

Study Unit 5

Close Corporations

Study Unit 5: Close Corporations

BACKGROUND AND OVERVIEW

Introduction

- Close Corporation (CC) is a form of business registered and operated under the Close Corporations Act 69 of 1984
- Separate legal person
- Owners called members who own a members interest %
- From 1 May 2011 no new CC's may be registered (Companies Act 71 of 2008)

Attributes (comparison)

	Sole Proprietor	Partnership	Close Corporation
Legal person separate from owner(s)	NO	NO	YES
Number of owners (access to capital)	1	2-20	1-10
Owners referred to as	Sole Proprietor	Partner (profit sharing ratio)	Member (members interest %)
Unlimited existence	NO	NO	YES
Protection due to Limited liability	NO	NO	YES
Taxed separately from owners	NO	NO	YES
Acquire rights to assets in its own name	NO	NO	YES
Incur obligations in its own name	NO	NO	YES
Legal requirements before distributing profits: - SOLVENT: Assets exceed liabilities LIQUID: Able to pay debts as they become due in ordinary course of business	N/A	N/A	Must comply to Close Corporations Act 69 of 1984

Equity in the SFP.....

Sole Proprietor	Partnership	Close Corporation
Capital Account	Capital Account(s)	Members Contribution
	Current Account(s)	Retained income
Reserves	Reserves	Reserves

Note that in the Sole Proprietor and the Partnership we referred to Drawings when owners took cash out of the business.
For Close Corporations we refer to Distributions.

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Overview and legal theory

*Not focus of exam, but for
background purposes*

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ADVANTAGES AND DISADVANTAGES (READ ONLY – NO VIDEO)

Advantages / Disadvantages

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none">• CC as a business will continue to operate / exist irrespective of changes in members• Members have protection of limited liability (unless Close Corporations Act is contravened)• Member / employee may be appointed as the accounting officer if all members agree thereto in writing• The CC may give financial interest to someone acquiring an ownership (members) interest in the CC• CC may repurchase a members interest (As long as solvent and liquid, and written consent of all members)• No transfer duties payable on transfer of members interest	<ul style="list-style-type: none">• Each member can act on behalf of the CC – a member can commit CC to risky transactions• Only natural persons allowed as members• Membership limited to 10 members• Interest on loans by members to acquire members interest is not tax deductible – as profit distributions not taxable income• AFS must be signed off by 51% members interest• Limited protection for minority interest members if less than 25%

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PRESCRIBED FORMS
(READ ONLY – NO VIDEO)

Prescribed forms

All documents with the Companies Intellectual Property Commission (CIPC) are available for public inspection. Previously held by the Registrar of Close Corporations.

Most common:

- CK1 Founding Statement (no new CC's)
- CK2 Amended Founding Statement
- CK3 Application for the Restoration of the Registration of the Corporation
- CK6 Resolution: Voluntary Liquidation

CK 1 Founding Statement

CK 1 includes the following information:

1. Full name of the Close Corporation
2. Principle business in which engaged
3. Postal address
4. Physical office of registered office
5. Each members details (address, ID number)
6. The % size of each members interest
7. Particulars of each members contribution to CC (cash of assets including value)
8. Name and address of qualified person accepting role as accounting officer
9. The financial year end date of the CC

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**NAME AND REGISTRATION NUMBER
(READ ONLY – NO VIDEO)**

Name and Registration Number

- Close Corporation must add CC to the end of the full registered name;
- If the Close Corporation is wound up / liquidated, the statement “Liquidation” or “Voluntary Liquidation” must be added to the name during liquidation;
- The Close Corporation registration number must be included on all letterheads, prescribed documentation and correspondence with the CIPC;
- Must display name (including CC at end) at every place of business as well as its registration number
- Must display name (including CC at end) as well as its registration number and a list of members (initial and surname) on all business letters / correspondence.

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MEMBERSHIP OF A CC
(READ ONLY – NO VIDEO)

Membership

- From 1 to a maximum of 10 members (owners)
- Members must be natural persons
 - No members can be companies / close corporations
 - Trusts as a rule not allowed unless:
 - Trustee of intervivos trust
 - No juristic person is a beneficiary of the trust
 - Such member has all the obligations and rights of a member
 - The CC has no obligation in terms of provisions between the trust and the member concerned
 - The number of beneficiaries of the trust (all natural persons) plus the other members of the CC do not exceed 10 in total
- Any change in membership of the CC must be registered with the CIPC by submitting an Amended Founding Statement (CK 2) to the commissioner

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INTERNAL RELATIONS
(READ ONLY – NO VIDEO)

Fiduciary duty of members

- Every member has a fiduciary duty to the CC
 - Members must act honestly and in good faith to benefit the CC;
 - Members must avoid conflicts of interest between their own interests and those of the CC:
 - Must notify the other members of any potential conflicts of interest, and
 - Members may not compete with the CC in any way.
- A member who has breached their fiduciary duty is liable to the CC for any loss suffered to recompense any economic benefits obtained

The Association Agreement

- Members may decide formalise internal “rules” for the running of the CC – these would be done by agreement in the Association Agreement.
 - Not compulsory, therefore no prescribed form
- All matters being addressed in this document must not result in any contraventions of the Close Corporations Act.
- New members will be bound by the Association Agreement

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**INTERNAL RELATIONS - VARIABLE RULES
(READ ONLY – NO VIDEO)**

Internal Rules....

The following rules regarding internal relations must be applied (unless the Association Agreement says otherwise):

- Every members is entitled to participate in the carrying on of the CC's business
- Every members has equal rights to the management of the business
- 75% members interest vote is required to do the following:
 - To change the principle business of the CC;
 - To dispose of a significant portion of the CC business including its assets
 - To acquire or sell any immovable property owned by the CC
- Decisions of members are made with a majority vote at a meeting of members (number of votes in line with % membership interest owned)
- Distributions made to members can only be made if the CC is solvent and liquid before and after the payments are made, and such a distribution must be agreed upon by members

Loans to members?

- A CC may only make a loan or provide security to any of its members if prior written consent is given by all the members.
- This would include the members directly, or indirectly by giving loans or security to any juristic person (Close Corporation, Company or trust) which the member or his close family control (for example a company which the member has 51% voting rights)

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EXTERNAL RELATIONS
(READ ONLY – NO VIDEO)

External Relations

Each member has a right to manage the CC

- Therefore each member is regarded as an agent of the CC when dealing with outside parties
- Each members actions will bind the CC, unless the member specifically does not have the power to act on behalf of the CC and the outside party can reasonably be expected to know of any such restrictions of power for that particular member
- Powers of members would be restricted in the association agreement, which is NOT a public document. Therefore outside parties can NOT be deemed to know about any such restrictions of power of a member.

Pre Incorporation Contracts

- A pre-incorporation contract is an agreement entered into (in writing) before the registration of a CC
- It can be described as a contract entered into by an agent of a yet to be formed CC
- Such a contract may be ratified (adopted) by the CC as if it had been in existence at the time of the pre-incorporation contract
- Ratification of such a contract requires written consent by all members of the CC.

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**ACCOUNTING RECORDS & FINANCIAL
REPORTING (READ ONLY – NO VIDEO)**

Accounting Records

- Accounting records to be kept by a CC include:
 - Fixed asset register
 - A cash book (details for daily receipts and payments of cash)
 - Record of all credit sales (goods and services) as well as credit purchases (goods and services). This is done in a customers (debtors) ledger and a supplier (creditors) ledger.
 - Inventory ledger and records of stock count
 - Records of assets and liabilities, members contributions, undrawn profits (retained earnings), loans to / from members.
 - Vouchers for the CC transactions must be kept as supporting evidence
- Records must be kept in such a way as to minimise falsification of accounting entries

Financial Statements

- The Founding Statement (CK1) must specify a financial year end date (may be changed with a CK2)
- Members to ensure that financial statements are prepared within 9 months after year end
- Financial Statements of a CC shall be in conformity with IFRS 9 or IFRS for SMEs) and shall consist of at least:
 - Statement of Financial Position plus notes
 - Statement of Profit or Loss and Other Comprehensive Income (or such similar statement where such form is appropriate) plus notes
 - A report from the Accounting Officer
- In terms of IFRS the AFS should also include:
 - Statement of cash flows

Financial Statements

- Shall disclose the aggregate and movements of each of the following separately:
 - Contributions by members
 - Undrawn profits (retained earnings or accumulated profits)
 - Revaluation of fixed assets
 - Loans to or from members
- Shall be in agreement with the underlying accounting records
 - In such a form that the Accounting Officer is enabled to report thereon without it being necessary to refer to any underlying records and vouchers
- The Annual Financial Statements (AFS) shall be approved and signed off by members holding at least a 51% members interest.
- The Accounting Officers report must be included and state:
 - Whether or not the AFS are in agreement with the accounting records of the CC
 - Whether the accounting policies presented are appropriate

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**THE ACCOUNTING OFFICER
(READ ONLY – NO VIDEO)**

Appointment and Qualifications

Legislation requires that a Close Corporation appoints an Accounting Officer, and subsequently should this appointment become vacant the members of the CC will have 28 days to appoint a new Accounting Officer.

An Accounting Officer must be a member of a recognised profession. The applicable professional body must require the following before admitting professionals:

- as a condition for membership require its professional members to pass examinations that cover accounting, tax etc.
- the professional body must have the power to exclude persons who have been found guilty of negligence in their professional duties, or discreditable professional conduct

Resignation or dismissal

The close corporation must notify the Accounting Officer in writing of such removal from office.

Upon removal, the accounting officer must inform in writing, every member in the CC in writing of such resignation / removal, and send a copy to the 1st know address of the CC.

The Accounting Officer must also inform the commissioner about a number of things including:

- Notification of resignation / removal
- The date of such resignation / removal
- Date up to which the duties of accounting officer were performed
- Any matters contravening the Close Corporations Act up to and including the date of resignation.

If there is a vacancy, the members have 28 days to appoint a new Accounting officer.

If the vacancy is open for 6 months, the members become liable for all debts of the CC (ie Limited Liability falls away).

Right of Access

- The Accounting Officer has the right to access all the accounting records, and supporting documentation and vouchers of the close corporation.
- The Accounting Officer also has the right to require any information and explanations from the members as he / she feels may be required to perform his duties as an accounting officer.

Basic duties of the Accounting Officer

Within three months of the preparation of the financial statements, the accounting officer must:

- Determine whether or not the financial statements agree to the accounting records
- Review the appropriateness of the accounting policies applied
- Report to the CC on the above matters