



Companies and Intellectual
Property Commission

a member of **the dti** group

GUIDANCE NOTE

APPLICATION OF SECTION 22, COMPANIES ACT 71 OF 2008 ON CLOSE CORPORATIONS

Section 22 of the Companies Act 2008 ("the Act") prohibits a company from trading under insolvent circumstances. This has led to many views and differences between technical insolvency and commercial insolvency.

Section 22(2) of the Act has been amended to provide that, if the Companies and Intellectual Property Commission ("the Commission") has reason to believe that a company –

is unable to pay its debts as they become due and payable in the normal course of business then the Commission can issue a notice to the company to show cause why it should be allowed to continue carrying on business.

If the company then fails within 20 days to satisfy the Commission that it is indeed "able to pay its debts as they become due and payable in the normal course of business" the Commission can issue a compliance notice in terms of section 22(3) to the company requiring it to cease carrying on business.

The fault of section 22(1) in its original stage referenced a company must not "*trade under insolvent circumstances*" but the Act did not make clear whether "*insolvent*" meant insolvent in the balance sheet sense or commercially insolvent. If this provision is interpreted as the former meaning, and prohibited a company from continuing in business if it was insolvent in the balance sheet sense, many companies throughout South Africa would have to close down, with major destructive consequences for the economy.

However the amendment to section 22(2) makes clear that this provision is concerned only with **commercial insolvency and not with balance sheet insolvency.**

In terms of the amended provision, even *commercial insolvency* does not have an automatic impact on the company's right to carry on business. The only consequence is that the Commission "may" call on the company to show cause why it should be allowed to continue trading.

The Act states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud or *is unable to pay its debts as they become due.* (Sect 22) If a company trades in such circumstances, the Commission may require the company to cease carrying on business.

However the Act, does not define insolvent circumstances; it simply provides a solvency test. The Commission thus in return receives massive amounts of reports, and creates the administrative burden to discharge the duties enshrined in Act.

Accordingly, Close Corporations have new duties such as having to meet the **solvency and liquidity test** of section 4 of the Act. In terms of Schedule 3 Item A of the Act specifically brought out legislation to make certain sections of the Act compulsory for close corporations, that being Parts D, E & F of Chapter 7 and Part A of Chapter 9 of the Companies Act 2008 becomes applicable. This means that Close Corporations have to effectively comply with these applicable provisions, as well as the Close Corporations Act.



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According to section 62(3) "Duties of accounting officers" of the Close Corporation Act 1984, if an accounting officer of a corporation during the performance of his duties finds that:

that the annual financial statements indicate that as at the end of the financial year concerned the corporation's liabilities exceed its assets; or (iii) that the annual financial statements incorrectly indicate that as at the end of the financial year concerned the assets of the corporation exceed its liabilities, or has reason to believe that such an incorrect indication is given,
he shall inform the Registrar by registered post of this fact.

The fact that liabilities exceed assets does not necessarily mean that a Close Corporation is insolvent – it may be an indicator of possible future insolvency.

Therefore if an accounting officer issues a report to the Commission indicating that close corporations liabilities exceed its assets – the Commission in return will apply the following :-

1. Reports reflecting 'technical insolvency', that is, 'liabilities exceeds assets' in the Close Corporation, may not always be investigated by the Commission, unless there is proof that warrants an investigation.
2. Reports reflecting 'commercial insolvency' wherein a Close Corporation is 'unable to pay its debts when they become due and payable....' the Commission shall review such matters, and this will lead to an investigation, should the latter be warranted.

Based on the above, it is the view of the Commission that trading under insolvent circumstances, in relation to 1 above, may not necessarily be trading recklessly as intended by section 22 of the Act.

This guidance note is issued to create awareness and education amongst industry and concerned parties of the application and procedure that the Commission may rely upon, in respect of the above circumstance.

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ACTING COMMISSIONER

CIPC

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