

Improper Recognition of Foreign Funding for the Stated Capital

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Introduction

Royal (Pvt) Ltd is a limited liability company, which was incorporated on the 28th of October 2014. This company is a joint venture company, jointly controlled by Royal international company in India and Royal Ltd in Sri Lanka who has 50% ownership equally. The client's trading is mainly focused on printing of labels and tags.

This case is relating to the foreign funding for the share capital and mainly discusses about the implication of the stamp duty act No 43 of 1982, Inland Revenue act No 10 of 2006 and company act No 07 of 2007.

Discussion of Issue

During the year Royal Company decided to issue 100,000 shares at Rs.15 to obtain a share capital of Rs. 1,500,000. For this purpose Royal international company sent a fund transfer through a foreign currency bank account, but Royal Ltd in Sri Lanka also has not made any preparations regarding the purchase of shares. The board of directors has already passed the board resolution for share issue, which is an undated resolution.

Normally, when a foreign company invests in shares, the relevant funding should be sent via a Securities Investment Account according to Exchange Control Department gazette notice No 06/04/18/2013 on 2nd June 2013. It is stated that, **"As a measure of facilitating inward remittances into Sri Lanka for investment purposes, it has been decided to offer more flexible avenues to receive and repatriate funds into and out Security Investment Account."**

In this situation company has received the fund via a normal NRFC account. So these funds cannot be used for the issue of shares. Therefore the client should return the funds received and collect back via a securities investment account. But the company has recorded the funds received as follows;

| | | | |
|-----------------|----|---------|---------|
| Advance account | Dr | 750,000 | |
| Stated capital | | Cr | 750,000 |

And also company did not receive any funds from Royal Ltd in Sri Lanka for the share issue, but the company has recognized the stated capital as follows;

| | | | |
|----------------|----|---------|---------|
| Receivable | Dr | 750,000 | |
| Stated capital | | Cr | 750,000 |

Though the company has recognized stated capital worth of Rs.1, 500,000, no funds were actually received nor stamp duty were paid for the issue of shares. As per the stamp duty act No 43 of 1982, the share issue date should be the date of resolution and within one month of issue of shares the company should pay stamp duty. **It is stated that, in 6(1) the stamp duty with which any instrument is chargeable shall be paid before or at the time of execution of the instrument and such payment shall be indicated on such instrument by means of adhesive stamps or impressed stamps except as otherwise permitted in this Act.**

(2) The following instruments shall be deemed to have been stamped before or at the time of execution of the instrument:

(a) Share transfers executed in Sri Lanka which are stamped within one month of execution."

Accordingly if the Company is unable to pay stamp duty within one month, company is then liable to pay penalty charges for the delay according to the Inland Revenue Act No 10 of 2006 provision 127, it is stated that,

Where any income tax for any pay period payable by any employer under the provisions of this Chapter is in default, such employer shall pay in addition to such tax-

(a) A penalty of a sum equivalent to ten per centum of such tax; and

(b) Where such tax is not paid before the expiry of thirty days after it has begun to be in default, a further penalty of a sum equivalent to two per centum of the tax in default in respect of each further period of thirty days or part thereof, during which it remains in default:

Provided that—

(i) the Commissioner-General may waive or reduce the amount of any such penalty payable by any employer, if such employer proves to the satisfaction of the Commissioner-General that the failure to pay was due to circumstances beyond his control and that he has paid the amount of the tax in default and has furnished the declaration required to be furnished at the time of such payment;

(ii) the total amount payable as penalty under the preceding provisions of this section, shall in respect of the tax in default for any pay period, not exceed fifty per centum of the tax in default.

Henceforth if the company is unable to pay the stamp duty within one month the company will be liable to pay penalty as follows

After one month - 10%

After that 2% additional tax up to the limit of 50%

In this scenario though a resolution has been passed, client did not pay any stamp duty for the share issue.

And also as per Companies Act No 07 of 2007 sub section 1 of section 78, it is stated that **“Every company shall within two months from the date of the date of allotment its shares, debentures or debenture stock; company should deliver the share certificates to the shareholders”**.

As per subsection 2 of section 78 of company act 2007,

“Where a company fails to comply with the requirements of subsection 1

- a) The company shall be guilty of an offence and be liable on conviction to a fine not exceeding fifty thousand rupees: and**
- b) Every officer of the company who is in default shall be guilty of an offence and be liable on conviction to a fine not exceeding fifty thousand rupees.**

Implication of the Issue

In this scenario the company did not receive any funds for issue of shares and company has shown the equity amount as fund received. Therefore the net assets of the company are over stated. And also if the company does not comply with the guidelines given by the company act no 07 of 2007 and do not pay stamp duty within one month the company liable to pay penalty charges. And also if the company is unable to issue share certificates within two months after the date of allotment, company and company officers should pay penalty for the delay of issue of the certificates. These will be extra cost to be bared the company.

Conclusion & Recommendation

- In this situation company cannot identify the share capital because they did not receive any fund for the share issue nor did they issue any shares. Therefore the company should reverse the entry for the share capital. We recommend them to return the funds received from Royal International via NRFC account and to resend the funds through a Security Investment Account. The company should reverse the entry as follows,

Share capital of Royal International

| | | |
|-----------------|----|---------|
| Stated capital | Dr | 750,000 |
| Advance account | Cr | 750,000 |

Share capital of Royal Ltd

| | | |
|----------------|----|---------|
| Stated capital | Dr | 750,000 |
| Receivable | Cr | 750,000 |

- Also we recommended that the company should obtain a reasoned date to the undated board resolution by confirming the date from the company secretary and should issue the shares to Royal international company and Royal Ltd Company within one month of the board resolution date and should pay the stamp duty within one month.
- Company should issue share certificates within two months of the payment date of stamp duty.