the "**1973 Act**") demonstrated many deficiencies that were not able to meet all the requirements of modern corporate practices. For example, companies were prohibited from providing financial assistance to acquire their shares. Furthermore, companies were not allowed to declare and pay dividends unless they could demonstrate the availability of distributable profits, which exist only if the company's assets exceed all of the company's liabilities and its entire issued capital. The failure to meet modern corporate practices was also highlighted by the team of American lawyers who were members of the Section of Business Law of the American Bar Association (hereafter referred to as "the **Review Committee**") which provided that modern corporate practice is not to limit to the power of a company to do various things such as financial assistance.[1] The new Companies Act 71 of 2008 (hereafter referred to as "the **2008 Companies Act**") changed most of the rules relating to company law in South Africa. Notably, under the 2008 Companies Act, companies are allowed to provide financial assistance and the Companies Act abolished the doctrine of capital maintenance. This report analyses the requirements of financial assistance in terms of section 44. The analysis is done using the latest unreported case as a foundation to highlight the key aspects of financial assistance. Furthermore, most BEE transactions implemented in South Africa are done through financial assistance (using conventional loans), with the BEE shareholder to whom the loan is granted typically utilizing dividends declared and paid by the company to repay the financial assistance. While this research admits that financial assistance is separate from fair consideration, it will also attempt to illustrate that for certain BEE transactions "fair consideration" and the solvency and liquidity test are critical. This paper also considers the connection, if any, between financial assistance and section*

[1] Committee on Corporate Laws of the American Bar Association's Section of Business Law, Report on South African Companies Act No. 61 Of 1973 and Related Legislation (2001).

46 of the Companies Act (the declaration of dividends by a company) and the implication of using dividends to repay a loan granted by a company in terms of section 44 of the Companies Act.

1. HISTORICAL BACKGROUND

Under the previous South African corporate laws, companies were not allowed to provide financial assistance to another company or person for the purchase of or subscription of their shares, as this was seen as a way by a company to indirectly acquire its shares.[2]

The prohibition of financial assistance for the purchase or subscription of shares originated from the doctrine of capital maintenance (the "**doctrine**"). The doctrine was developed by courts in the 19th century, and it was later further developed and structured by the decision of the House of Lords in the case of *Trevor v Whitworth*.[3] The principles of the doctrine were based on two elements: firstly, it was to protect the interest of the company's creditors, and secondly it was to ensure the lawful use of the assets of a company.[4] Lord Watson and Lord MacNaghton, respectively stated the following:

Lord Watson stated that: No law can prevent paid-up capital from decreasing or disappearing during a company's operations, but people who deal with and lend credit to a limited company naturally rely on the fact that the company is operating with a certain amount of capital already paid as well as on the responsibility of its members for the capital that is still available at call.[5] They have the right to assume that none of the capital that has been deposited into the company's coffers has ever been paid out in the past unless it was in the normal course of the company's operations.[6]

The principle of limited liability allows a company to buy its shares if authorised by its articles. However, this raises a broader question - can a limited company invest any of its capital in buying its shares or returning capital to shareholders without following the legal requirements set by

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[2] Companies Act 61 of 1973. See Cilliers et al Cilliers and Benade Corporate Law 329; Benade, Henning, Du Plessis, Delport, De Koker and Pretorius Entrepreneurial Law (2008) 192; and see also Blackman, Jooste and Everingham Commentary on the Companies Act (2002) 4-55.

[3] *Trevor v Whitworth* (1887) 12 App Cas 409 (HL) (*Trevor*).

[4] Md. Saidul Islam "*The Doctrine of Capital Maintenance and its Statutory Developments: An Analysis"* The Northern University Journal of Law, Volume IV (2013) page 49.

[5] *Trevor* supra note 2

[6] Ibid.

Parliament?[7] According to this principle, a company cannot withdraw funds that are shared by others without following the prescribed legal course.[8]

As stated above and amongst other things, the *Trevor v Whitworth* case through the doctrine also provided a prohibition on a company to provide financial assistance for the acquisition or subscription of its shares.[9] This principle was then codified by various jurisdictions including the Republic of South Africa ("**South Africa**").

In the context of South Africa, the prohibition of a company to offer financial assistance for purposes of the acquisition of its shares was set out in section 38 of the 1973 Act, which originated from section 54 of the English Companies Act of 1948 ("**English Companies Act**"). The 1973 Act and the English Companies Act prohibited companies from providing financial assistance for purposes of the acquisition of their shares.[10] The wording between the English Companies Act and the 1973 Act are identical, this confirms that the South African 1973 Act was adopted from the English Companies Act.

Section 38 of the 1973 Act provided that:

"*No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company, or where the company is a subsidiary company, of its holding company*."[11] Section 38 of the 1973 Act follows section 86*bis* of the Companies Act 46 of 1926 ("**1926 Act**"), these two sections have the same provision. In this regard, most cases that were decided before the 1973 Act were decided under the 1926 Act.

From the wording of section 38 of the 1973 Act, any transaction between the company and the shareholder that would have resulted in a shareholder subscribing for shares or purchasing the companies' shares using a loan from the company would have not been permitted as it was outright

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[7] Ibid page 432.
[8] Ibid page 432.
[9] Md. Saidul Islam op cit note 4 page 47.
[10]Heidi Miller and Mzi Mgudlwa Financing empowerment: *The implications of Section 38 of the Companies Act* (2003\037\BEE\CR) page2.
[11] Section 38 of the 1973 Act.

prohibited. The wording of "whether direct or indirect" in section 38 made the section to be widely interpreted by various courts. In the *Lipschitz v UDC Bank* case, the court stated "*that prohibition in s 86 bis (2) of the Companies Act 46 of 1926 comprises two elements; one is the giving of financial assistance, the other is the purpose for which it is given (or the "in connection with" provision). The two elements are linked to form a single prohibition but although so linked they are vitally different in concept*." [12] The *Lipschitz v UDC Bank* case was decided on the 1926 Act, however, the principle and the interpretation were applied to section 38 of the 1973 Act.

Based on the doctrine, the 1973 Act, the 1926 Act, and *the Lipschitz v. UDC Bank* case, companies were not able to embark on any transactions that involved a loan being granted for purposes of acquiring shares in that company, whether by way of subscription for authorised shares or by way of purchase of shares from another shareholder of the company.

Setting up a Black Economic Empowerment ("**BEE**") through a share scheme or loan granted by the company was not possible and such transactions were considered void and unenforceable. Looking at the doctrine and the 1973 Act, transactions financed through a loan from the company for purposes of acquiring shares of the company would not have been possible for BEE partners, given the fact that payment of dividends was also prohibited by the doctrine. Section 38 of the 1973 Act posed a challenge to BEE transactions since it prohibited financially capable companies from providing financial support to potential BEE partners who could not afford to acquire shares on their own.[13]

The doctrine was harshly treating honest companies and shareholders and assumed that every shareholder was not trustworthy,[14] and the doctrine was placing creditors ahead of all the potential business needs of a company. [15] The criticism of the doctrine was highlighted by the court in the *Lipschitz v UDC Bank* case, in terms of which the court made reference to an English report which

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[12] *Lipschitz No v UDC Bank Ltd* 1979 (1) SA page 789 (*Lipschit*).

[13] Yeats JL "*The Drafter Dilemma: Some comments on Corporate Laws Amendment Bill 2006" SALJ* (2006) Volume 123 page 607 (Yeats JL). Yeats argues that it is an accepted commercial and legal fact that section 38 has hampered black economic empowerment by preventing financially strong companies from offering assistance for the acquisition of shares to potential BEE partners who do not have the requisite resources to acquire those shares independently.

[14] Ibid.

[15] Ibid.

observed that the prohibition of financial assistance was an occasional embarrassment to the honest shareholders, not inconvenient to unscrupulous.[16]

The prohibition of companies to provide financial assistance was being criticised in various jurisdictions. As the result of the wave of criticisms and the development of corporate law and governance, section 38 of the 1973 Act was subsequently amended by section 9 of the Corporate Laws Amendment Act 24 of 2006. The 2006 Amendment Act introduced section 38(2A) which permitted companies to grant financial assistance for the acquisition of their shares, subject to the solvency and liquidity test being satisfied by the company, and a special resolution was also introduced as a key requirement for purposes of approving and granting financial assistance.[17]

The permission to grant financial assistance in terms of section 38(2A) was then added to facilitate BEE transactions.[18] This was the first time an exception was granted in respect of a company granting financial assistance for the acquisition of its shares, but it must be noted that such an exception was only limited to BEE transactions. In this regard, Yeats stated that the introduction of section 38(2A) was to assist with the diversification of shareholders and BEE in South African businesses.[19]

The corporate world was evolving, and this led to changes in the laws governing companies in various jurisdictions worldwide. As a result, section 38(2A) was no longer appropriate and was impeding companies' ability to compete fairly in the global financial market, prompting South Africa to reassess and modify its approach to corporate and company law. The Review Committee reviewed the 1973 Act in 2001 and provided the following comment regarding Section 38 of the 1973 Act (financial assistance):

> "*Modern corporate practice is not to limit the power of a company to provide financial assistance to purchasers of shares from the company, e.g., by permitting them to pay for their shares with a promissory note to the corporation.*"[20]

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[16] *Lipschitz* supra note 12 page 797.

[17] Commentary on the Companies Act of 2008 Companies Act 71 of 2008 Chapter 2 Part D Capitalisation of profit companies (ss 35–48)/44 Financial assistance for subscription of securities Juta commentary: OS, 2018, p 2-375.

[18] Ibid.

[19] Yeats JL op cit note 15 page 607.

[20] Committee on Corporate Laws Op cit note 1 page. 11 (Commentary on s38 of the 1973 Companies Act).

The Review Committee criticised the 1973 Act for being highly creditor-oriented,[21] and recommended that clause 38 of the 1973 Act be deleted in its entirety and advised the legislators to consider the wording of the Model Act section 6.21(b) and the Delaware General Corporation Law section 152 which had already incorporated progressive provisions in respect of financial assistance.[22]

2. THE RATIONAL OF FINANCIAL ASSISTANCE

Following the recommendations by the Review Committee, South Africa introduced Section 44 of the 2008 Companies Act, which abolished the prohibition placed on companies when it comes to granting financial assistance for purposes of subscribing to or purchasing shares of the company.

Companies are provided an inherent right to provide financial assistance to any person for the purchase or subscription of their shares, provided that a company is permitted to do so by its memorandum of incorporation, and that it complies with sections 44 (3) and 44(4).[23] It is clear from the wording of section 44 that there is a complete shift from the way financial assistance was perceived in the past. Other commentators on corporate law argued that section 44 is the death of the doctrine in South Africa.[24] Allowing companies to provide financial assistance should not be perceived negatively instead it should be commended as it allows South African companies to be able to compete and be part of the economic growth at the global scale.

The rationale behind the 2008 Companies Act regulating the granting of financial assistance by a company for the acquisition of its shares is primarily to protect the company's value and assets, while allowing strategic business decisions to be made by the directors of the company. The 2008 Companies Act is meant to provide some level of flexibility on how companies are operated in South Africa.[25] In this regard, section 7 of the 2008 Companies Act outline the purpose of the Act, which is to promote the development of the South African economy by creating flexibility and simplicity in the formation and maintenance of companies and to continue to provide for the

[21] Ibid page 4.
[22] Committee on Corporate Laws Op cit note 1 page 11.
[23] Companies Act, section 44.
[24] Wainer HE "*The Companies Act Changes – Problems and Doubts*" *SALJ* (2001) 133 at page 133.
[25] Section 7 of the Companies Act.

creation and use of companies,[26] in a manner that enhances the economic welfare of South Africa as a partner within the global economy.[27]

The allowance of financial assistance does not in any way disregard the interest of creditors or of those who are minority shareholders in a company. This is also clear from the 2008 Companies Act, as it provides for specific requirements that must be met before a company can provide financial assistance for the acquisition of its shares. In addition, creditors are very capable of protecting their interests, for example, creditors can protect their interests through financial terms, such as credit insurance, collateral, and contractual covenants, which are well-developed and are more effective, flexible, and debtor-specific than corporation statutes such as the Companies Act.[28] Shareholders also have other provisions of the Companies Act to rely on to protect their interest in the company for example section 163 of the 2008 Companies Act protect minority shareholders.

Financial assistance should be perceived as a strategic tool for corporate entities to promote business and economic growth in South Africa. One of the best ways to ensure that the best employees are committed to the company is through transactions such as an employee share scheme, where a company establishes an employee share scheme that allows employees to acquire shares with financial assistance from the company.

3. WHAT IS FINANCIAL ASSISTANCE?

Just like all previous corporate statutes, the 2008 Companies Act does not provide definition of “financial assistance”, but instead it provides a negative section that describes things that are not to be considered financial assistance.[29] In this regard, section 44 (1) states that financial assistance does not include loans made by businesses whose main activity is lending money in the regular course of business.[30]

Financial assistance is not a term capable of a clear legal definition, and the court stated that it is unwise for the law maker to lay down a clear and precise definition of this term.[31] In the case of

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[26] Ibid.
[27] Ibid.
[28] Op cit note 17 page 4.
[29] Section 44 of the Companies Act.
[30] Ibid.
[31] *Anglo Petroleum Ltd v TFB (Mortgages) Ltd* 2008 1 BCLC 185 (CA) para 26 at 190–1.

Charterhouse Investments Trust Ltd v Tempest Diesel Ltd, the court stated that when assessing financial assistance "*One must examine the commercial realities of the transaction and decide whether it can properly be described as giving financial assistance by the company, bearing in mind that the section is a penal one and should not be strained to cover transactions which are not fairly within it*."[32]

In *the Lewis v Oneanate (Pty) Ltd* case, the court attempted to provide clarity as to what is meant by "financial assistance" and it stated that financial assistance is any assistance of a financial nature that is given directly or indirectly for or in connection with acquisition of shares.[33] Furthermore, the court stated that the true nature of each transaction must be considered.[34] The same principle was highlighted by the court in the case of *Gradwell* (*Pty*) *Ltd v Rostra Printers Ltd*. This also confirms that section 44 does not only cover the lending of money as a type of financial assistance. If a company gives up its assert, which it owns as security for one to obtain a loan and use such a loan to purchase or subscribe for shares in that company, such transaction will constitute financial assistance.

In the case of *Rossfield Group Operations Pty Ltd v Austral Group Ltd*, the court stated that financial assistance is not given when the transaction's direct object is to provide what the other person is already entitled to. [35]

My understanding of the wording of Section 44 (1) is that if company **A**'s primary business is to offer loans to any person with an applicable interest rate, and then, if company A lends money to a person (using its normal interest rate) to subscribe for its authorised shares, such transaction will be exempted from section 44 as it is company A's ordinary business to offer loans. While if company **B**'s primary business is to manufacture and sell beer, and it then lends money to a BEE partner to subscribe for its shares, such transactions will be subject to Section 44. Company B, through its board of directors, must ensure that Section 44 requirements are satisfied before approving and granting such a loan.

[32] *Charterhouse Investments Trust Ltd v Tempest Diesel Ltd* [1986] 1 BCLC 1.
[33] *Lewis v Oneanate (Pty) Ltd* (1992) 4 SA 811 (A).
[34] Ibid page 10.
[35] *Rossfield Group Operations Pty Ltd v Austral Group Ltd* 1981 QdR 279 286.

3.1 Types of financial assistance

Financial assistance is not only the granting of money by the company to the borrower. Financial assistance may take different forms, and regard should be given to the true nature of the transaction.[36] A financial assistance transaction can be one of the below examples.

- Employee Share Scheme is a transaction where a company establishes an employee share scheme that allows employees to acquire shares in the company with financial assistance from the company.[37]
- Guarantees or collateral, a transaction where a company provides guarantees or collateral for a loan taken out to acquire shares in the company or one of the companies in the group company structure. [38]
- Debt forgiveness is a transaction where a company writes off debt owed by a shareholder or entity in exchange for shares in the company. As mentioned above, if such a write-off meets all the elements for the acquisition of shares by the person who was owing the company, such a transaction will be regarded as financial assistance in terms of Section 44.
- Cross-shareholding arrangements are transactions where a company provides financial assistance to another shareholder to acquire shares held by another shareholder in the same company.

In determining whether the transaction is a "financial assistance transaction", the focus should be on the purpose of the transaction and not the form (the true nature of the transaction). In this regard and in *the Gradwell v Printers* case, the court stated that the direct object of the provision of financial assistance was relevant when determining if the transaction was within the ambit of the Act.[39]

4. STATUTORY REQUIREMENTS

Firstly: the board of directors of a company may now authorise financial assistance to be provided by the company by way of a loan, guarantee, or the provision of security to any person to subscribe

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[36] *Lewis v Oneanate (Pty) Ltd* (1992) 4 SA 811 (A) at 10.
[37] Section 44 (3) read with section 97 of the Companies Act
[38] Section 44 (2) of the Companies Act.
[39] *Gradwell (Pty) Ltd v Rostra Printers Ltd* (1959) 4 SA 419 (A).

for shares issued in that company.[40] There are arguments which are made by some legal analysts in respect of the authorisation of financial assistance for share acquisition:

> Delport argues that the board cannot authorise the company to provide financial assistance. He indicates that the company should authorise the board, not the other way around.[41]
>
> Petrus Lafras argues that the section 44(2) seems to be erroneous and requires correction since it is indeed the "company that have to authorise its board to provide financial assistance for the acquisition of its shares."[42]

However, these arguments do not have a stronghold for the following reasons: Section 44 requires that any financial assistance must have been approved by a shareholders' special resolution (safeguard provision).[43] Furthermore, the board oversees the company's business on daily basis and ensure that the company comply with all applicable laws and regulations.[44]It is also the board of directors that must consider the best interests of the company in all transactions, including financial assistance transactions.[45] In this regard, section 66 provides that "*The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.*" [46]

A decision to offer and grant financial assistance is a business decision by the directors, therefore, the regulator was correct to allow the board to authorise financial assistance for the acquisition of the company shares. This position was also supported by the Review Committee which stated that the board is responsible for the determination the consideration to be received by the company when shares are being issued[47]

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[40] Section 44 of the Companies Act.
[41] Delport PA *The New Companies Act* Manual (2011) Lexis Nexis 2nd Edition page 54.
[42] Petrus Lafras de Jager *A Legal Comparison between sections 38, 226, 90, and 85 of the Companies Act, 1973, and sections 44, 45, 46, and 48 of the Companies Act, 2008* (unpublish LLM thesis, University of Pretoria) page 15.
[43] Section 44 of the Companies Act.
[44] Vardags "*Do shareholders have more power than directors*", available at https://vardags.com/law-guide/shareholder-agreements-and-disputes/do-shareholders-have-more-power-than-directors, accessed on 29 March 2023.
[45] Ibid.
[46] Section 66(1) of the Companies Act
[47] Committee on Corporate Laws Op cit note 1 page. 11 (Commentary on s38 of the 1973 Companies Act).

Secondly: the financial assistance may only be authorised by the board for one of two reasons. Under the employee scheme in accordance with section 97,[48] or if the board has been authorised by a shareholders special resolution that should have been passed within the previous two years.[49]

Thirdly: the company's directors must be satisfied that the terms of the financial assistance are fair and reasonable to the company, and the company would, after providing the financial assistance, still be both solvent and liquid.[50] This means that the company must satisfy the solvency and liquidity test which is outlined in section 4 of the Companies Act.

Lastly: all conditions of the memorandum of incorporation must be complied with.

The next section outlines the requirements of financial assistance in detail, using an unreported case of *Booysen and Others v Kohrs and Others* as a foundation to outline the principles and elements to be considered when dealing with section 44 (financial assistance).

5. FINANCIAL ASSISTANCE PRINCIPLES AND CASE LAW

The Companies Act came into effect in May 2011 and our courts have not yet been approached with sufficient matters in respect of Section 44. This means that there are no reported leading cases in terms of financial assistance for the subscription of shares/securities. There is, however, a recent unreported case of *Booysen and Others v. Kohrs and Others*.

5.1 *Booysen and Others v Kohrs and Others*

The Gauteng High Court was approached on an urgent basis to adjudicate and provide interim relief, among other legal matters, on whether the financial assistance was valid. In this case, the company in question was CP De Leeuw (Pretoria) Limited (hereafter referred to as the "**CP De Leeuw**"). CP De Leeuw was one of the oldest quantity surveying firms in South Africa. On May 8, 2012, the applicants, Mr. Booysen and Mr. Van Oudtshoorn, and the respondents, Mr. Serfontein and Mr. Kohrs, entered into a sale of shares agreement in which each of the respondents acquired 102 shares in CP De Leeuw. The sale of shares agreements between the first and second

[48] Section 44 of the 2008 Companies Act.

[49] A special resolution involves a resolution adopted by the majority of at least 75% of the voting rights exercised on resolutions, or a higher percentage that may be allowed by the memorandum of incorporation.

[50] Section 44 of the Companies Act.

respondents stated that Mr. Booysen, the first applicant, and Mr. van Rheede van Oudtshoorn, the second applicant, would sell 102 shares for a total of R2,550,000. The respondents were to pay a deposit of R255,000, and the remaining balance would be payable over five years. The applicants and the respondents signed a delegation of payment of the outstanding debt (of the first and the second respondents) to CP De Leeuw on the same day they signed the sale of shares agreement.

According to the delegation agreement, both the first and second respondents owe Mr. Booysen and Mr. van Rheede van Oudtshoorn a sum of R2,295,000 each. The company's board has decided to help the respondents acquire the shares, and consequently, the first and second respondents have transferred their obligations under the sale of share agreement to CP De Leeuw. The agreement stipulates that 70% of the declared dividend for the respondents will be used to settle the outstanding purchase price and will be paid over five years. At the time of this transaction, CP De Leeuw didn't have a memorandum of incorporation.

The applicants and the respondent started not seeing eye to eye, and that subsequently led to the matter being taken to the High Court. The court had to determine whether the financial assistance to purchase shares in CP De Leeuw in the form of delegation of obligations was valid or void under Section 44(5). The court considered sections 44(1) to 44(5). In this paper, the *Booysen and Others v. Kohrs and Others* case is used as a foundation to critically analyse the requirements of financial assistance in terms of Section 44 of the Companies Act.

5.2 Ordinary course of business

In the case of *Booysen and Others v Kohrs and Others,* the court held that section 44(1) was not applicable as CP De Leeuw did not lend "*money in the ordinary course of its business*".[51] The court read and applied section 44(1) in a slightly confusing manner,[52] to put it simply section 44(1) applies to this matter as CP De Leeuw did not lend "*money in the ordinary course of its business*". The court failed to elaborate on the applicability of section 44 (1), specifically, it failed to explain the type of a company/business that will be exempted from section 44 when offering and granting financial assistance for the acquisition of its shares. Furthermore, the non-existence of the memorandum of incorporation does not make section 44 (1) to be not applicable but rather requires

[51] *Booysen and Others v Kohrs and Others* (59732/2016) (*Booysen*) at para 27.
[52] Ibid at para 27.

the determination of CP De Leeuw's primary business. In *Mitchell's Plain Town Center Merchants Association v McCleod*,[53] it was stated that the question of "primary business" is a factual question to be answered with the actual business of the company and the memorandum of incorporation.[54]

As mentioned above, CP De Leeuw stepped into the shoes of the debtors by taking over the repayment of the debt on behalf of the applicants to the respondents for shares that were acquired in CP De Leeuw. Effectively, CP De Leeuw became surety to the respondents (sellers).[55] In this regard, the court held that the direct object of the transaction was to assist the first and second respondents financially to acquire the shares in CP De Leeuw, and therefore section 44(2) applied to the matter.[56] Furthermore, in respect of section 44(2) previous judgments provided that, "*If the direct object is not the provision of financial assistance by the company for the purpose of or in connection with* a *purchase of its shares, then it is irrelevant that the ultimate goal of the transaction was to enable* a *person to purchase such shares.*"[57]

The delegation agreement was signed and concluded without a special resolution as required. Section 44(3) (a) is being one of the safeguards provisions for financial assistance for shares acquisition, it is not a surprise that Pretorius J stated that the requirements of this section were not complied with.[58] In respect of section 44(3), the court stated that the board could not and did not satisfy the solvency and liquidity test immediately after making the company stand surety.[59] In this regard, the court stated that actual (objective) solvency and liquidity is not the only test,[60] and that "*the test is also as to the solvency and liquidity immediately after providing the financial assistance. Insolvency (factual) or illiquidity outside this moment would be irrelevant*".[61]

[53] 1996 (4) SA 159 (A) 168
[54] *Ibid*.
[55] *Booysen* supra note 51 at para 36.
[56] Ibid.
[57] *Schreiner JA in Gradwell (Pty) Ltd v Rostra Printers Ltd* 1959 ; *Lipschitz v UDC Bank Ltd* supra 799. In these cases, the distinction was drawn between giving financial assistance and doing something merely to enable the transaction involving the purchase of the company's shares to go forward.
[58] *Booysen* supra note 51 at para 37.
[59] Ibid para 38.
[60] Ibid.
[61] Ibid and Henochsberg on the Companies Act, 71 of 2008 in the commentary to section 44(3).

5.3 Solvency and liquidity test

To determine whether a company is solvent and to avoid that companies trade while being insolvent, is crucial as failure to do so may cause irreparable damages to creditors. The 2008 Companies Act recognises the role that companies play in the development of the South African economy.[62]. The inclusion of section 4 (solvency and liquidity test) aims to ensure and promote companies' financial viability.[63] In addition, section 4 of the Companies Act clarifies how to determine whether a company is solvent or insolvent when dealing with financial assistance.

For the purposes of Section 4 of the Companies Act, a company satisfies the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company at that time:

(a) the assets of a company or, the aggregate assets of a company, as fairly valued, equal or exceed the liabilities of a company[64]; and
(b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for 12 months after the date on which the test is considered, or in the case of a distribution, 12 months following such distribution.[65]

"*Solvency refers to the business' long-term financial position, meaning the business has positive net worth and ability to meet long-term financial commitments, while liquidity is the ability of a business to meet its short-term obligations*."[66] When dealing with the solvency and liquidity test, it is important to note that it contains two main elements, "solvency" and "liquidity".

5.3.1 Solvency Test

The solvency part of the test will be satisfied for a certain transaction at a particular time if in considering all reasonably foreseeable financial circumstances of the company at the time of the transaction, the fair value of the company's assets equals or exceeds its fairly valued liabilities.[67]

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[62] Section 7 of the 2008 Companies Act.
[63] Bidie s "*The nature and extent of the obligation imposed on the board of directors of a company In respect of the solvency and liquidity test under section 4 of the companies act 71 of 2008*" (2019) (5) (1) "JCCL & P" 80.
[64] Section 4 of the Companies Act.
[65] Ibid.
[66] Online Article: https://www.freshbooks.com/hub/accounting/solvency-vs-liquidity accessed on 15 June 2023.
[67] Van der Linde K "*The Solvency and Liquidity approach in the Companies Act 2008*" TSAR (2009) pages 226 and 227.

The Solvency test entails a balance sheet test based on the assets and current liabilities of the company and it is referred to as solvency in the bankruptcy.[68]

This simply means that a company will be considered insolvent if its business cannot pay its debts when they become due and payable. Furthermore, the solvency test prevents a company from making any payments to an individual who will use the money to buy shares that the company has issued. This is done if there are reasons to believe that after the payment, the fairly valued consolidated assets of the company will be less than its consolidated liabilities.

It is clear from the wording of the Companies Act that the solvency element of the test is based on a prediction of the future and it may be argued that it is not appropriate to have the solvency element as part of the test to determine whether financial assistance should be granted or whether a company should pay out distribution to its shareholders. Section 44(b)(i) requires a company to be solvent immediately after providing financial assistance, however, it may be argued that it is permissible and acceptable for a company to be "insolvent" shortly thereafter and still properly provide financial assistance for the acquisition of its shares.[69] The usage of the word "immediate" in section 44 (3)(b) creates uncertainty on whether a company needs to satisfy the test immediately after the board made the decision or after the agreements have been concluded, or after the whole transaction is has been completed (loan granted).

It may be argued that the solvency test is an unnecessary inclusion in respect of financial assistance transactions, especially in respect of Section 46 (distribution). The financial assistance provisions are meant to allow companies to easily navigate the economic space both locally and internationally; however, the solvency test seems to be an additional burden for companies, and it does not add any value to the Companies Act, in particular for sections 44 and 46.

5.3.2 Liquidity Test

The liquidity test assesses whether a company can settle its debts in the next twelve months, considering its ability to pay its obligations as they become due in the ordinary course of business.

[68] Ibid pages 225 and 226.
[69] Yeats J and Jooste R "*Financial Assistance – A New Approach*" South African Law Journal (2009) Volume 126 (3) at 588.

The liquidity test involves a cash flow analysis of a company (the ability to pay debts and remain liquid).[70] In simple terms, a liquidity test is a financial assessment used to evaluate the ability of a company to meet short-term financial obligations without causing significant financial distress. This test is used to ensure that a company has enough cash on hand to cover immediate expenses.

In respect of the liquidity element, it must be noted that there is a time frame element of twelve months.[71] In this regard, Kathleen stated that, in determining the time when the solvency and liquidity test should be considered and applied, it is crucial to differentiate between the time when the test should be considered and the time concerning which the requirements should be complied with.[72]

A company and its stakeholders should be protected in transactions that require the company to pay money or to provide security to anyone, however, the argument may be made that there is no reason for the different solvency and liquidity requirements, as "*they are confusing and an overall objective reasonableness test appears to be the most appropriat*e."[73]

In the case of *Booysen and Others v Kohrs and Others*, the financial statement of the Company showed that the Company failed the liquidity test as there were more liabilities than assets.[74] The court held that the applicants did not comply with section 44 as set out above and stated that the sale of shares agreement and the delegation agreement were all declared void.[75]

5.4 Fair and reasonable for the company

The court in the *Booysen and Others v Kohrs and Others* case did not pronounce whether the financial assistance was fair and reasonable to the company. This is because the court interpreted section 44 with limitations and leaned to case law and interpretation of section 38 of the 1973 Act, which only required the shareholders' special resolution and the solvency and liquidity test for the board to approve financial assistance.[76] The board was not required to determine whether the terms

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[70] Van der Linde K Op cit note 67 page 226.
[71] Section 4 (1)(b)(i) of the Companies Act.
[72] Van der Linde K Op cit note 67 page 233
[73] Yeats J and Jooste R op cit note 69 at 588.
[74] *Booysen* op cit note 51 at 40.
[75] Ibid.
[76] Cassim FHI et al., *Contemporary Company law* 2ed (2012) Juta & Co at 330.

and the financial assistance were fair and reasonable to the company.[77] This means that the board was able to approve financial assistance irrespective of whether such financial assistance was fair and reasonable to the company.[78]

A decision to grant financial assistance may be in the best interest of the company, as required by the fiduciary duties (i.e. bringing in a BEE partner that will help the company to grow financially), however, the best interest of the company is not sufficient, the board must also satisfy that the terms of the financial assistance are fair and reasonable to the company.[79] Delport argues that the board members may incur liability in terms of breach of fiduciary duties if they do not comply with the fair and reasonable provision of section 44.[80] The Companies Act does not provide direction on what will be considered fair and reasonable in so far as financial assistance is concerned. This presents a challenge for the directors who are required to approve financial assistance transactions. The fair and reasonable determination makes the financial assistance requirements more onerous to the board members[81].

In an attempt to interpret the "fair and reasonable" provision, Yeats J. and Jostee R. provided the following questions, which may be factored in:

> "*although it is not clear what is meant by 'the terms under which the assistance is proposed' being 'fair and reasonable to the company'. Does it mean that viewed from a commercial perspective, the transaction, whatever it might be, will benefit the company? In other words, must there be a reasonable quid pro quo? Or does it simply mean that the company is provided with 'fair and reasonable' security?*"[82]

The questions by Yeats and Jooste[83] are not directly answered by the Companies Act. It may be argued that if the terms of the financial assistance are clear and precise on how the loan and interest will be repaid by the recipient of the financial assistance, then the "fair and reasonable"

[77] Yeats J and Jooste R op cit note 69 at 576.
[78] Ibid.
[79] Section 44(3)(b)(ii) of the Companies Act.
[80] Delport PA op cit note 41 page 54.
[81] Yeats J and Jooste R op cit note 69 page 580.
[82] Ibid page 576 and 577.
[83] Ibid.

requirement should be fulfilled unless there is evidence that directors breached their fiduciary duties in approving such assistance.

In other words, the board may authorize proposed financial assistance only if it deems the terms of the assistance fair and reasonable to the company.[84] Cassim argues that the "fair and reasonable" requirement makes the Companies Act tougher to negotiate compared to section 38 of the 1973 Act.[85] Building on this notion, the uncertainty on the factors to be considered when dealing with the fair and reasonable requirement for financial assistance makes, makes this requirement seen as having less value. According to Awarab, "*The approach taken under the 2008 Act on requiring assistance is fair and reasonable and is the right move as this approach could protect the financial interest of the company. However, what is regrettable is that the Act does not indicate clearly what fair and reasonable is related to*."[86]

6. ADEQUATE CONSIDERATION IN FINANCIAL ASSISTANCE TRANSACTIONS

According to Section 40 of the Companies Act, the board of directors is authorized to issue shares only if they are deemed to be adequately compensated to the company, as decided by the board.[87] Alternatively, the shares may be issued in accordance with conversion rights associated with previously issued securities of the company, or as capitalization shares..[88] Although section 40 is not required for approval of financial assistance in terms of section 44, any issuing of the shares of the company to any person must be done for adequate consideration.

Section 40 provides for four elements. Firstly, the board is empowered to allot and issue shares of a company.[89] Secondly, the shares can only be issued if the company has received consideration for the shares to be issued.[90] Thirdly, the consideration received by the company must have been assessed to be adequate by the board.[91] In this regard, the Review Committee recommended that

[84] Cassim F H I Op cit note 76 at 330.
[85] Ibid.
[86] Marvin Ricardo Awarab *Applying Employee Share-ownership Schemes as a Transformation Mechanism Aimed at Decreasing Poverty Levels in South Africa: A Comparative Socio-legal Perspective* (Unpublished LLD thesis, 2021) page 103.
[87] Section 40 (1) of the Companies Act.
[88] Ibid.
[89] Ibid.
[90] Ibid.
[91] Ibid.

"*The adequacy of the consideration to be received by the company for issuance of its shares should be determined by the board of directors*".[92] Lastly, the determination as to the adequacy of the consideration can only be challenged if it is shown that there has been a breach of the director's fiduciary duties.[93]

Notwithstanding, the required adequate consideration as per section 40, in some cases, the board may decide to issue shares of a company without receiving immediate payment.[94] This happens when the subscribing party offers a negotiable instrument or agrees to provide future services, benefits, or payment as consideration for the shares.[95]

A financial assistance transaction that complies with all the requirements of Section 44 may also need to comply with Section 40 of the Companies Act. This means that the board must determine and confirm that the shares that will be issued to the financial assistance recipient are issued for adequate consideration. It must be noted that the consideration of Section 40 will only be applicable if financial assistance is provided for the specific subscription of shares and will not be necessary for financial assistance that is provided for the purchase of shares, as the value of such shares will be determined by the selling shareholder.

In my opinion, the section 40 consideration is important because there is sometimes no flow of funds in a financial assistance transaction. For example, let's say that company A offers 2 million (financial assistance) to Sabatha for him to subscribe for 20 shares in company A at the value of 2 million,. Company A may only issue the 20 shares and pass the necessary resolution without paying the actual money to Sabatha.

Section 44 and section 40 must be considered side by side, especially when dealing with a transaction where the recipient of the company loan will rely on the company to declare a dividend in the future before the loan (the financial assistance) may be repaid. The understanding of

[92] Committee on Corporate Laws Op cit note 1 page 11.
[93] Section 40(3) of the Companies Act, read with sections 76 and 77(2).
[94] Des Kruger Brian Dickinson issuing shares in exchange for negotiable Instrument at 23 and Section 40 of the Companies Act.
[95] Ibid.

adequate consideration is important as "consideration" is required in exchange for share ownership in a company.[96]

7. VALIDITY OF THE BOARD DECISION AND AGREEMENTS

A decision to grant financial assistance and an agreement for financial assistance is void to the extent that the provision of any such assistance is inconsistent with section 44 or falls under a prohibition in terms of section 44(4).[97]

If financial assistance is granted by a company in a manner that does not comply with the requirements of section 44 or does not comply with any conditions or restrictions contained in a company's memorandum of incorporation in respect of the offering and granting of financial assistance, then the decision of the board, or an agreement pursuant to the granting of such financial assistance, is void to the extent of any such inconsistency. In this regard, directors should act in good faith, observe proper purpose, and act in the company's best interest.[98]

In law section 44(5) effectively makes a transaction to be automatically void ab initio by operation of law.[99] This has been confirmed by the court in the case of *Booysen and Others v Kohrs,* where the court pronounced that the agreement in respect of the financial assistance was invalid in accordance with section 44(5) as they failed to comply with the section 44 requirement.[100]

7.1 Directors' liability into section 44

If a resolution or an agreement is void in terms of s 44(5), a director of the company is liable to the extent set out in s 77(3)*(e)*(iv) if the director was present at the meeting when the board approved the resolution or agreement or participated in the making of such a decision in terms of section 74 and failed to vote against the resolution or agreement, despite knowing that the provision of financial assistance was inconsistent with this section or a prohibition, condition or requirement set out in the memorandum.[101]

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[96] Marvin Ricardo Awarab Op cit note 86 at page 104.
[97] Section 44 (5) of the Companies Act.
[98] Marvin Ricardo Awarab Op cit note 86.
[99] Yeats J and Jooste R op cit note 69 page 581.
[100] *Booysen* op cit note 51 at page 19.
[101] Section 44(6) of the Companies Act

Before a director may be liable, must first have attended the meeting where the decision was made and must have abstained from voting or voted in favour of the transaction.[102] In addition, the directors must have known the fact that the financial assistance is inconsistent with the requirements set out in section 44.[103] The directors who were present at the meeting and did not vote against the resolution (including those who abstained from voting) may be held liable only for loss, damage, or costs sustained by the company.[104]

8. DECLARATION AND PAYMENT OF DIVIDENDS

Before getting to distribution in terms of section 46 of the Companies Act. It is important to note that companies have no obligations to pay dividends. Each company have its dividend policy which regulates when and how dividend should be paid by the company. A company's investment policy and the way investments are financed within a company influence dividend policy.[105]

Similarly, financial assistance for the acquisition of shares, declaration, and paying out of dividends by a company was prohibited by the doctrine of capital maintenance, which has been discussed above in this paper.

Section 1 of the Companies Act defines distribution as a direct or indirect transfer by a company of money or other property of the company, other than its shares, to or for the benefit of one or more holders of any of the shares of the company whether as a dividend, as consideration for the acquisition by the company of its shares or otherwise in respect of any shares of that company. [106] It is important to remember that a distribution "*does not include payments to shareholders in some other capacity for example, salary or bonus for a manager who is also a shareholder or compensation to a service provider who is also a shareholder*."[107]

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[102] Commentary on the Companies Act of 2008 Companies Act 71 of 2008 Chapter 2 Part D Capitalisation of profit companies (ss 35–48)/44 Financial assistance for subscription of securities Juta commentary (OS): OS, 2018, page 2-397.

[103] Ibid.

[104] Section 77(3)(e)(iv) of the Companies Act.

[105] Vermeulen, M.; Smit, E.v.d.M. "Dividend payout and future earnings growth: A South African study" South African Journal of Business Management .2011,42(4) (Vermeulen, M) page 34.

[106] Section 1 of the Companies Act.

[107] James J. Hanks Jr., 'The New Legal Capital Regime in South Africa' in T.H. Mongalo (ed), *Modern Company Law for a Competitive South African Economy* (2010), 143

Section 46 of the Companies Act provides that a company can only make a distribution if it is legally obligated to do so, either by board resolution or ordered by a court,[108] and the solvency and liquidity test has been applied and satisfied by the board of the company.[109] The board of the company wishing to declare dividends must acknowledge that the company has complied with the solvency and liquidity test before declaring and paying such dividends.[110]

It is important to clarify that the board's involvement in authorising a distribution contains two steps:

> **Step 1**, the board must authorise the distribution before any form of payment or transfer,[111] in this regard it is important to note that a shareholders' special resolution is not required as part of the authorisation of declaring and payment of dividends, however, in some cases, the company's memorandum of incorporation or shareholders' agreement may require shareholder approval for the declaration of dividends. However, it is not a statutory requirement for dividends to be approved by shareholders. The subject of the special resolution is one of the biggest differences between section 46 (special resolution is optional) and section 44 (special resolution is mandatory).
>
> **Step 2**, the board must confirm the application and passing of the solvency and liquidity test and the board must acknowledge that it has applied the test and that they are satisfied that upon completion of the distribution the company will pass the solvency and liquidity requirements.[112]It is clear from the wording of the section that step 2 needs to be further broken down into two elements. Firstly, there must be confirmation that the solvency and liquidity test has been considered. Secondly, there must be approval by the board that the company will pass the solvency and liquidity Test. This is also different from section 44 as it is not a requirement for the solvency and liquidity test for financial assistance transactions.

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[108] Section 46(1) of the Companies Act.
[109] Ibid.
[110] Ibid.
[111] Ibid 46(1) (a) (ii).
[112] Ibid section 46(1) (c).

It may be argued that the solvency and liquidity test is meant to ensure that dividends are declared from a company's distributable profits, which include, without limitation, retained earnings and other reserves that are legally available for distribution from the company.

Section 46(3) provide for only 120 days time limit for the company to pay out dividend following the board's approval. If the company fails to pay the approved distribution or part of the distribution within 120 days, then the board must consider the solvency and liquidity test again in respect of the remaining distribution and the company must not proceed with the distribution unless the board adopts a further resolution[113].

A crucial point to take note of is that declaring and paying a distribution without complying with the requirements of section 46 does not render the distribution void (unlike sections 44 and 45 of the Act which specifically state that non-compliance will result in transactions and decisions being void).[114] In so far as the repayment of financial assistance is concerned, dividends payment to the shareholders is crucial as in most financial assistance transactions, the assisted shareholder will depend on the divided to repay the loan,

8.1 Directors' liability in so far as the declaration of distributions is concerned

The directors of the board may be held liable to the extent set out in section 77(3) of the Act if they fail to vote against the making of a distribution despite knowing such distribution is contrary to section 46 of the Companies Act.[115] Given that there is a possibility of being liable, the board of directors must carefully consider whether any unusual payment, transfers, or arrangements at the intra-group level comply with section 46. Compliance through passing the necessary resolutions and conducting the appropriate solvency and liquidity test should safeguard the process from future difficulties. It has been argued that "*The court may relieve the director on any terms*

[113] Section 46(1)(c) of the Companies Act.
[114] Corporate and Commercial alert Cliff Dekker (20 July 2022) Distributions: More than meets the (i): *Distributions: More than meets the (i) - Cliffe Dekker Hofmeyr* accessed on 17 June 2023.
[115] Section 46(6) of the Companies Act.

the court considers just if it appears to the court that the director has acted honestly and reasonably."[116]

As part of the safeguards, the directors must ensure that the company maintains proper records of the declaration and payment of dividends. These records should include details such as the amount of the dividend, the date of declaration, and the shareholders entitled to receive the dividends.

9. BLACK ECONOMIC EMPOWERMENT TRANSACTIONS

Broad-based black economic empowerment (BEE) is a government policy aimed at promoting economic transformation and increasing the economic participation of black South African citizens of African, Coloured, and Indian descent..[117] The Constitution of the Republic of South Africa, 1996, states that all people in South Africa have the right to equality, and the enactment of the Broad-Based Black Economic Empowerment Act, 2003 (as amended) and the generic Codes of Good Practice on Broad-Based Black Economic Empowerment (BEE Codes) were pursuant to the right to equality.[118]

Despite the right to equality, South Africa is one of the most unequal societies in the world and the contributing factor is that not all people are born to equal circumstances. Lazarus Zim stated that "*the wide gap between the haves and the have-nots is an open invitation for future socio-economic unrest and even political upheaval in the country*."[119] The well-known history of South Africa greatly contributed to an economic and opportunity disparity based on race and resulted in the majority of black people in South Africa not enjoying opportunities, and therefore not enjoying the right to equality.

The purpose of the BEE Act and BEE Code is to bridge the gap between formal and substantive equality to ensure that all people in South Africa fully enjoy the right to equality. Black Ownership

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[116] Commentary on the Companies Act of 2008 Companies Act 71 of 2008 Chapter 2 Part D Capitalisation of profit companies (ss 35–48)/44 Financial assistance for the subscription of securities Juta commentary (OS): OS, 2018, page 2-400

[117]Amber Kardamilakis "Broad-based black economic empowerment – basic principles"*https://www.nortonrosefulbright.com/en-za/knowledge/publications/fe87cd48/broad-based-black-economic-empowerment--basic-principles* accessed on 15 July 2023.

[118] The Constitution of the Republic of South Africa, section 9.

[119] Lazarus Zim *Time and Chance: Daring to Dream* (2021) page 307.

in mining companies was also one of the key pillars of the mining charter.[120] The extent to which black people participate in the ownership of equity in companies is an important measure of a company's compliance with BEE legislation and the BEE Code. This is always challenging for companies that are willing to comply with BEE as many of the participants in BEE transactions do not have the money (funding) to acquire ownership of equity (shares) in the measured entities.

The lack of funding by BEE participants in BEE transactions has resulted in financial assistance being used as a popular means for implementing BEE transactions. To this end, BEE transactions may be structured in various ways. In this paper, only 3 types of BEE transaction funding structures are discussed, as set out below:

> By way of a conventional loan structure, in terms of which the BEE shareholder acquires the shares and settles the acquisition price through a loan raised with the company in which the shares are being acquired (the "**Conventional Loan**") or through third-party funding. This paper will only deal with a conventional loan that has been raised by the company in which shares are being acquired through subscription of shares. Throughout the transaction, when the BEE shareholder receives dividends from the company, all or part of such dividends are used to pay down the loan (financial assistance). This is a very simple and straightforward financial structure; however, it is not used often in modern corporate practice as it is not tax efficient.[121]

> By way of an "*NVF structure, when the BEE shareholder acquires its shares usually only a small portion of the subscription fee or (sometimes none at all) with the balance being credited to the BEE shareholder as a notional loan. This notional loan is then repaid over time through the upfront waiver by the BEE shareholder of the right to receive dividends from the company*."[122]

[120] L Zim Op cit note 119 page 307.
[121] Transcend "funding arrangements for bee ownership: are you getting it right?" https://insights.transcend.co.za/funding-arrangements-for-bee-ownership-are-you-getting-it-right accessed on 24 July 2023.
[122] Ibid.

By way of Employee Share-Ownership Plans or Schemes ("**ESOP**"), in terms of which a company establishes an employee share scheme that allows employees to acquire shares with financial assistance from the company.[123]

9.1 Conventional Loan Transactions

Many corporate companies undergo restructuring through a merger or a takeover. Often, these transactions involve setting up a BEE through a share scheme or by having a BEE shareholder. Many, if not most, share acquisition transactions that involve BEE shareholders implemented in South Africa are vendor-financed (as already described above).

BEE transactions that are funded through the Conventional Loan (as illustrated above) fall squarely within the ambit of financial assistance in terms of Section 44 of the Companies Act, and therefore such transactions must comply with the provisions of the Companies Act. Furthermore, Conventional Loan structured transactions will require the company to comply with the solvency and liquidity tests at least twice before the BEE shareholder may start making repayments on the Conventional Loan. Firstly, the test must be met as part of granting the financial assistance under Section 44, and subsequently, the test must be considered and be met later on when the company is declaring and paying dividends to its shareholders (including the BEE partner who would have been financially assisted by the company), Section 46.

Although it is not a requirement, the board must also consider when determining whether the financial assistance is fair and reasonable, the board must also consider whether payment of dividends by the company is reasonably foreseeable. It is important to remember that "*the payment of dividends reflects information about a company's financial wellbeing and is valuable for investors in their investment decision practices*."[124] I am of the view that future earnings must be considered on a financial assistance transaction for the acquisition of shares in the company to determine how long will it take for the BEE partner to repay the Conventional Loan.

[123] Marvin Ricardo Awarab Op cit note 86.
[124] Vermeulen, M Op cit note 105 page 33.

It is important to note that, it is not an easy task to determine whether a company will pay dividends or not, however, financial market studies may guide in this regard.[125] Vermeulen and Smith, suggest that for a South African Company dividend payout ratio should be taken into consideration when evaluating the growth expectations of a company, as well as the current profitability and level of growth in assets of the company.[126]Considering the future earnings and dividend payout by the board might assist the board with satisfying the "fair and reasonable" provision required by section 44(3)(b)(ii).[127] A company dividend policy should play an important role for a firm that wishes to conclude a BEE transaction as these policies play a major role in the repayment of the Conventional Loan.

The Section 44 transactions in particular the Conventional Loan transactions are very interesting and to some extent confusing. To put it simply, the ability of the BEE partner to own shares in the company is dependent on the company's ability to meet the requirements of financial assistance, in particular the solvency and liquidity test. The ability of the loan to be repaid by the BEE partner is dependent on the company's ability to pass the solvency and liquidity test when declaring and paying dividends. In essence, the solvency and liquidity test is at the center of the BEE partner's ability to own shares in a company it is meant to guard against possible financial hardships that the company could otherwise be faced with.[128]

9.2 NVF Transactions

In practice, the BEE transactions are usually structured as notional vendor finance ("**NVF**"), as it is tax efficient.[129] In NVF transactions, the vendor companies facilitate the Bee transactions using various financial models such as providing loan guarantees on behalf of the BEE partner, providing share price discounts, or internal notional vendor financing at or below market rates to the BEE

[125] Ibid.
[126] Ibid page 45.
[127] Section 44 of the Companies Act.
[128] Marvin Ricardo Awarab Op cit note 86 at page 102.
[129] Corporate and Commercial alert Cliff Dekker Op cit note 114.

partner.[130] This type of financing is preferred in the market and it lowers the risk of the investment and it may increase investor confidence.[131]

Muneer Hassan & Michelle van Heerden provided a good example of an NVF:

> "*The shares of the BEE Company, ABC Limited, are trading at a price of R100 a share, but the company sells them to the SPV at R1 a share. The rest of the buying price (R99) is a notional loan to the SPV ("notional" because no money has changed hands). Thus, for every 1,000 shares issued, ABC receives R1 000 and is owed R99 000. The company needs to perform well and pay enough in dividends during the empowerment period (when trading is restricted) to enable the investors to repay their debt. If, during the lock-in period, the share price increases from the original R100 a share to R200 a share, and the company pays a total of R49 a share in dividends (R49 000 in all), the SPV will be left with a debt of R50 000 (R99 000-R49 000) when the lock-in period is lifted. This means that they will need to sell 250 shares (R250 xR200 = R50 000) at maturity to settle the debt. This will leave the SPV with 750 shares, which will often be converted into ordinary shares. If this happens, shareholders will be in the money. This simplified example does not take into account interest rates, CGT, and call options that also form part of the debt the SPV needs to repay.*"[132]

In South Africa, as well as under modern corporate law. It has been accepted that NVF transactions are not regarded as a loan in the ordinary use of the term "loan", as a result, NVF transactions are not required to comply with Section 44 of the Companies Act. Without being against the NVF transactional structure, as they are assisting with the purpose of the Companies Act set out in Section 7 and trying to bring about equality as set out in Section 9, I am of the view that an NVF structured transaction is a loan in so far as the Companies Act is concerned and should be subject to the requirements of Section 44 of the Companies Act.

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[130] Emuron Plaatjies, "*Funding structure efficiency and empowerment success: A Broad-Based Economic Empowerment Study*" on page 21.
[131] Ibid, page 21.
[132] Muneer Hassan & Michelle van Heerden (2020) *Donations tax implications of BEE transactions: More than meets the eye*? South African Journal of Accounting Research, 34:3, 236-253, DOI: at page 246.

Even if it can be demonstrated that NVF transactions do not include a notional interest rate, the structure could contain a dividends tax benefit as loans from a company to its shareholders and in certain instances still regarded as deemed dividends and attract dividends tax.[133] "*Accordingly, if dividends tax is not payable as a result of the NVF there is a substantial tax benefit in using the NVF, and even more so if the structure includes a notional interest rate*."[134]

In the case of *CSARS v NWK*, the court developed the "substance-over-form" doctrine in terms of which the court considered the commercial rationale of the transaction and, more specifically, whether the purpose of the transaction was to evade tax.[135] This inquiry by the court is consistent with the "Ramsey Approach" which entails a purposive interpretation of the statute that leads a court to look beyond the legal substance of transactions, be they composite or single.[136] Both the Ramsey Approach and the *CSARS v NWK* are in respect of tax avoidance, however, this principle should be applied when dealing with NVF transactions from the Companies Act perceptive.

NVF is a tax-driven transaction, and Section 44 seems to be ignored and plays no part. There is an argument to be made that NVF transactions are disguised loan funding structures, and to this end, the approach when dealing with NVF has been form over substance.

9.3 Employee Share-Ownership Plans or Schemes

Financial assistance may also be used in an ESOP transaction. ESOP is a transaction or mechanism that is regulated by section 97 of the Companies Act, which is aimed at allowing employees of a company where they are employed to own shares and may even receive dividends.[137] ESOPs are meant to build on the Companies Act purpose outlined in section 7 of the Companies, and an ESOP could be used to address poverty, inequality[138] and to contribute to the economic development of South Africa.

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[133]Stephan Spamer "*The imaginary world of notional vendor finance*" *https://www.thesait.org.za/news/120219/The-imaginary-world-of-notional-vendor-finance.htm* accessed on 17 August 2023.
[134] Ibid.
[135] *CSARS v NWK* (27/10) [2010] ZASCA 168 (1 December 2010).
[136] John Vella (2007) Departing from the Legal Substance of Transactions in the Corporate Field: The Ramsay Approach Beyond the Tax Sphere, Journal of Corporate Law Studies, 7:2, 243-283, DOI: at page 249.
[137] Marvin Ricardo Awarab Op cit note 86 at page 3.
[138] Ibid.

ESOP is a transaction or scheme that facilitates the ownership/holding of shares in a company for the benefit of a specific group of the company's employees.[139] It may be argued that an ESOP is an investment by a company and its employees where both the company and the employees use their skills and resources with the expectation of earning returns in the future. In these types of arrangements, the employees are given incentives for staying longer and being loyal to the company. ESOPs ensures that business operations continue without any potential job losses and job opportunity usually grows.[140]

Unlike the Conventional Loan and the NVF, an ESOP is usually administered through a trust that will hold the shares in the company for the benefit of the employees. "*ESOPs are one of the powerful mechanisms that can be employed in fighting poverty in South Africa. What makes ESOPs so powerful is the fact that they can be tailored for employees of any type of company. A financially healthy company can implement ESOPs by transferring share ownership to its employees. This can be done by issuing unissued shares within the company's authorised capital and providing financial assistance for purchase considerations, where necessary*."[141]

10. CONCLUSION

Financial assistance is a great tool to be utilised by companies towards the growth of their businesses and for companies to meaningfully contribute to the development of the South African economy. It is clear from the financial assistance requirements that South African company law may be seen as being brought in line with the purpose and aims of modern economically developed countries[142], although there are still a lot of legal uncertainties in respect of the applications of the provisions of section 44 of the Companies Act.

This paper emphasizes that financial assistance is a regulated tool, but its regulation may be ambiguous because it solely relies on the solvency and liquidity test. The solvency and liquidity have not been fully tested by our courts as yet; however, they appear to be based on future earnings. This means that a financial assistance transaction's legal framework and validity are based on reasonable predictions. The same argument may be raised concerning Section 46 (distributions).

One of the challenges of the provisions of Section 44 is that they may also be more far-reaching than expected by companies. Without undermining the principles of separate legal entity entities, the solvency and liquidity test slows down strategic decisions in so far as related and inter-related

[139] Cassim F H I Op cit note 76.
[140] Social Capital Partners "Building an employee ownership economy" Discussion paper, available at http://www.employee-ownership.ca, accessed on 14 September 2023.
[141] Marvin Ricardo Awarab Op cit note 86 at page V.
[142] Ibid at page 107.

companies' loans are concerned. I am of the view that group companies should not be subjected to the solvency and liquidity test. Furthermore, Section 44 applies not only to the acquisition of shares, but also to the acquisition of securities, which is a broader term.

There are still gaps in the Companies Act, for instance, section 4 does not provide proper guidance on what is fair and reasonable related to the provisions of section 44. The Corporate Law Reform in South Africa is fostering business growth and economic growth,[143] however, a company is still expected to meet a list of requirements before financial assistance may be given. These requirements include the special resolution requirement that is an essential safeguard against potential abuse of power by the directors, as the power to offer and grant financial assistance is vested in the directors of a company.

South African companies may use financial assistance for a variety of strategic or financial reasons. This is welcomed for a developing economy; however, much clarity is still required concerning the requirements for granting financial assistance.

[143] Marvin Ricardo Awarab Op cit note 86 at page 107.

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