**Testbank**

to accompany

**Company law: an interactive approach**

**1st edition**

by

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**Module 1: Business organisations**

**TRUE/FALSE QUESTIONS**

1. **The concept of limited liability applies to associations created under the various states’ Associations Incorporation Acts even though those entities are not formed under the *Corporations Act 2001* (Cth).**

*Answer: True [LO1.7]*

1. **Trustees owe fiduciary duties to beneficiaries of a trust.**

*Answer: True [LO1.5.5]*

1. **When making a decision on which business structure to use many factors must be taken into account including taxation, costs, personal liability.**

*Answer: True [LO1.1]*

1. **A partnership is two or more people carrying on a business in common with a view to a profit.**

*Answer: True [LO1.1.2]*

1. **Only a company can be appointed as trustee in a trust relationship.**

*Answer: False [LOs1.5.1, 1.5.4, 1.5.5, and 1.5.6]*

1. **The maximum number of partners in all types of partnerships is twenty (20).**

*Answer: False [LO1.3.1,]*

1. **Since corporations are created under the *Corporations Act (Cth)* 2001 they can never serve as trustees of trusts which are created under state law.**

*Answer: False [LO1.5.5]*

1. **Each Partner in a partnership owes every other partner fiduciary duties.**

*Answer: True [LO1.3.4]*

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**MULTIPLE CHOICE QUESTIONS**

1. **Which of the following is the best description of a joint venture?**
2. **A and B carry on a restaurant business together.**
3. **A and B own land together, A owns 30% and B owns 70%.**
4. **A and B own land together in equal parts, their interests are created at the same time and they agree that if either dies, the other person will automatically receive their share.**
5. **A and B have agreed to stage a concert together and have agreed to share the gross returns, but this is the only time that they will do this.**

*Answer: (d) [LO1.4]*

*The key factor that makes the undertaking in (d) a joint venture is the agreement to share gross returns (rather than profits). Joint ventures are frequently used for a single venture of limited duration.*

1. **Hansel and Gretel form a partnership for their business making ginger bread houses. Before making any ginger bread houses, Hansel instructs Gretel to find a warehouse to store the ginger bread houses that the partnership will be making. Gretel finds a large warehouse in Burleigh Heads and enters into a lease with the landlord on behalf of the partnership. When Hansel inspects the warehouse he is disappointed as it is not what he expected. He informs Gretel that he no longer wishes to proceed with the partnership. Which of the following is the most correct answer:**
2. **It is likely that Hansel would incur no liability with respect to the warehouse lease as he did not sign the agreement.**
3. **The lease would most likely be binding on the partnership if the partners ratified it as it is a pre-registration contract.**
4. **Hansel and Gretel would be jointly and severely liable on the lease as they are partners.**
5. **The lease is not binding because at the time it was entered into no partnership existed and thereby it is not binding against anyone.**
6. **Hansel is not liable on the contract because Gretel signed it and he has validly terminated his interest in the partnership.**

*Answer: (c) [LO1.3.3]*

*In the normal course of the partnership business partners are assumed to be acting together. Partners are collectively responsible and individually responsible.*

1. **Hoytie Pie Pty Ltd has 100 issued shares. 99 of those shares are owned by David. The remaining share is held by Paul in trust and David is the sole beneficiary of that trust. David is the only director of Hoytie Pie Pty Ltd. When Hoytie Pie Pty Ltd was registered, it adopted a comprehensive constitution which modified all the replaceable rules applicable to Hoytie Pie Pty Ltd.**
2. **David cannot be an employee of Hoytie Pie Pty Ltd because he is the sole director and has control of all the shares in the company.**
3. **David has a beneficial interest in the share held by Paul.**
4. **The constitution has the effect as contract between David in his capacity as director and Paul in his capacity as a member pursuant to section 140(1) of the *Corporations Act (Cth)* 2001.**
5. **Hoytie Pie Pty Ltd can only enter into a contract if the contract is signed by David as the sole director.**
6. **Both (c) and (d) are correct.**

*Answer: (b) [LO15.1]*

*As trustee Paul holds the trust property i.e. the share, for the benefit of the beneficiaries i.e. David.*

1. **Which of the following is correct:**
2. **A public company is limited to 50 members.**
3. **In most instances a partnership can have no more than 30 partners.**
4. **A trust can only ever have one trustee and the trustee must be an individual.**
5. **A joint venture is a business that is owned by one person.**
6. **None of the above is correct.**

*Answer: (e) [LO1.1, 1.2, 1.3]*

*This question is about the number of participants in the various business structures. In each case, (a)-(d) are incorrect. A public company has no limit on the number of members; in most instances a partnership can have no more than 20 partners; a trustee does not have to be an individual person; a sole trader, not a joint venture, is a business that is owned by one person.*

1. **Which of the following is most likely to be deemed a partnership?**
2. **John and David start a business selling ducks. David is an excellent duck farmer and John is a superb duck salesperson. They agree that they will share the gross proceeds from sales on a 50/50 basis. David will be responsible for his costs associated with breeding the ducks and John will be responsible for his costs associated with selling the ducks.**
3. **Paul is a plumber. He owns all his equipment in his own name and runs the business in his name. Paul employs Matt and pays him $500 per week plus a bonus of $150 per week if clients are billed in excess of $5000 for the week.**
4. **Tory and James agree to start a restaurant business called “Sweet Alex”. They agree that Tory (who is a chef) will receive 60% of the net proceeds and James will receive 40%. While they have not yet opened the restaurant, they have located suitable premises and are in the process of remodelling it for the business.**
5. **Louie holds a business in trust for George and Peppa. Pursuant to the trust agreement, Louie is required to distribute the net profits of the business to George and Peppa in equal shares on the last day of each financial year.**
6. **Chris registers a company called Chris Pty Ltd to conduct a stockbroking business. Pursuant to the terms of the constitution, the company is required to pay a dividend every year to the shareholders in an amount equal to the net profits generated by the company that year.**

*Answer: (c) [LO1.3.1]*

*Tory and James are carrying business together with a view to profit.*

1. **Which of the following is a separate legal entity:**
2. **Big Drain Plumbing – a partnership formed by Alex and James to conduct a plumbing business.**
3. **Burleigh Chess Club Inc. – a chess club.**
4. **Massive Mines N.L. – an Australian listed mining organisation employing 1000 people.**
5. **All of the above.**
6. **Both B and C.**

*Answer (e) [LO1.6,LO1.7]*

*Bond Chess Club Inc. is an incorporated association and Massive Mines N.L is a company both of which are artificial separate legal entities.*

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**REVISION QUESTIONS**

1. **List three different business structures and the advantages and disadvantages of each.**

*Answer:* ***Sole trader*** *advantages – flexibility, fewer regulatory and reporting obligations, privacy, and less cost, disadvantages – unlimited liability, possibly more difficult to raise capital, and life of business limited to that of trader.*

***Partnership*** *advantages – individuals can combine capital, not taxed separately, privacy and relatively straight forward and easy to establish. Disadvantages – partners jointly and severally liable, possible limitation on number of partners and decision making can be difficult.*

***Company*** *advantages – limited liability in most circumstances, perpetual succession (i.e. company continues to exist until it is deregistered, transferable ownership (i.e. shares can be traded), usually have unlimited number of investors, has contractual capacity like an individual, flexibility in establishing internal rules and in Australian has a 30 % tax rate. Disadvantages – compliance costs, legal disclosure rules, penalties for non-compliance with regulation and in some circumstances members and operators can be responsible. [LOs 1.2, 1.3, and 1.6]*

1. **Explain the concept of limited liability.**

*Answer: The debts of a company, as a separate legal entity are its own; members are not liable for company debts. [LO 1.6.3]*

1. **Compare the manner in which partnerships, joint ventures, trusts and companies are managed.**

*Answer: A partnership is managed by the partners with some decisions needing to be unanimous e.g. admitting a new partner. A joint venture will usually be managed by a separate manager and parties must manage their involvement so as to form as partnership. The trustee/s management the affairs of the trust for the benefit of the beneficiaries. A company is managed by its directors and officials and employees that answer to the directors. [LOs 1.3, 1.4, 1.5, and 1.6]*

1. **Give an example of when a constructive trust may come into existence.**

*Answer: Constructive trust arise by operation of law commonly used by courts to bring about restitution and unwind the consequences of unjust enrichment.*

*[LO 1.5.4]*

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**PROBLEM QUESTIONS**

1. **Jenna, Koda and Lula decide to start a business baking expensive wedding cakes. Jenna and Koda will each invest $10,000 in the business. While they don’t want to participate in the day-to-day running of the business they still want to have an active role in management. Lula has no money to invest, but she has years of experience baking cakes.**

**Lula’s son, Asa, also wants to invest $50,000 in the business. He wants to have a steady income from his investment. While he does not want to be involved in the management of the company, he still wants to have some ability to direct how his $50,000 investment is spent.**

**What legal structure would you advise for their project: a partnership, an incorporated association, a company (if a company, provide details on the type of company) or some other structure? Why would you recommend this structure – provide details?**

*Answer: A Proprietary company would seem the most appropriate. A proprietary company would offer the opportunity for Jenna, Koda, Lula and Asa to all have the benefit of limited liability. All four people could achieve involvement in management a of the business if appointed as directors and Asa and others investing in the business could obtain the right to income from the business by being issued with shares. [LO 1.6]*

1. **Jacob and Marley are avid tennis players and decided to form a club called the Burleigh Breakers Tennis Club. Jacob becomes the president and Marley the secretary. Malcolm, Jason and Alex and ten other people join the club as members. Each member pays a membership fee of $100.**

**The club organizes a tournament and all the members are invited to participate. At the tournament, the club supplies sports drinks to the players. Unfortunately the drinks contain a contaminate and many players fall ill. It turns out that in order to save money, the club had purchased the drinks at a discount as they been recalled due to bacteria been found in some bottles.**

**Can the ill players bring an action in negligence against the club? If not, what remedy do they have? What would you have recommended Jacob and Marley to do differently when forming the club?**

*Answer: The Burleigh Breakers Tennis Club is and unincorporated association and as such has no legal standing. In the circumstances the ill players would bring their action against the individual members. To avoid individual members running the risk of being liable an incorporated association could have been formed to conduct the affairs of the club. [LO 1.7]*

1. **John is a foreign exchange trader working for a large bank. John and twenty five of his fellow workmates decide to leave the bank and start their own foreign exchange trading firm. They decide to operate as a partnership. Do you think this is a good structure for the business?**

*Answer: A partnership is not a good structure for the firm. The maximum number of partners is 20 except for some professional partnerships of which this does not seem to be one so a partnership could not accommodate John and all his 25 workmates. Members of a partnership are jointly and severally liable for affairs of the partnership so conducting a partnership would expose all partners to personal liability, with business like foreign exchange trading personal liability would be a matter participants in the business may be eager to limit. [LO 1.3]*

1. **Darryl and Julia are both passionate chess players. They meet for the first time at a recent chess tournament. After a short discussion about their love of chess, they decide they should open a chess store together selling exotic chess products to other likeminded chess fanatics. Unfortunately, neither Darryl nor Julia have any money. Julia’s friend, Otis, told Julia he had saved some money and was looking to invest it in a business. Julia and Darryl approach Otis and pitch their chess store idea. Otis is completely blown away by the pair's enthusiasm for the idea and agrees to invest $100,000. The three agree that Otis will not receive any interest on his investment, but will get 50% of the net profits generated by the business.**

**Darryl is given the responsibility of finding a suitable location for the business. He finds a store in Burleigh Heads and promptly enters into a lease. As Julia is out of town on business, Darryl signs the lease in his name.**

**Darryl engages a firm of architects to prepare designs for the store.**

**When Julia returns, she is told about the new premises. She takes her good friend Glenda to check out the new premises. When they enter the store, Glenda trips over a broom that was left lying on the floor and severely injures her leg.**

**Julia is horrified by the new premises. She doesn’t like the location, it is too dark and it is too expensive. She tells Darryl that the whole chess store idea just won’t work and she has no interest in perusing the venture any further.**

**Who is liable for the lease obligations, the architects’ fees and Glenda’s injuries?**

*Answer: If Darryl, Julia and Otis are shown to be:*

* *Carrying on business and,*
* *In common with each other and,*
* *With a view to profit*

*There will be a partnership between the three, which will make them jointly and severally liable for the affairs of the partnership. [LO 1.3]*

1. **Leroy is considering starting a catering business. Leroy has three children (aged 3, 16 and 21) and is married to Melanie.**

**The proposed business will cater to high end corporate clients and wealthy individuals. In order to have the ability to cater events for these clients, Leroy needs approximately $4 million of capital. Leroy intends to invest the $2 million into the enterprise from his own funds and get the balance from third party sources.**

**Leroy wants to have his wife and children involved in the business as well.**

**Advise Leroy.**

**How would your advice change if Leroy said his friend Linus owned a commercial kitchen and he wanted to invest that asset in the business for a 25% interest in the business?**

*Answer: The three options available are partnership, company or trust. Matters to consider include:*

* *As Leroy’s children are under 18 they cannot be directors or partners*
* *Financing*
* *Succession Planning, particularly when the children turn 18*
* *If a partnership is involved does Linus’s kitchen become partnership property?*

*[LOs 1.3, 1.5, and 1.6]*