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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

No. of pages: 10

Corporate Level

Corporate Law

Instructions to candidates

(1) Time allowed: Reading and planning – 15 minutes
Writing – 3.5 hours

(2) Total: 100 marks

(3) **All questions are compulsory.**

(4) This paper consists of three sections.

Section 1:10 multiple choice questions (MCQs)

Section 2: 4 questions

Section 3: 2 questions

(5) This is an **open book** examination.

(6) Answers to Question 1 (the most appropriate answer (A, B, C or D)) should be entered against the relevant question number.

(7) All answers should be in the **English language**.

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DECEMBER 2020

Online Examination

SECTION 1

Question 01

All questions are compulsory.
Total marks for Section 1 is 20 marks.
Recommended time for the section is 42 minutes.

1.1 The following statements are in relation to an incorporated company.

(i) It cannot own property in its name.
(ii) Its assets are separate from the assets of its owners.
(iii) It can maintain bank accounts, but they must be in its owners' names.
(iv) It can sue under its own name.

Which of the above statements in relation to an incorporated company are correct?

A. (i) and (ii) only
B. (ii) and (iii) only
C. (ii) and (iv) only
D. (iii) and (iv) only

(2 marks)

1.2 The Companies Act No. 07 of 2007 provides for companies limited by guarantee, and the following statements are in relation to such companies.

(i) Two Sri Lankan citizens can get together to apply for the formation of such a company.
(ii) The members of such companies are entitled to receive dividends.
(iii) "Covid Aid", a charitable organisation that is funded by grants given by generous donors, can qualify as such a company.
(iv) The articles of these companies could be altered without the prior written approval of the Registrar.

Which of the above statements in relation to companies limited by guarantee are correct?

A. (i) and (iii) only
B. (ii) and (iv)only
C. (i), (ii) and (iv) only
D. (ii), (iii) and (iv) only

(2 marks)

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1.3 Some timber perished in a fire, and it belonged to a company in which the insured was the sole shareholder.

This scenario relates to which of the following decided cases on the separate legal personality of a company?

A. Salomon v Salomon & Co Ltd
B. Macaura v Northern Assurance Co Ltd
C. De Costa v Bank of Ceylon
D. Lee v Lee's Air Farming Ltd

(2 marks)

1.4 Kamalesan (K) who is presently living in India, is married to a Sri Lankan lady from Kandy.

According to the Foreign Exchange Act, No. 12 of 2017, K qualifies as a resident of Sri Lanka if,

(i) K is a diplomatic representative of the Sri Lankan Government.
(ii) K is an Indian, and has stayed for more than 183 days in Sri Lanka during the last 12 months.
(iii) K is a Sri Lankan citizen, and has left Sri Lanka temporarily for not more than 365 days.
(iv) K is a Sri Lankan citizen who is living in India on a resident visa.

The correct criteria would be:

A. (i) and (ii) only
B. (i) and (iii) only
C. (ii) and (iv) only
D. (iii) and (iv) only

(2 marks)

1.5 Which of the following statements is an advantage of incorporating a company, over a sole proprietorship?

A. A company can raise more capital as it can issue shares.
B. Less expenses are required to establish a company.
C. In a company, its owners need not pay tax as long as the company pays tax.
D. The owners have more control of the daily management of a company.

(2 marks)

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1.6 PW Pty Ltd (PW) was incorporated in Australia in 2005. It has now decided to open a branch in Sri Lanka in accordance with the provisions of the Companies Act No. 07 of 2007 ("Act").

Consider the following statements.

(i) As PW existed before the operation of the Act, it need not register under the Act.
(ii) PW must first register under the Act, before establishing a place of business within Sri Lanka.
(iii) PW must deliver the documents specified in the Act to the Registrar within one month of establishing a place of business in Sri Lanka.
(iv) A certified copy of the constitution of PW is an important document that must be submitted to the Registrar at registration.

Which of the above statements is/are correct?

A. (i) only
B. (i) and (iv) only
C. (ii) and (iv) only
D. (iii) and (iv) only

(2 marks)

1.7 Which of the following is the most likely situation where the courts may lift the veil of incorporation?

A. When the number of shareholders of a company exceeds two.
B. When the company has been used as a cover for the wrongdoings of another party.
C. When a company covers up a negligent act of its board of directors.
D. When a company deliberately tries to avoid its obligations under a contract with another company.

(2 marks)

1.8 Which of the following is an important feature of a limited liability company?

A. It has a separate legal personality when its issued capital exceeds the amount specified in its Articles.
B. It has perpetual succession, as long as the Companies Act under which it was incorporated is in force.
C. Its liability is unlimited, even though its name says "Limited".
D. Its shares are freely transferable, subject to its Articles.

(2 marks)

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1.9 The following statements are in relation to an overseas company, which is registered in Sri Lanka under the Companies Act No. 07 of 2007 ("Act").

(i) It must deliver the documents specified in the Act to the Registrar within six months of establishing its place of business in Sri Lanka.
(ii) It can engage in the activity of carrying out a liaison office, as long as such activity does not provide any income to the company.
(iii) It must prepare financial statements for each calendar year in the same manner as required of a company that is incorporated under the Act.
(iv) As it is already registered, it need not mention the country of its incorporation in a prospectus inviting subscriptions for its shares in Sri Lanka.

Which of the above statements are correct?

A. (i) and (iv) only
B. (ii) and (iii) only
C. (i), (ii) and (iii) only
D. (ii), (iii) and (iv) only

(2 marks)

1.10 The following statements are in relation to the Land (Restriction on Alienation) Act No. 38 of 2014 ("Act").

(i) It stipulates restrictions on the alienation of land in Sri Lanka to foreigners.
(ii) It prevents Sri Lankan companies in which more than 50% of the shareholding is held by a foreign company, from holding land in Sri Lanka.
(iii) Per the Act, a Sri Lankan company in which more than 50% of the shareholding is held by a foreign individual, can hold land in Sri Lanka.
(iv) It allows Sri Lankan companies in which more than 50% of the shareholding is held by a foreign individual, to take on lease, lands in Sri Lanka up to 33 years.

Which of the above statements is/are correct?

A. (i) only
B. (iii) only
C. (i) and (ii) only
D. (i), (iii) and (iv) only

(2 marks)

(Total: 20 marks)

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SECTION 2

All questions are compulsory.
Total marks for Section 2 is 40 marks.
Recommended time for the section is 84 minutes.

Question 02

Dilhani Rodrigo is a management trainee at Cross Line PLC (CL), a listed company located in the Biyagama Free Trade Zone.

She has consulted you on the listing rules of the Colombo Stock Exchange, specifically on the corporate governance rules.

Required:

(a) **State** the minimum number of non-executive directors that must be on the board of CL, per the corporate governance rules.

(3 marks)

(b) **Explain** the rule on the disclosures to be made by CL in relation to its directors.

(7 marks)

(Total: 10 marks)

Question 03

The Companies Act No. 7 of 2007 ("Act") says that a company must satisfy the solvency test immediately after making a distribution. The Act also says that a dividend is a distribution out of the profits of the company.

ABC (Pvt) Ltd (ABC) has proposed to make a dividend distribution to its shareholders at the forthcoming Annual General Meeting (AGM). Ranjith de Mel, the CFO of the company, tells you that after the proposed distribution is accounted for, the projected financial position of ABC would be as follows.

- Non-current assets: Rs. 60 million
- Current assets: Rs. 40 million
- Total liabilities: Rs. 85 million
- Stated capital: Rs. 25 million

Required:

Explain to Ranjith de Mel:

(a) whether ABC will satisfy the solvency test, after making the proposed distribution.

(6 marks)

(b) whether the proposed distribution can be validly made by ABC, even if it had failed the solvency test.

(4 marks)

(Total: 10 marks)

Question 04

(a) XYZ (Pvt) Ltd (XYZ) is a company incorporated in Sri Lanka under the Companies Act No. 07 of 2007.

The directors of XYZ intend to expand business operations outside of Sri Lanka. In this regard, Saman Silva, the Chairman, has proposed to open an overseas office in Pakistan by investing USD 150,000 through an Outward Investment Account (OIA).

Required:

Explain whether the Chairman's proposal can be implemented.

(5 marks)

(b) ABC Pte Ltd (ABC), a company incorporated in Singapore, plans to set up a university in Malabe, Sri Lanka.

Required:

Explain the two (02) main steps that should be followed by ABC in order to be able to undertake this activity.

(5 marks)

(Total: 10 marks)

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Question 05

Southlands (Pvt) Ltd (SPL) was incorporated in 2008 under the Companies Act No. 07 of 2007 ("Act").

Northwood (Pvt) Ltd (NPL) is a fully-owned subsidiary of SPL. Due to recurring losses, SPL intends to wind up NPL's operations.

(a) There are 7 directors in the board of NPL. Out of these 7, 4 are not in favour of winding up NPL.

The directors of SPL are considering whether to go for a creditors' voluntary winding up or a shareholders' voluntary winding up.

Required:

Explain whether it is possible for NPL to be wound up voluntarily by its shareholder.

(5 marks)

(b) Saranapala who is a lawyer, is a creditor of SPL. However, Saranapala also functioned as a director of NPL until 31 December 2019. Now SPL intends to appoint Saranapala as its liquidator, since he knows the law.

Required:

Explain, with reference to the Act, whether Saranapala is qualified or not to be appointed as the liquidator of SPL.

(5 marks)

(Total: 10 marks)

SECTION 3

Both questions are compulsory.
Total marks for Section 3 is 40 marks.
Recommended time for the section is 84 minutes.

Question 06

(a) Asuntha (A) and Hasna (H), two home bakers, are intending to register a "private company" under the provisions of the Companies Act No. 07 of 2007 ("Act").

They are considering the following options for the name of the company.

- National Home Foods (Pvt) Ltd
- Home Foods PLC
- Home Foods Ltd
- Home Foods (Pvt) Ltd

At present there is no company that has been registered under the Act under the name "Home Foods". Further A and H have not obtained any additional supporting documents from anyone, in relation to any of these names.

Required:

Explain with reference to the Act, which of the names given above would be the most likely one to be accepted by the Registrar of Companies.

(10 marks)

(b) Per the latest balance sheet of Samata Pol Company (Pvt) Ltd (SPC), the company has assets worth Rs. 150 million.

SPC now intends to purchase a tea factory for Rs. 100 million, and it has passed a special resolution to this effect.

Susil Premanath (S), a minority shareholder of SPC, is not happy with this decision of the company, and wishes to exit SPC.

He now intends to exercise his minority buy-out rights under the Companies Act No. 07 of 2007.

Required:

(i) **Explain** whether S is eligible to exercise his minority buy-out rights in this instance.

(6 marks)

(ii) **Explain** what SPC should do if it receives a notice from S, requiring SPC to purchase his shares.

(4 marks)

(Total: 20 marks)

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Question 07

(a) Ranarasa (R), a very knowledgeable chartered accountant, was recently appointed as a director of Star Dust (Pvt) Ltd (SD). After the appointment R got to know that SD intends to enter into a mutually beneficial commercial agreement with Manpower (Pvt) Ltd (MP), an unrelated company. R is a director of MP.

The Articles of SD have a clause saying that its directors cannot do business with SD.

Required:

Analyse with reference to any three (03) duties of a director under the Companies Act No. 07 of 2007, whether this agreement can be entered into, without R violating each of these duties.

(10 marks)

(b) You are the company secretary of Moonlight (Pvt) Ltd (MPL). MPL intends to hold an extraordinary general meeting (EGM) on 5 February 2021 at its head office at No. 1111, Galle Road, Colombo 03 at 9.30 am.

The purpose of this EGM is to adopt the following resolutions.

1. To consider changing the name of the company from Moonlight (Pvt) Ltd to Moonlight Exports (Pvt) Ltd.
2. To venture into an additional business area, namely agriculture.
3. To approve a special budget for Covid-19 relief to its employees.

The shareholders will also be allowed to discuss any other matters relevant to them under the category "Any other business".

You have been instructed to inform the shareholders that the proxy form can be in any accepted format, and that it should be delivered to the registered office of the company on or before 2 February 2021.

Required:

Prepare the notice and agenda for this EGM.

(10 marks)

(Total: 20 marks)

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