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Testbank

to accompany

Company law: an interactive approach

2nd edition

by
Chapple et al.

WILEY

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Chapter 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 [LO1.8]

2. Trustees owe fiduciary duties to beneficiaries of a trust.

Answer: True [LO1.5.5]

3. 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]

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

Answer: True [LO1.1.2]

5. 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]

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

Answer: False [LO1.3.1]

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

Answer: False [LO1.5.5]

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

Answer: True [LOs1.3.4, 1.3.5]

9. Cooperatives are never allowed to generate a surplus.

Answer: False [LO1.7.1]

10. A hybrid business structure can allow consolidation of control, regulatory arbitrage and asset protection.

Answer: True [LO1.9.1]

MULTIPLE CHOICE QUESTIONS

1. Which of the following is the best description of a joint venture?

- (a) A and B carry on a restaurant business together.
- (b) A and B own land together, A owns 30% and B owns 70%.
- (c) 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.
- (d) 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.

2. 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:

- (a) It is likely that Hansel would incur no liability with respect to the warehouse lease as he did not sign the agreement.
- (b) The lease would most likely be binding on the partnership if the partners ratified it as it is a pre-registration contract.
- (c) Hansel and Gretel would be jointly and severally liable on the lease as they are partners.
- (d) The lease is not binding because at the time it was entered into no partnership existed and thereby it is not binding against anyone.
- (e) 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.

- 3. 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.**
- (a) 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.**
 - (b) David has a beneficial interest in the share held by Paul.**
 - (c) 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.**
 - (d) Hoytie Pie Pty Ltd can only enter into a contract if the contract is signed by David as the sole director.**
 - (e) 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.

4. Which of the following is correct:

- (a) A public company is limited to 50 members.**
- (b) In most instances a partnership can have no more than 30 partners.**
- (c) A trust can only ever have one trustee and the trustee must be an individual.**
- (d) A joint venture is a business that is owned by one person.**
- (e) 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.

5. Which of the following is most likely to be deemed a partnership?

- (a) 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.
- (b) 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.
- (c) 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.
- (d) 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.
- (e) 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.

6. Which of the following is a separate legal entity:

- (a) Big Drain Plumbing – a partnership formed by Alex and James to conduct a plumbing business.
- (b) Burleigh Chess Club Inc. – a chess club.
- (c) Massive Mines N.L. – an Australian listed mining organisation employing 1000 people.
- (d) All of the above.
- (e) 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.

7. Which of the following types of cooperative is regulated under the Corporations Act 2001 (Cth)?

- (a) Producer cooperatives**
- (b) Purchasing cooperatives**
- (c) Digital cooperatives**
- (d) Financial cooperatives**
- (e) Both C and D.**

Answer (d) [LO1.7.1]

Most types of cooperatives are regulated by State cooperatives legislation. Financial cooperatives or mutual banks are regulated by the Corporations Act (as well as the Banking Act 1959 (Cth) and APRA) and their regulation is similar to that of banks.

8. Some businesses use a hybrid structure to take advantage of regulatory arbitrage. What is regulatory arbitrage:

- (a) Quarantining assets in different markets**
- (b) Consolidating control using trusts and subsidiaries**
- (c) Transferring funds between subsidiaries to minimise tax**
- (d) Using a hybrid structure to meet regulatory requirements in the local market**
- (e) Taking advantage of cost differences arising from different regulations that apply in different markets.**

Answer (e) [LO1.9.1]

Regulatory arbitrage means taking advantage of cost differences related to different regulations that apply in different national jurisdictions (e.g. forming an offshore subsidiary to access labour at a lower legislated minimum wage).

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]*

2. 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]

3. 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]

4. 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]

5. Distinguish between a trading cooperative and a non-trading cooperative.

Answer: Trading cooperatives can engage in commercial activities, generate a surplus and distribute it to members, have an unlimited number of members and have a 'one member, one vote' system. Non-trading cooperatives must reinvest any surpluses in its activities. [LO 1.7.1, 1.7.2]

6. Briefly describe the meaning of 'hybrid business structure'.

Answer: A hybrid business structure combines multiple business entities, having potentially different business structures, locations and other features, into a larger legal structure that allows the business to achieve its strategic goals more effectively than a single business structure would allow. [LO 1.9]
