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UNIT 2:

THE INDIAN PARTNERSHIP ACT, 1932

1. DEFINITION & NATURE OF PARTNERSHIP

INTRODUCTION

- The law of partnership is contained in the Indian Partnership Act, 1932,which **came into force on 1st October 1932, except Section 69 (dealing with the effect of non-registration of firms), which came into force on 1st October 1933.**
- Since partnership comes into existence only by a contract between the parties for the purpose, the provisions of the Indian Contract Act, except when they are inconsistent with the express provisions of the Partnership Act, continue to apply to partnership firms **(Sec. 3).**

DEFINITION OF PARTNERSHIP

Section 4 of the Indian Partnership Act, 1932, defines 'partnership' in the following terms:

"Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

ESSENTIAL ELEMENTS: This definition contains five elements which constitute a partnership, namely: (1) There must be a agreement; (2) between two or more persons; (3) who agree to carry on a business; (4) with the object of sharing profits; and (5) the business must be carried on by all or any of them acting for all *(i.e.,* there must be mutual agency).

All the above elements must coexist in order to constitute a partnership. If any of these is not present, there cannot be a partnership. **We now discuss these elements one by one:**

1. **Contract:**
   - Partnership is the result of a contract. It does not arise from status, operation of law or inheritance.
   - **'Contract' is the very foundation of partnership**. It may, however, be either **express or implied**. Again, it may be **oral or in writing.**
   - Thus at the death of father, who was a partner in a firm, the son can claim share in the partnership property but cannot become a partner unless he enters into a contract for the same with other persons concerned.
   - Similarly, the members of Joint Hindu Family carrying on a family business cannot be called partners for their relation arises not from any contract but from status.
   - **To emphasise the element of contract, Sec. 5 expressly provides that "the relation of partnership arises from contract and not from status."**

2. **Association of two or more persons:**
   - Since partnership is the result of a contract**, at least two persons are necessary to constitute a partnership.**
   - The Partnership Act does not mention any thing about the maximum number of persons who can be partners in a partnership firm but **Sec. 464 of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm.**
   - **Only persons competent to contract** can enter into a contract of partnership.
   - Persons may be **natural or artificial**.

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- A **company** may, being an artificial legal person, enter into a contract of partnership, if authorised by its Memorandum of Association to do so. Even there could be a partnership between a number of companies.
- A **partnership firm,** since it is not recognised as a legal person having a separate entity from that of partners, cannot enter into contract of partnership with another firm or individuals . When a firm (under a firm name) enters into a contract of partnership with another firm or individual, in that case, in the eye of law the members of the firms or firm become partners in their individual capacity.

3. BUSINESS:

- In this context, we will consider **two propositions**.
- **First,** there must exist a **business**. **The term 'business' is used in its widest sense and includes every trade, occupation or profession [Sec. 2(b)].** The existence of business is essential.
- **Secondly,** the **motive of the business is the "acquisition of gains**" which leads to the formation of partnership. Therefore, there can be no partnership where there is no intention to carry on the business and to share the profit thereof. **In other words, if the purpose is to carry on some charitable work, it will not be a partnership.**
- If a number of persons agree to share the income of a certain property or to divide the goods purchased in bulk amongst themselves, there is no partnership and such persons cannot be called partners because in neither case they are carrying on a business. **Thus, where *A* and *B* jointly purchased a tea shop and incurred additional expenses for purchasing pottery and utensils for the job, contributing necessary money half and half and then leased out the shop on rent which was shared equally by them, it was held that they are only co-owners and not partners as they never carried on any business**

4. SHARING OF PROFITS:

- This essential element provides that the agreement to carry on business must be with the object of sharing profits amongst all the partners. Impliedly the partnership must aim to make profits because then only profits may be divided amongst the partners.
- The sharing of profits is thus an essential feature of partnership**. There can be no partnership where only one of the partners is entitled to the whole of the profits of the business**.
- **The partners may, however, agree to share profits in any ratio they like.**
- ***Sharing of losses not necessary****:*
  - To constitute a partnership it **is not essential that the partners should agree to share the losses**
  - It is open to one or more partners to agree to bear all the losses of the business.
  - The Act, therefore, does not seek to make agreement to share losses a test of the existence of partnership.
  - **Section 13(*b*), however, provides that the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm, unless otherwise agreed.**
  - Thus sharing of losses may be regarded as consequential upon the sharing of profits and **where nothing is said as to the sharing of losses, an agreement to share profits implies an agreement to share losses as well.**
  - Even though a partner may not share in the losses of the business, yet his liability *vis-a-vis* outsiders shall be unlimited because there cannot be 'limited partnerships ' in our country under the Partnership Act**.**

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5. MUTUAL AGENCY:

- The fifth element in the definition of a partnership provides that the **business must be carried on by all the partners or any (one or more) of them acting for all, that is, there must be mutual agency**.
- Thus every partner is **both an agent and principal** for himself and other partners, *i.e.,* he can bind by his acts the other partners and can be bound by the acts of other partners in the ordinary course of business**. He is an agent in so far as he can bind the other partners by his acts and he is a principal to the extent that he is bound by the act of other partners.**
- The importance of the element of mutual agency lies in the fact **that it enables every partner to carry on the business on behalf of others.**
- Partners may agree among themselves that some one of them shall not enter into any contracts on behalf of the firm, but by virtue of the principle of mutual agency, such partner can bind the firm *vis-a-vis* third parties without notice in contracts made according to the ordinary usage of trade. Of course he can be made liable by other partners *inter-se* for exceeding his authority.
- **It may be noted that the true test of partnership is mutual agency rather than sharing of profits. If the element of mutual agency is absent, then there will be no partnership.**

TRUE TEST OF PARTNERSHIP

Mode of determining existence of partnership (Section 6):

In determining whether a group of persons is or is not a firm, or whether a person is or not a partner in a firm, regard shall be had to **the real relation between the parties**, as shown by all relevant facts taken together. For determining the existence of partnership, it must be proved.

1. There was an **agreement** between all the persons concerned
2. The agreement was to **share the profits** of a business and
3. the business was **carried on by all or any of them** acting for all.

1. **Agreement:** Partnership is created by agreement and not by status (Section 5). The relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on business as such are not partners in such business.
2. **Sharing of Profit:** Although sharing of profits is an evidence of partnership but this is **not the conclusive test of partnership.** There may be persons sharing the profits of a business but who do not by that reason become partners. In this respect **Explanation II to Section 6 clearly states: "The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not of itself make him a partner with the persons canying on the business; and, in particular, the receipt of such share or payment:**
   a) by a lender of money to persons engaged or about to engage in any business,
   b) by a servant or agent as remuneration,
   c) by a widow or child of a deceased partner, as annuity, or
   d) by a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business.

   Although the right to participate in profits is a strong test of partnership, and there may be cases where, upon a simple participation in profits, there is a partnership, yet whether the relation does or does not exist must depend upon the whole contract between the parties.
   Where there is an express agreement between partners to share the profit of a business and the business is being carried on by all or any of them acting for all, there will be no difficulty in the light of provisions of Section 4, in determining the existence or otherwise of partnership.
   But the task becomes difficult when either there is no specific agreement or the agreement is such

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as does not specifically speak of partnership. In such a case for testing the existence or otherwise of partnership relation, Section 6 has to be referred.

According to Section 6, regard must be had to the real relation between the parties as shown by all relevant facts taken together. The rule is easily stated and is clear but its application is difficult.

Cumulative effect of all relevant facts such as written or verbal agreement, real intention and conduct of the parties, other surrounding circumstances etc., are to be considered while deciding the relationship between the parties and ascertaining the existence of partnership

3. **Agency:** Existence of Mutual Agency which is the cardinal principle of partnership law, is very much helpful in reaching a conclusion in this regard. Each partner carrying on the business is the principal as well as an agent of other partners. So, the act of one partner done on behalf of firm, binds all the partners.

If the elements of mutual agency relationship exist between the parties constituting a group formed with a view to earn profits by running a business, a partnership may be deemed to exist.

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Santiranjan Das Gupta Vs. Dasyran Murzamull (Supreme Court)

In Santiranjan Das Gupta Vs. DasyranMurzamull, following factors weighed upon the Supreme Court to reach the conclusion that there is no partnership between the parties:

a) Parties have not retained any record of terms and conditions of partnership.
b) Partnership business has maintained no accounts of its own, which would be open to inspection by both parties
c) No account of the partnership was opened with any bank
d) No written intimation was conveyed to the Deputy Director of Procurement with respect to the newly created partnership.

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PARTNERS, FIRM AND FIRM NAME

- Persons who have entered into partnership with one another are **called individually 'partners'** and **collectively a 'firm'** and **the name under which their business is carried on is called the 'firm name'** (Sec. 4).
- A 'firm' is not a separate legal entity distinct from its members. It is merely a collective name of the individuals composing it.
- Hence, unlike a company which is a separate legal entity distinct from its members, a firm cannot possess property or employ servants, neither it can be a debtor nor a creditor.
- It cannot sue or be sued by others. It is only for the sake of convenience that in commercial usage terms like 'firm's property,' 'employee of the firm,' 'suit against the firm' and so on are used, but in the eye of law that simply means 'property of the partners,' 'employee of the partners ' and 'a suit against the partners' of that firm. It is relevant to state that for the purposes of the Income Tax Act, a partnership firm is an entity quite distinct from the partners composing it and is assessable separately

PARTNERSHIP VS. JOINT STOCK COMPANY

Basis	Partnership	Joint Stock Company
Legal status	A firm is not legal entity i.e., it has no legal personality distinct from the personalities of its constituent members.	A company is a separate legal entity distinct from its members *(Salomon v. Salomon)*.

Agency	In a firm, every partner is an agent of the other partners, as well as of the firm.	In a company, a member is not an agent of the other members or of the company, his actions do not bind either.
Distribution of profits	The profits of the firm must be distributed among the partners according to the terms of the partnership deed.	There is no such compulsion to distribute its profits among its members. Some portion of the profits, but generally not the entire profit, become distributable among the shareholders only when dividends are declared.
Extent of liability	In a partnership, the liability of the partners is unlimited. This means that each partner is liable for debts of a firm incurred in the course of the business of the firm and these debts can be recovered from his private property, if the joint estate is insufficient to meet them wholly.	In a company limited by shares, the liability of a shareholder is limited to the amount, if any, unpaid on his shares, but in the case of a guarantee company, the liability is limited to the amount for which he has agreed to be liable. However, there may be companies where the liability of members is unlimited.
Property	The firm's property is that which is the "joint estate" of all the partners as distinguished from the 'separate' estate of any of them and it does not belong to a body distinct in law from its members.	In a company, its property is separate from that of its members who can receive it back only in the form of dividends or refund of capital.
Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	In a company a shareholder may transfer his shares, subject to the provisions contained in its Articles. In the case of public limited companies whose shares are quoted on the stock exchange, the transfer is usually unrestricted.
Management	In the absence of an express agreement to the contrary, all the partners are entitled to participate in the management.	Members of a company are not entitled to take part in the management unless they are appointed as directors, in which case they may participate. Members, however, enjoy the right of attending general meeting and voting where they can decide certain questions such as election of directors, appointment of auditors, etc.
Registration	Registration is not compulsory in the case of partnership.	A company cannot come into existence unless it is registered under the Companies Act, 2013.
Winding up	A partnership firm can be dissolved at any time if all the partners agree.	A company, being a legal person is either wind up by the National Company Law Tribunal or its name is struck of by the Registrar of Companies.
Number of membership	According to section 464 of the Companies Act, 2013, the number of partners in any association shall not exceed 100. However, the Rule given under the Companies *(Miscellaneous) Rules, 2014* restrict the present limit to 50.	A private company may have as many as 200 members but not less than two and a public company may have any number of members but not less than seven. A private Company can also be formed by one person known as one person Company.

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Duration of existence	Unless there is a contract to the contrary, death, retirement or insolvency of a partner results in the dissolution of the firm.	A company enjoys a perpetual succession.

PARTNERSHIP VS. CLUB

Basis of Difference	Partnership	Club
Definition	It is an association of persons formed for earning profits from a business carried on by all or any one of them acting for all.	A club is an association of persons formed with the object not of earning profit, but of promoting some beneficial purposes such as improvement of health or providing recreation for the members,
Relationship	Persons forming a partnership are called partners and a partner is an agent for other partners.	Persons forming a club are called members. A member of a club is not the agent of other members.
Interest in the property	Partner has interest in the property of the firm.	A member of a club has no interest in the property of the club.
Dissolution	A change in the partners of the firm affect its existence.	A change in the membership of a club does not affect its existence.

PARTNERSHIP VS. HINDU UNDIVIDED FAMILY

Basis of difference	Partnership	Joint Hindu family
Mode of creation	Partnership is created necessarily by an agreement.	The right in the joint family is created by status means its creation by birth in the family.
Death of a member	Death of a partner ordinarily leads to the dissolution of partnership.	The death of a member in the Hindu undivided family does not give rise to dissolution of the family business.
Management	All the partners are equally entitled to take part in the partnership business.	The right of management of joint family business generally vests in the Karta, the governing male member or female member of the family. [1]
Authority to bind	Every partner can, by his act, bind the firm.	The Karta or the manager, has the authority to contract for the family business and the other members in the family.
Liability	In a partnership, the liability of a partner is unlimited.	In a Hindu undivided family, only the liability of the Karta is unlimited, and the other coparcener are liable only to the extent of their share in the profits of the family business.
Calling for accounts on closure	A partner can bring a suit against the firm for accounts, provided he also seeks the dissolution of the firm.	On the separation of the joint family, a member is not entitled to ask for account of the family business.
Governing Law	A partnership is governed by the Indian Partnership Act, 1932.	A Joint Hindu Family business is governed by the Hindu Law.
Minor's capacity	In a partnership, a minor cannot become a partner, though he can be admitted to the benefits of partnership, only with the consent of all the partners.	In Hindu undivided family business, a minor becomes a member of the ancestral business by the incidence of birth. He does not have to wait for attaining majority.

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Continuity	A firm subject to a contract between the partners gets dissolved by death or insolvency of a partner.	A Joint Hindu family has the continuity till it is divided. The status of Joint Hindu family is not thereby affected by the death of a member.
Number of Members	In case of Partnership number of members should not exceed 50.	Members of HUF who carry on a business may be unlimited in number.
Share in the business	In a partnership each partner has a defined share by virtue of an agreement between the partners.	In a HUF, no coparceners has a definite share. His interest is a fluctuating one. It is capable of being enlarged by deaths in the family diminished by births in the family.

1. Joint Hindu Family: The amendment in the Hindu Succession Act, 2005, entitled all adult members – Hindu males and females to become coparceners in a HUF. They now enjoy equal rights of inheritance due to this amendment. **On 1st February 2016, Justice Najmi Waziri of Delhi High court gave a landmark judgement which allowed the eldest female coparceners of an HUF to become its Karta.**

PARTNERSHIP VS. CO-OWNERSHIP OR JOINT OWNERSHIP (i.e. the relation which subsists between persons who own property jointly or in common.)

Basis of difference	Partnership	Co-ownership
Formation	Partnership always arises out of a contract, express or implied.	Co-ownership may arise either from agreement or by the operation of law, such as by inheritance.
Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.
Nature of interest	There is community of interest which means that profits and losses must have to be shared.	Co-ownership does not necessarily involve sharing of profits and losses.
Transfer of interest	A share in the partnership is transferred only by the consent of other partners.	A co - owner may transfer his interest or rights in the property without the consent of other co-owners.

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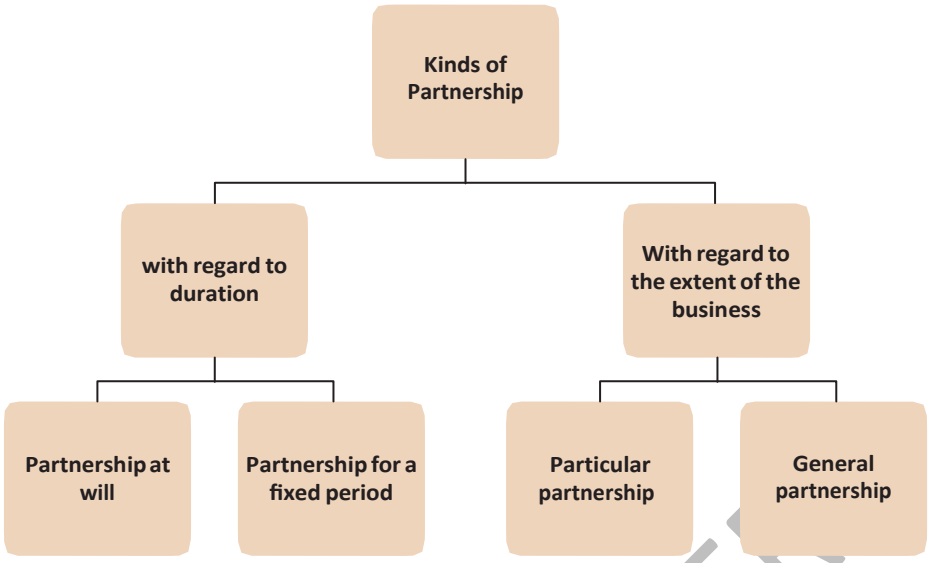
PARTNERSHIP VS. ASSOCIATION

Basis of difference	Partnership	Association
Meaning	Partnership means and involves setting up relation of agency between two or more persons who have entered into a business for gains, with the intention to share the profits of such a business.	Association evolve out of social cause where there is no necessarily motive to earn and share profits. The intention is not to enter in a business for gains.
Examples	Partnership to run a business and earn profit thereon.	Members of charitable society or religious association or an improvement scheme or building corporation or a mutual insurance society or a trade protection association.

KINDS OF PARTNERSHIPS

The following chart illustrates the various kinds of partnership



The various kinds of partnership are discussed below:

1. **Partnership at will**
   - **According to Section 7 of the Act, partnership at will is a partnership when:**
     i. no fixed period has been agreed upon for the duration of the partnership; and
     ii. there is no provision made as to the determination of the partnership.

     These two conditions must be satisfied before a partnership can be regarded as a partnership at will.
   - But, where there is an agreement between the partners either for the duration of the partnership or for the determination of the partnership, the partnership is not partnership at will.
   - **Where a partnership entered into for a fixed term is continued after the expiry of such term, it is to be treated as having become a partnership at will**.
   - A partnership at will may be **dissolved by any partner by giving notice in writing to all the other partners of his intention to dissolve the same.**
   - It may be noted that if this **freedom to dissolve the firm at will is curtailed by agreement**, say, if the agreement provides that the partnership can be dissolved by mutual consent of all the partners only, **it will not constitute a 'partnership at will.'**
2. **Partnership for a fixed period:**
   - Where a provision is made by a contract for the duration of the partnership, the partnership is called 'partnership for a fixed period'.
   - It is a partnership created for a particular period of time.
   - Such a partnership comes to an end on the expiry of the fixed period
3. **Particular partnership:**
   - When a partnership is formed for **a *particular or specific adventure or undertaking***, *e.g.,* for working a coal mine or producing a film, it is called a **'particular partnership' (Sec. 8).**
   - In such a case the partnership is **automatically dissolved on the completion of the adventure** (Sec. 42).
   - Before such time the partnership would not be dissolved unless all the partners agree to it (Sec. 40).
   - **If the partners decide to continue such a partnership even after the completion of the specific adventure or undertaking then it becomes a 'partnership at will.'**

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4. **General partnership:**
   - Where a partnership is constituted with respect to the business in general, it is called a general partnership.
   - A general partnership is different from a particular partnership. In the case of a particular partnership the liability of the partners extends only to that particular adventure or undertaking, but it is not so in the case of general partnership.

PARTNERSHIP DEED

- Partnership is the result of an **agreement**. No particular formalities are required for an agreement of partnership.
- It may be in **writing or formed verba**lly. But it is desirable to have the partnership agreement in writing to avoid future disputes.
- **The document in writing containing the various terms and conditions as to the relationship of the partners to each other is called the 'partnership deed'**.
- **It is a document in which the respective rights and obligations of the members of a partnership are set forth .**
- It should be drafted with care and **be stamped according to the provisions of the Stamp Act, 1899**.
- Where the partnership comprises immovable property, the instrument of partnership must be in writing, stamped and registered under the Registration Act.

Partnership deed may contain the following information:-

1. Name of the partnership form.
2. Names of all the partners.
3. Nature and place of the business of the firm.
4. Date of commencement of partnership.
5. Duration of the partnership firm.
6. Capital contribution of each partner
7. Profit Sharing ratio of the partners.
8. Admission and Retirement of a partner.
9. Rates of interest on Capital, Drawings and loans.
10. Provisions for settlement of accounts in the case of dissolution of the firm.
11. Provisions for Salaries or commissions, payable to the partners, if any.
12. Provisions for expulsion of a partner in case of gross breach of duty or fraud.

The terms laid down in the Deed may be varied by consent of all the partners, and such consent may be expressed or may be implied by a course of dealing [Sec. 11(1)].

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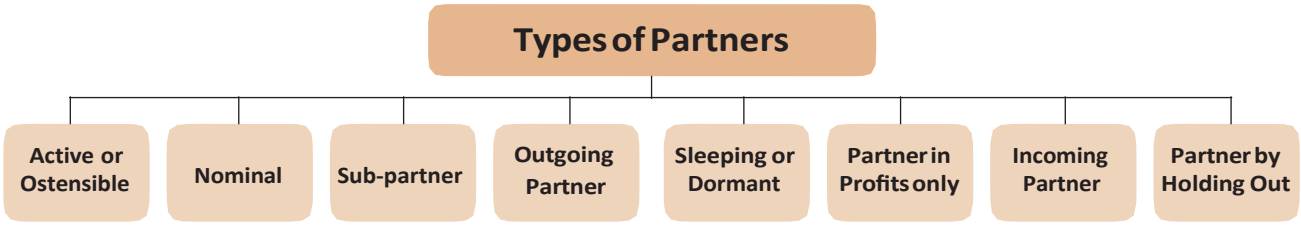
TYPES OF PARTNERS

Based on the extent of liability, the different classes of partners are:



1. **Active or actual or Ostensible partners:**
   - It is a person who has become partner by agreement and who actively participates in the conduct of the partnership business

- He acts as an agent of other partners for all acts done in the ordinary course of business.
- In the event of his retirement, he must give a public notice in order to free himself of liabilities for acts of other partners done after his retirement.

2. **Sleeping or Dormant partners:**
   - It is a person who has become partner by agreement and **who does not actively participate in the conduct of the partnership business**
   - They share profits and losses and are liable to the third parties for all acts of the firm.
   - They are, however not required to give public notice of their retirement from the firm.
3. **Nominal partners**
   - A person who **lends his name to the firm, without having any real interest in it,** is called a nominal partner.
   - He is **not entitled to share the profits of the firm**.
   - Neither he invest in the firm nor takes part in the conduct of the business.
   - He is, however liable to third parties for all acts of the firm
4. **Partners in profit only:**
   - A partner who is entitled to share the profits only without being liable for the losses is known as the partner for profits only.
   - As a rule such a partner has no voice in the management of the business.
   - However, his liability *vis-a-vis* third parties will be unlimited.
5. **Incoming partners:**
   - A person who is admitted as a partners into an already existing firm with the consent of all the existing partners is called as "incoming partner".
   - Such a partner is not liable for any act of the firm done before his admission as a partner.
6. **Outgoing partner:**
   - A partner who leaves a firm in which the rest of the partners continue to carry on business is called a retiring or outgoing partner.
   - Such a partner remains liable to third parties for all acts of the firm until public notice is given of his retirement.
7. **Partner by holding out (Section 28):**
   - If a person represents to the outside world by words spoken or written *or* by his conduct, that he is a partner in a certain partnership firm, he is then estopped from denying his being a partner, and is liable as a partner in that firm to any one who has on the faith of such representation granted credit to the firm.
   - Actually such a person is not a partner in that firm-no agreement, no sharing in profits and losses, no say in the management, may not be knowing exact place of business, but as he holds himself out to be a partner, he becomes responsible to outsiders as a partner on the principle of *estoppel or holding out.* It is for this reason that such a person is called as **'partner by estoppel' or 'partner by holding out.'**
   - It is only the person to whom the representation has been made and who has acted thereon that has right to enforce liability arising out of 'holding out'.
   - For the purpose of fixing liability on a person who has, by representation, led another to act, it is not necessary to show that he was actuated by a fraudulent intention.
   - **The rule given in Section 28 is also applicable to a former partner who has retired from the firm without giving proper public notice of his retirement.** In such cases a person who, even subsequent to the retirement, give credit to the firm on the belief that he was a partner, will be entitled to hold him liable.

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ILLUSTARTIONS

(a) P represents to *R* that he is a partner in the firm of *X,* Y and Z, while actually he is not a partner. On the faith of this representation *R* gives credit to the firm. The firm of *X, Y* and Z becomes insolvent. *R* can make P liable on the basis of holding out and P is estopped from denying that he is a partner in the firm.

(b) X and Y are partners in a partnership firm. X introduced A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 T.V sets to the firm on credit. After expiry of credit period, Z did not get amount of T.V sets sold to the partnership firm. Z filed a suit against X and A for the recovery of price. Here, in the given case, A, the Manager is also liable for the price because he becomes a partner by holding out (Section 28, Indian Partnership Act, 1932).

(c) *A,* B and C are partners in a firm. *D,* who is generally seen in the company of *A,* B and C, tells *M* that he is also a partner in the firm. *P,* who overhears this talk of *D* to M and thinking *D* to be a partner of the firm gives credit to the firm. *P* can make *D* liable for the credit given to the firm on the basis of holding out because for taking advantage of the doctrine of holding out it is not necessary that the representation must be made directly to the person so giving credit.

(d) *X,* who is not a partner in the firm consisting of Y and Z, represents to *A* that he is also a partner in the firm. *B,* who does not know of the representation gives credit to the firm of *Y* and *Z. B* cannot make *X* liable for the credit given to the firm on the basis of holding out because he has not actually acted on the faith of the representation while giving credit to the firm.

(e) A partnership firm consists of *A, B,* C and *D. D* retires from the firm, but fails to give public notice of his retirement and his name continues to be used on letter heads. *D* is liable as a partner by holding out to creditors who have lent on the faith of his being a partner

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2. Rights, Duties & Liabilities of Partners

MUTUAL RIGHTS AND DUTIES

- "SUBJECT to the provisions of this Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied by a course of dealing. Such contract may be varied by consent of all the partners, and such consent may be express or may be implied by a course of dealing" **[Sec. 11(1)].**
- Thus, except in cases where the Partnership Act makes a mandatory provision, the partners are entitled to agree to any terms and provide for their mutual rights and duties.

DUTIES OF PARTNERS

1. **GENERAL DUTIES OF PARTNERS (SECTION 9):** Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative.

   Analysis:

   i. **Duty to carry on the business to the greatest common advantage (Sec. 9):** Every partner is bound to carry on the business of the firm to the greatest common advantage. It implies that every partner must use his knowledge and skill for the benefit of the firm and not for his personal gain. He must conduct the business with the best of his ability and secure maximum benefits for the firm.

   ii. **Duty to be just and faithful inter-se (Sec. 9):** An ideal partnership is one where there is mutual trust and confidence, and spirit of helpfulness and goodwill among the partners. As such every partner must be just and faithful to his co-partners. He must observe utmost good faith and fairness towards other partners of the firm.

   iii. **Duty to render true accounts (Sec. 9).** Every partner must render true and proper accounts to his co-partners. It implies that each partner must be ready to explain the accounts of the firm and produce vouchers in support of the entries. No partner should think of making a secret profit at the expense of the firm.

   iv. **Duty to provide full information (Sec. 9).** Every partner must give full information of all things affecting the firm to his co-partners. A partner, being an agent of other partners, must not conceal any information concerning the firm from the other partners by reason of the law of agency as well. Law of agency provides that knowledge to the agent is deemed to be knowledge to the principal.

2. **DUTY TO INDEMNIFY FOR LOSS CAUSED BY FRAUD (SEC. 10):**
   - A partner can cause loss to the firm by his neglect or want of skill or omission or fraud while acting in the ordinary course of business.
   - The general practice is that where a partner acts *bonafide the* loss caused by his neglect or want of skill or omission is borne by the firm.
   - **But when the loss is caused by fraud committed against a third party by a partner, the same must be recovered from the guilty partner and cannot be shared among all the partners.**
   - **Section 10** gives statutory recognition to this rule and provides that ***"every partner must indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm."***
   - The object of this provision is to discourage partners to deal fraudulently in the conduct of the business.

CA SAHIL GROVER

3. **DUTY TO ATTEND DILIGENTLY TO HIS DUTIES [SEC 12(b)].** Every partner is bound to attend diligently to his duties in the conduct of the business.

RIGHTS OF PARTNERS:

1. **THE CONDUCT OF THE BUSINESS (SECTION 12):** Subject to contract between the partners-
   a) every partner has a right to take part in the conduct of the business;
   b) every partner is bound to attend diligently to his duties in the conduct of the business;
   c) any difference arising as to ordinary matters connected with the business may be decided by majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all partners; and
   d) every partner has a right to have access to and to inspect and copy any of the books of the firm.

Analysis:

(i) Right to take part in the conduct of the Business [Section 12(a)]:

- Every partner has the right to take part in the business of the firm. This is because partnership business is a business of the partners and their management powers are generally coextensive.
- **Example:** Now suppose this management power of the particular partner is interfered with and he has been wrongfully precluded from participating therein. Can the Court interfere in these circumstances? The answer is in the affirmative. The Court can, and will, by injunction, restrain other partners from doing so. It may be noted in this connection that a partner who has been wrongfully deprived of the right of participation in the management has also other remedies, e.g., a suit for dissolution, a suit for accounts without seeking dissolution, etc.
- **The above mentioned provisions of law will be applicable only if there is no contract to the contrary between the partners.** It is quite common to find a term in partnership agreements, which gives only limited power of management to a partner or a term that the management of the partnership will remain with one or more of the partners to the exclusion of others. In such a case, the Court will normally be unwilling to interpose with the management with such partner or partners, unless it is clearly made out that something was done illegally or in breach of the trust reposed in such partners.

(ii) Right to be consulted [section 12(c)]:

- Where any difference arises between the partners with regard to the business of the firm, it shall be determined by the **views of the majority of them**, and **every partner shall have the right to express his opinion before the matter is decided.**
- But no **change in the nature of the business of the firm can be made without the consent of all the partners.**
- This means that in routine matters, the opinion of the majority of the partners will prevail. Of course, the **majority must act in good faith and every partner must be consulted as far as practicable**.
- It may be mentioned that the aforesaid majority rule will not apply where there is a change in the nature of the firm itself. In such a case, the unanimous consent of the partners is needed.

(iii) Right of access to books [Section 12 (d)]:

- Every partner **whether active or sleeping** is entitled to have **access to any of the books of the firm** and **to inspect** and **take out of copy thereof**. The right must, however, be exercised ***bona fide.***

2. **MUTUAL RIGHTS AND LIABILITIES (SECTION 13):** Subject to contract between the partners-
   (a) a partner is not entitled to receive remuneration for taking part in the conduct of the business;
   (b) the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm;

CA SAHIL GROVER

(c) where a partner is entitled to interest on the capital subscribed by him such interest shall be payable only out of profits;

(d) a partner making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six percent per annum;

(e) the firm shall indemnify a partner in respect of payments made and liabilities incurred by him-

(i) in the ordinary and proper conduct of the business, and

(ii) in doing such act, in an emergency, for the purposes of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances; and

(f) a partner shall indemnify the firm for any loss caused to it by his willful neglect in the conduct of business of the firm.

ANALYSIS:

(i) Right to remuneration [Section 13(a)]:

- **No partner is entitled to receive any remuneration** in addition to his share in the profits of the firm for taking part in the business of the firm.
- But this **rule can always be varied by an express agreement**, or **by a course of dealings**, in which event the partner will be entitled to remuneration.
- Thus, a partner can claim remuneration even in the absence of a contract, when such remuneration is payable under the continued usage of the firm. In other words, where it is customary to pay remuneration to a partner for conducting the business of the firm he can claim it even in the absence of a contract for the payment of the same.

(ii) Right to share Profits [Section 13 (b)]:

- Partners are **entitled to share equally in the profits earned and so contribute equally to the losses sustained by the firm.**
- The amount of a partner's share must be ascertained by enquiring whether there is any **agreement in that behalf between the partners**.
- If there is no agreement then one should make a presumption of equality and the burden of proving that the shares are unequal, will lie on the party alleging the same.
- There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed towards the capital of the firm.

(iii) Interest on Capital [Section 13 (c)]:

The following elements must be there before a partner can be entitled to interest on moneys brought by him in the partnership business:

(i) an express agreement to that effect, or practice of the particular partnership or

(ii) any trade custom to that effect; or

(iii) a statutory provision which entitles him to such interest.

Where a partner is entitled to interest on capital subscribed by him, such **interest shall be payable only out of profits.**

(iv) Interest on advances [Section 13 (d)]:

- Where a partner makes, for the purpose of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, he is entitled to interest thereon at the rate of **6 per cent per annum.**
- **While interest on capital account ceases to run on dissolution, the interest on advances keep running even after dissolution and up to the date of payment.**

CA SAHIL GROVER

(v) Right to be indemnified [Section 13 (e)]:

- Every partner has a right to claim indemnity from the firm in respect of payments made or liabilities incurred by him:
  - **a)** in the **ordinary and proper conduct of the business**, and
  - **b)** in doing such act, in an **emergency, for the purpose of protecting the firm from loss**, as would be done by a person of ordinary prudence, m his own case, under similar circumstances.

PARTNERSHIP PROPERTY (SECTION 14)

- ***Section 14 lays down '*** *Subject to contract between the partners, the property of the firm includes all property and rights and interest in property originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business.'*
- **Unless the contrary intention appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm.**

Analysis of section 14:

- The expression **'property of the firm',** also referred to as **'partnership property'**, **'partnership assets'**, **'joint stock'**, **'common stock'** or **'joint estate'**, denotes all property, rights and interests to which the firm, that is, all partners collectively, may be entitled.
- The property which is deemed as belonging to the firm, in the absence of any agreement between the partners showing contrary intention, is **comprised of the following items**:
  (i) all property, rights and interests which partners may **have brought into the common stock as their contribution to the common business;**
  (ii) all the property, rights and interest **acquired or purchased by or for the firm**, or for the purposes and in the course of the business of the firm; and
  (iii) **Goodwill of the business.**
- The determination of the question whether a particular property is or is not 'property' of the firm **ultimately depends on the real intention or agreement of the partners**.
- Thus, the mere fact that the property of a partner is being used for the purposes of the firm shall not by itself make it partnership property, unless it is intended to be treated as such.
- Partners may, by an agreement at any time, convert the property of any partner or partners (and such conversion, if made in good faith, would be effectual between the partners and against the creditors of the firm) or the separate property of any partner into a partnership property.

Goodwill:

- Section 14 specifically lays down that the goodwill of a business is subject to a contract between the partners, to be regarded as 'property' of the firm'.
- But this Section does not define the term Goodwill. **Goodwill may be defined as the value of the reputation of a business house in respect of profits expected in future over and above the normal level of profits earned by undertaking belonging to the same class of business.**
- When a partnership firm is dissolved every partner has a right, in the absence of any agreement to the contrary, to have the goodwill of business sold for the benefit of all the partners.
- **Goodwill is a part of the property of the firm. It can be sold separately or along with the other properties of the firm.**
- Any partner may upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified

CA SAHIL GROVER

local limits and notwithstanding anything contained in Section 27 of the Indian Contract Act, 1872. Such agreement shall be valid if the restrictions imposed are reasonable.

Property of a partner:

- Where the property is exclusively belonging to a person, it does not become a property of the partnership merely because it is used for the business of the partnership, such property will become property of the partnership if there is an agreement.

ILLUSTRATIONS

(a) *A* and *B* are partners. *A buys* some shares in his own name with the moneys and on account of the firm. The shares are partnership property.

(b) *A* and *B* are partners. *A* buys land with partnership moneys, for his sole benefit. Thereafter *A* debits himself in the firm books and becomes a debtor to the firm for the amount of the purchase money. The land is not partnership property, because there was clearly a contrary intention.

APPLICATION OF THE PROPERTY OF THE FIRM (SECTION 15)

- *'Subject to contract between the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business.'*
- **Section 15 provides that the property of the firm shall be held and used exclusively for the purpose of the firm. No partner should use partnership property for his personal benefit**.
- In partnership, there is a community of interest which all the partners take in the property of the firm. But that does not mean than during the subsistence of the partnership, a particular partner has any proprietary interest in the assets of the firm.
- Every partner of the firm has a right to get his share of profits till the firm subsists and he has also a right to see that all the assets of the partnership are applied to and used for the purpose of partnership business.

PERSONAL PROFIT EARNED BY PARTNERS (SECTION 16)

According to section 16, subject to contract between the partners,-

(a) If a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;

(b) If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

Analysis of section 16

(i) Duty to account for personal profits derived:

Where a partner derives any profit for himself from any transaction of the firm or from the use of the property or business connection of the firm or firm name, he must account for that profit and pay it to the firm.

Example:

A, B, C & D established partnership business for refining sugar. A, who was himself a wholesale grocer, was entrusted with the work of selection and purchase of sugar. As a wholesale grocer, A was well aware of the variations in the sugar market and had the suitable sense of propriety as regards purchases of sugar. He had already in stock sugar purchased at a low price which he sold to the firm when it was in need of some, without informing the partners that the sugar sold had belonged to him. It was held that A was bound to account to the firm for the profit so made by him. This rule, however, is subject to a contract between partners.

(ii) Duty to account and pay for profits of competing business:

- Where a partner carries on a **competing business**, he must account for and pay to the firm all profits made by him in that business. A partner may, however**, carry on a non-competing business** and may retain profits of that business to himself.

CA.SAHIL GROVER

- The deed of partnership may contain a clause that some or all the partners are not allowed to carry on business other than that of the firm during the continuance of partnership. Such a restraint is valid ,notwithstanding anything contained in section 27 of the Indian Contract Act, 1872.**[Section 11]. A breach of such provison by any partner may entitle the other partners to recover damages from the defaulting partner,but it will not give rise to any occasion for accounting to his co-partners for profits earned unless the business is shown to be in rivalry with the business of the firm.**

Example:

A,B, C and D started a business in partnership for importing salt from foreign ports and selling it at Chittagong. A struck certain transactions in salt on his own account, which were found to be of the same nature as the business carried on by the partnership. It was held that A was liable to account to the firm for profits of the business so made by him. This rule is also subject to a contract between the partners.

RELATION OF PARTNERS TO THIRD PARTIES

1. PARTNER TO BE AGENT OF THE FIRM (SECTION 18): Subject to the provisions of this Act, a partner is the agent of the firm for the purposes of the business of the firm.

Analysis of section 18:

- Section 4 lays down that partnership is the relationship between the partners who have agreed to share the profits of the business carried on by all or any of them acting for all **(Section 4).**
- Thus as per this definition mutual agency between the partners is one of the essential elements of a partnership. And, therefore, each partner is both a principal and an agent for the other and each is bound by the others' contract in carrying on the trade.
- **Section 18 declares that from the point of view of the third parties a partner is an agent of the firm for the purposes of the business of the firm**. As such even if only one partner acts on behalf of the firm, the third party can make all the partners of the firm liable.
- **However one partner can make other partners liable towards the third parties only if he acts within the scope of his express or implied authority**

EXPRESS AUTHORITY OF A PARTNER

- When a partner is expressly authorised by an agreement of all the partners to do certain acts on behalf of the firm, it is called express authority of a partner.
- The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.

IMPLIED AUTHORITY OF A PARTNER

- The firm is also bound by all acts of a partner done within the scope of his implied authority.
- An implied authority of a partner can be inferred from the circumstances of the case. **Generally speaking , such acts of a partner which are incidental to or usually done in the course of the proper conduct of the business come within the scope of his implied or apparent or ostensible authority.**
- Consequently, as between the partners and the outside world (whatever may be their private arrangements between themselves), each partner is agent of every other in every matter connected with the partnership business; his acts bind the firm.
- **Sections 19(1) and 22 define the scope of the implied authority of a partner. Accordingly, for an act to be covered within the implied authority it is necessary that:**
  - **a)** The act done must relate to the usual business of the firm, that is, the act done by the partner must be within the scope of his authority and related to the normal business of the firm.
  - **b)** The act is such as is done for normal conduct of business of the firm. The usual way of carrying on the business will depend on the nature and circumstances of each particular case [Section 19(1)].

CA SAHIL GROVER

c) The act to be done in the name of the firm or in any other manner expressing or implying an intention to bind the firm (Section 22).

Thus the implied authority of a partner cannot extend to his acts done beyond the scope of the business of the firm. If in a firm of cloth merchants, a partner buys sugar, that will be outside the implied authority of the partner for which the firm cannot be bound.

Example:
X, a partner in a firm of solicitors, borrows money and executes a promissory note in the name of firm without authority. The other partners are not liable on the note, as it is not part of the ordinary business of a solicitor to draw, accept, or endorse negotiable instruments, however it may be usual for one partner of firm of bankers to draw, accept or endorse a bill of exchange on behalf of the firm.

If partnership be of a general commercial nature,

(i) he may pledge or sell the partnership property;

(ii) he may buy goods on account of the partnership;

(iii) he may borrow money, contract debts and pay debts on account of the partnership;

(iv) he may draw, make, sign, endorse, transfer, negotiate and procure to be discounted, Promissory notes, bills of exchange, cheques and other negotiable papers in the name and on account of the partnership.

Statutory Restrictions On Implied Authority [Sec. 19(2)].
Certain acts have been statutorily excluded from the scope of implied authority of a partner and a partner **cannot, therefore, bind the firm by such acts unless the usage or custom of trade permits him or all the other partners expressly authorise him.** As such the third party should ascertain as to whether the partner is authorised and if the third party deals without ascertaining this fact, he cannot make the furn liable.

Section 19(2) contains the list of acts regarding which a partner does not have an implied authority unless there is usage or custom or contract to the contrary. Accordingly, a partner cannot:

- **a)** submit a dispute relating to the business of the firm to arbitration;
- **b)** open a banking account on behalf of the firm in his own name;
- **c)** compromise or relinquish any claim or portion of a claim by the firm;
- **d)** withdraw a suit or proceeding filed on behalf of the firm;
- **e)** admit any liability in a suit or proceeding against the firm;
- **f)** acquire immovable property on behalf of the firm;
- **g)** transfer immovable property belonging to the firm; or
- **h)** enter into partnership on behalf of the firm.

EXTENSION AND RESTRICTION OF PARTNERS' IMPLIED AUTHORITY (SECTION 20)

According to section 20, the partners in a firm may, by contract between the partners, extend or restrict implied authority of any partners. Notwithstanding any such restriction, any act done by a partner on behalf of the firm which falls within his implied authority binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner.

Analysis of section 20:
The implied authority of a partner may be extended or restricted by contract between the partners. Under the following conditions, the restrictions imposed on the implied authority of a partner by agreement shall be effective against a third party:
1. The third party knows about the restrictions, and
2. The third party does not know that he is dealing with a partner in a firm.

CA SAHIL GROVER

Example: A, a partner, borrows from B Rs.1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying of the debts of the firm. Here, the fact that the firm has contracted debts suggests that it is a trading firm, and as such it is within the implied authority of A to borrow money for the business of the firm. This implied authority, as you have noticed, may be restricted by an agreement between him and other partners. Now if B, the lender, is unaware of this restriction imposed on A, the firm will be liable to repay the money to B. On the contrary B's awareness as to this restriction will free the firm of its liability to repay the amount to B.

- **It may be noted that the above-mentioned extension or restriction is only possible with the consent of all the partners.**
- **Any one partner, or even a majority of the partners, cannot restrict or extend the implied authority.**

PARTNER'S AUTHORITY IN AN EMERGENCY

Section 21 extends the authority of a partner in an emergency and lays down that "a partner has authority, in an emergency,to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm."

EFFECT OF ADMISSION BY PARTNER

An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of business **(Sec. 23).**

Analysis of section 23:

Partners, as agents of each other can make binding admissions but only in relation to partnership transaction and in the ordinary course of business. An admission or representation by a partner will not however, bind the firm if his authority on the point is limited and the other party knows of the restriction. The section speaks of admissions and representations being evidenced against the firm. That is to say, they will affect the firm when tendered by third parties; they may not have the same effect in case of disputes between the partners themselves.

Example: X and Y are partners in a firm dealing in spare parts of different brands of motorcycle bikes. Z purchases a spare part for his Yamaha motorcycle after being told by X that the spare part is suitable for his motorcycle. Y is ignorant about this transaction. The spare part proves to be unsuitable for the motorcycle and it is damaged. X and Y both are responsible to Z for his loss.

CA SAHIL GROVER

EFFECT OF NOTICE TO ACTING PARTNER

- Notice to a partner, who habitually acts in the business of the firm, of any matter relating to the affairs of the firm operates as notice to the firm, except in the case of a fraud on the firm, committed by or with the consent of that partner **(Sec. 24).**
- Thus, in order that notice to one partner operates as a notice to the whole firm it is necessary that the notice must be given to an active partner and not to a dormant or sleeping partner. It must further relate to the firm's business. Only then it would constitute a notice to the firm.
- As such once a notice is served on an acting partner, other partners cannot plead ignorance of the same.

  Example:

  P, Q, and R are partners in a business for purchase and sale of second hand goods. R purchases a second hand car on behalf of the firm from S. In the course of dealings with S, he comes to know that the car is a stolen one and it actually belongs to X. P and Q are ignorant about it. All the partners are liable to X, the real owner.
- But this general rule is subject to one important exception. When a partner is a party to a fraud upon the firm, his knowledge of such fraud, and of the facts and circumstances connected therewith, cannot be said knowledge of the firm.

- For example, if one of the partners knows that the vendor, who is his relative, is defrauding the firm by supplying goods of short weight, that knowledge would not prevent the remaining partners from suing the vendor for his fraud.

Example:
A, a partner who actively participates in the management of the business of the firm, bought for his firm, certain goods, while he knew of a particular defect in the goods. His knowledge as regards the defect, *ordinarily,* would be construed as the knowledge of the firm, though the other partners in fact were not aware of the defect. But because A had, in league with his seller, conspired to conceal the defect from the other partners, the rule would be inoperative and the other partners would be entitled to reject the goods, upon detection by them of the defect.

LIABILITY OF PARTNERS TO THIRD PARTIES

The liability of partners to third parties may be divided into three categories:

1. Liability of a partner for acts of the firm.[Section 25]
2. Liability of the firm for wrongful acts of a partner.[Section 26]
3. Liability of the firm for misapplication by partners[Section 27]

1. Liability of a partner for acts of the firm (Sec. 25).

- Every partner is liable, **jointly with all the other partners and also severally, for all acts of the firm done while he is a partner.**
- Further, the liability of all the partners is unlimited. By virtue of joint and several liability, a creditor of the firm has several causes of action. He can sue all partners together, or can sue them separately (in successive actions if necessary).
- As between the partners themselves, the partner paying for more than his share of the liability may claim contribution from the others according to the terms of the partnership agreement.
- In order to bring a case under Section 25, **it is necessary that the act of the firm, in respect of which liability is brought to be enforced against a party, must have been done while he was a partner**.

Example:
Certain persons were found to have been partners in a firm when the acts constituting an infringement of a trademark by the firm took place, it was held that they were liable for damages arising out of the alleged infringement, it being immaterial that the damages arose after the dissolution of the firm.

2. LIABILITY OF THE FIRM FOR WRONGFUL ACTS OF A PARTNER (SECTION 26):

- Where, by the wrongful act or omission of a partner in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefor to the same extent as the partner.

Analysis of section 26:

- The firm is liable to the same extent as the partner for any loss or injury caused to a third party by the wrongful acts of a partner, if they are done by the partner while acting.
  (a) in the ordinary course of the business of the firm
  (b) with the authority of the partners.
- Thus all the partners in a firm are liable to a third party for loss or injury caused to him by the negligent act of a partner acting in the ordinary course of the business.

Example:
One of the two partners in coal mine acted as a manager was guilty of personal negligence in omitting to have the shaft of the mine properly fenced. As a result thereof, an injury was caused to a workman. The other

CA SAHIL GROVER

partner was also held responsible for the same.

3. LIABILITY OF FIRM FOR MISAPPLICATION BY PARTNERS (SECTION 27):

Where-

a) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or

b) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm,

the firm is liable to make good the loss.

Analysis of section 27:

It may be observed that the workings of the two clauses of Section 27 is designed to bring out clearly an important point of **distinction between the two categories of cases of misapplication** of money by partners.

Clause (a) covers the case where

- a partner acts within his authority and due to his authority as partner,
- he receives money or property belonging to a third party and
- misapplies that money or property.

For this provision to the attracted, it is not necessary that the money should have actually come into the custody of the firm.

On the other hand, the provision of clause (b) would be attracted

- when such money or property has come into the custody of the firm and
- it is misapplied by any of the partners.

The firm would be liable in both the cases.

- But if receipt of money by one partner is not within the scope of his apparent authority, his receipt cannot be regarded as a receipt by the firm and the other partners will not be liable, unless the money received comes into their possession or under their control.

Example:

A, B, and C are partners of a place for car parking. P stands his car in the parking place but A sold out the car to a stranger. For this liability, the firm is liable for the acts of A.

RIGHTS OF TRANSFEREE OF A PARTNER'S INTEREST (SECTION 29)

(1) A transfer by a partner of his interest in the firm, either absolute or by mortgage, or by the creation by him of a charge on such interest, does not entitle the transferee, during the continuance of the firm, to interfere in the conduct of business, or to require accounts, or to inspect the books of the firm, but entitles the transferee only to receive the share of profits of the transferring partner, and the transferee shall accept the account of profits agreed to by the partners.

(2) If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled as against the remaining partners to receive the share of the assets of the firm to which the transferring partner is entitled, and, for the purpose of ascertain that share, to an account as from the date of the dissolution.

ANALYSIS OF SECTION 29:

- **A share in a partnership is transferable like any other property**, but as the partnership relationship is based on mutual confidence, the **assignee of a partner's interest by sale, mortgage or otherwise cannot enjoy the same rights and privileges as the original partner.**

THE RIGHTS OF SUCH A TRANSFEREE ARE AS FOLLOWS:

1. **During the continuance of partnership,** such **transferee** is **not entitled:**
   (a) to interfere with the conduct of the business,
   (b) to require accounts, or

CA SAHIL GROVER

(c) to inspect books of the firm.

He is **only entitled to receive the share of the profits** of the transferring partner and he is bound to accept the profits as agreed to by the partners, i.e. **he cannot challenge the accounts.**

2. On the **dissolution of the firm** or **on the retirement of the transferring partner**, the transferee will be entitled, against the remaining partners:

(a) to receive the **share of the assets** of the firm to which the transferring partner was entitled, and

(b) for the purpose of ascertaining the share, he is **entitled to an account as from the date of the dissolution**.

By virtue of Section 31, no person can be introduced as a partner in a firm without the consent of all the partners. A partner cannot by transferring his own interest, make anybody else a partner in his place, unless the other partners agree to accept that person as a partner. At the same time, a partner is not debarred from transferring his interest. A partner's interest in the partnership can be regarded as an existing interest and tangible property which can be assigned.

MINOR ADMITTED TO THE BENEFITS OF PARTNERSHIP

- Partnership is based on mutual contract and, therefore, only those who possess the capacity to contract can be partners in a partnership firm.
- **According to the Indian Contract Act an agreement by a minor is void *ab-initio* as against him but he can derive benefit under it.**
- As such a **minor cannot be a full-fledged partner, he can atmost be admitted to the benefits of a partnership**.
- Section 30 of the Partnership Act thus provides that though a minor cannot be a partner in a firm, but, with the ***consent of all the partners*** for the time being, he may be admitted to the benefits of partnership.

The rights and liabilities of such a minor will be governed under Section 30 as follows:

(1) Rights:

i. A minor partner has a right to his agreed share of the profits and of the firm.

ii. He can have access to, inspect and copy the accounts of the firm.

iii. He can sue the partners for accounts or for payment of his share but **only when severing his connection with the firm, and not otherwise.**

iv. On attaining majority he may within 6 months elect to become a partner or not to become a partner. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

(2) Liabilities:

(i) Before attaining majority:

a) The liability of the minor is confined only to the extent of his share in the profits and the property of the firm.

b) Minor has no personal liability for the debts of the firm incurred during his minority.

c) Minor cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee.

(ii) After attaining majority:

- Within 6 months of his attaining majority or on his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor partner has to decide whether he shall remain a partner or leave the firm.
- Where he has elected not to become partner he may give public notice that he has elected not to become partner and such notice shall determine his position as regards the firm.

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- If he fails to give such notice he shall become a partner in the firm on the expiry of the said six months.
- Such minor shall give notice to the Registrar that he has or has not become a partner

(a) When he becomes partner:

If the minor becomes a partner on his own willingness or by his failure to give the public notice within specified time, his rights and liabilities as given in Section 30(7) are as follows:

a) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.
b) His share in the property and the profits of the firm remains the same to which he was entitled as a minor

(b) When he elects not to become a partner:

a) His rights and liabilities continue to be those of a minor up to the date of giving public notice.
b) His share shall not be liable for any acts of the firm done after the date of the notice.
c) He shall be entitled to sue the partners for his share of the property and profits.

INCOMING AND OUTGOING PARTNERS

- Any change in the relation of partners will result in reconstitution of the partnership firm.
- Thus, on admission of a new partner or retirement of a partner or expulsion of the partner, or on insolvency of a partner etc. a firm will be reconstituted.

INCOMING PARTNER (SEC. 31)

- Subject to contract between the partners, no person can be admitted as a partner into a firm without the consent of all the existing partners.
- Mutual confidence and trust among the partners being an essential ingredient of an ideal partnership it is very much natural that there must be a consent of all the partners to the introduction of a new partner, unless the partners have already agreed otherwise

LIABILITY OF AN INCOMING PARTNER:

- A new partner becomes liable for the debts and acts of the firm **only from the date he is admitted as a partner.** He cannot be held liable for the acts of the old firm.
- A new partner may, however, agree to be liable for debts existing prior to his admission but such agreeing will not give to a prior creditor the right of suing him because of 'absence of privity of contract.' He will be liable to other co-partners only. The creditors can make him liable if he had agreed with them, expressly or impliedly, for being liable towards them for the past debts. Thus the creditor's consent is necessary in every case to make the transaction operative. Novation is the technical term in a contract for this substituted liability.
- **In case of partnership of two partners:** This section does not apply to a partnership of two partners which is automatically dissolved by the death of one of them. In this event there is no partnership at all for any new partner to be introduced into it without the consent of others.

RETIREMENT OF A PARTNER (SEC. 32)

- A partner is said to retire when he ceases to be a member of the firm without bringing to an end the subsisting relations between the other members, or between the firm and third parties.

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- The term 'does not cover the case where a partner withdraws from a firm by dissolving it, which should properly be referred as a dissolution and not as a retirement. Retirement of a partner from a firm does not dissolve it.
- **SECTION 32 lays down '**A partner may retire:
  (a) with the consent of all the other partners;
  (b) in accordance with an express agreement by the partners; or
  (c) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

Liability of a retiring partner:

- **For acts done prior to retirement: (Section 32(2))** A retiring partner continues to be liable for the acts of the firm done before his retirement. He may, however, free himself from his liability towards third parties for the debts of the firm incurred before his retirement by an agreement with such third parties and the partners of the reconstituted firm discharging the outgoing partner from all liabilities. The remaining partners alone cannot give this freedom to the retiring partner. He may be discharged only if the creditors agree.
- **Liability of a retiring partner for acts of firm post retirement(Sec 32(3)):** A retiring partner also continues to be liable for the acts of the firm, even after retirement, until public notice is given of the fact of retirement. Similarly, the partners of the reconstituted firm continue to be liable for the acts of the retired partner though done after retirement, until public notice is given of the retirement.
- **Such a public notice may be given either by the retiring partner or by any partner of the reconstituted firm. [Sec 32(4)]**
- A dormant or sleeping partner, however, need not give any such notice.
- **If the partnership is at will, the partner by giving notice in writing to all the other partners of his intention to retire will be deemed to be relieved as a partner without giving a public notice to this effect.**

EXPULSION OF A PARTNER (SECTION 33)

1. A partner may not be expelled from a firm by any majority of the partners, save in the exercise in good faith of powers conferred by contract between the partners.
2. The provisions of sub-section (2), (3) and (4) of section 32 shall apply to an expelled partner as if he were a retired partner.

ANALYSIS OF SECTION 33:

(i) the power of expulsion must have existed in a contract between the partners;
(ii) the power has been exercised by a majority of the partners; and
(iii) It has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bonafide interest of the business of the firm.

The test of good faith as required under Section 33(1) includes three things:

i. The expulsion must be in the interest of the partnership.
ii. The partner to be expelled is served with a notice.
iii. He is given an opportunity of being heard.

If a partner is otherwise expelled, the expulsion is null and void.

The expulsion of partners does not necessarily result in dissolution of the firm. The invalid expulsion of a partner does not put an end to the partnership even if the partnership is at will and it will be deemed to continue as before.

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Example:

A, B and C are partners in a Partnership firm. They were carrying their business successfully for the past several years. Spouses of A and B fought in ladies club on their personal issue and A's wife was hurt badly. A got angry on the incident and he convinced C to expel B from their partnership firm. B was expelled from partnership without any notice from A and C.

Considering the provisions of Indian Partnership Act, 1932 state whether they can expel a partner from the firm?

A partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by contract between the partners. It is, thus, essential that:
(i) the power of expulsion must have existed in a contract between the partners;
(ii) the power has been exercised by a majority of the partners; and
(iii) it has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bonafide interest of the business of the firm.Thus, according to the test of good faith as required under Section 33(1), expulsion of Partner B is not valid.

The provisions of Sections 32 (2), (3) and (4) which we have just discussed, will be equally applicable to an expelled partner as if he was a retired partner.

INSOLVENCY OF A PARTNER (SEC. 34)

- When a partner in a firm is adjudicated an insolvent, he ceases to be a partner on the date of the order of adjudication whether or not the firm is thereby dissolved.
- His estate (which thereupon vests in the official assignee) ceases to be liable for any act of the firm done after the date of the order.
- The firm also is not liable for any act of such a partner after such date (whether or not under a contract between the partners the firm is dissolved by such adjudication).

The effect of insolvency of partner is summarised as follows:

i. The insolvent partner cannot be continued as a partner. He will be ceased to be a partner from the very date on which the order of adjudication is made.
ii. The estate of the insolvent partner is not liable for the acts of the firm done after the date of order of adjudication.
iii. The firm is also not liable for any act of the insolvent partner after the date of the order of adjudication.
iv. Ordinarily but not invariably, the insolvency of a partner results in dissolution of a firm; but the partners are competent to agree among themselves that the adjudication of a partner as an insolvent will not give rise to dissolution of the firm

DEATH OF A PARTNER (SEC. 35)

- Ordinarily, the effect of the death of a partner is the dissolution of the partnership but if the other partners so agree the firm may not be dissolved ,unless the firm consists of only two partners
- Where a firm is not dissolved, the estate of a deceased partner is not liable for any act of the firm done after his death.
- His estate is liable only for liabilities undertaken during his life time.
- No public notice of death is required to relieve the deceased partner's estate from future liabilities.

Example:

X was a partner in a firm. The firm ordered goods in X's lifetime; but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable for the debt; a creditor can have only a personal decree against the surviving partners and a decree against the partnership assets in the hands of those partners. A suit

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for goods sold and delivered would not lie against the representatives of the deceased partner. This is because there was no debt due in respect of the goods in X's lifetime.

RIGHTS OF OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS (SECTION 36)

(1) An outgoing partner may carry on business competing with that of the firm and he may advertise such business, but subject to contract to the contrary, he may not,

(a) use the firm name,

(b) represent himself as carrying on the business of the firm or

(c) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

Agreement in restraint of trade- (2) A partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within a specified period or within specified local limits and, notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.

RIGHT OF A OUTGOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS (SEC. 37).

If any member of a firm ceases to be a partner (death, retirement, insolvency, etc) and the business of the firm is carried on without any final settlement of accounts with him, then, in the absence of a contract to the contrary, he or his legal representative has an option either:

(a) to claim such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm *(i.e.,* to claim profits in capital ratio);

Or

(b) to claim interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

Example 1: A, B and C are partners in a manufacture of machinery. A is entitled to three-eighths of the partnership property and profits. A becomes bankrupt whereas B and C continue the business without paying out A's share of the partnership assets or settling accounts with his estate. A's estate is entitled to three-eighths of the profits made in the business, from the date of his bankruptcy until the final liquidation of the partnership affairs.

Example 2: A, B and C are partners. C retires after selling his share in the partnership firm. A and B fail to pay the value of the share to C as agreed to. The value of the share of C on the date of his retirement from the firm would be pure debt from the date on which he ceased to be a partner as per the agreement entered between the parties. C is entitled to recover the same with interest

REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM (SECTION 38)

According to section 38, a continuing guarantee given to a firm or to third party in respect of the transaction of a firm is, in the absence of an agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.

Analysis of section 38:

Mere changes in the constitution of the firm operates to revoke the guarantee as to all future transactions. Such change may occur by the death, or retirement of a partner, or by introduction of a new partner.

MUTUAL RIGHTS AND DUTIES OF PARTNERS AFTER CHANGE IN THE FIRM [SEC. 17(a)]

- Subject to contract between the partners, where a change occurs in the constitution of a firm *(i.e.,* where a new partner is admitted or where a partner ceases to be a partner by retirement, expulsion, insolvency or

CA SAHIL GROVER

death), the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change, as far as may be possible.

- Thus, where *A,* B and C are partners sharing profits in the ratio of 4:3:3 and *D* is admitted as a new partner who is to get 1/4 of the profits, the remaining 3/4 of the profits will be distributed between *A,* B and C in their old ratio of 4:3:3. Sometimes a new partner may be admitted without specifying even the profit sharing ratio of the new partner. In that case the new partner should be deemed to share equally in the profits of the business and the remainder should be distributed among the old partners in their *inter-se* old profit sharing ratio.
- For example, if *A, B,* C and D are partners sharing profits in the ratio of 4:3:2:1 and E is admitted as a new partner without any terms as to sharing of profits, then E is entitled to 1/5 of the profits and the remaining 4/5 will be distributed between *A, B,* C and D in the ratio of 4:3:2: 1.
- In practice, usually, everything is settled among the partners in black and white by means of a partnership deed about their rights and duties whenever one or the other change in the constitution of the firm takes place.

CA.SAHIL GROVER

3. Registration and Dissolution of a Firm

Registration of Firms-Optional

- Under the Partnership Act it is *not compulsory* for every partnership firm to get itself registered, but an unregistered firm suffers from a number of disabilities. In practice, therefore, few partnerships would deem it advisable to remain unregistered.

Procedure of registration (Sec. 58).

- An application in the prescribed form along with the prescribed fee has to be submitted to the Registrar of Firms of the State in which any place of business of the firm is situated or proposed to be situated.
- The application or statement must be signed by all the partners, or by their agents specially authorised in this behalf, and must contain the following particulars:
    1. The name of the firm.
    2. The place or principal place of business of the firm.
    3. The names of any other places where the firm carries on business.
    4. The date when each partner joined the firm.
    5. The names in full and permanent addresses of the partners.
    6. The duration of the firm.
- A firm name shall not contain any of the following words, namely:-
  'Crown', Emperor', 'Empress', 'Empire', 'Imperial', 'King', 'Queen', 'Royal', or words expressing or implying the sanction, approval or patronage of Government except when the State Government signifies its consent to the use of such words as part of the firm-name by order in writing.
- **When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the statement in a Register called the Register of Firms and shall file the statement. Then he shall issue a certificate of Registration. (Section 59).**
- However, registration is deemed to be completed as soon as an application in the prescribed form with the prescribed fee and necessary details concerning the particulars of partnership is delivered to the Registrar. The recording of an entry in the register of firms is a routine duty of Registrar.

Change of particulars

- With a view to keep the Registrar of Firms posted with up-to-date information regarding the firm, if any change takes place in any of the particulars given above, it should be notified to the Registrar, who shall thereupon incorporate the necessary change in the Register of Firms.
- Further, the Registrar should also be informed when any partner ceases to bea partner by retirement, expulsion, insolvency or death, or when a new partner is admitted or a minor, having been admitted, elects to become or not to become a partner, or when the firm is dissolved. (Secs. 60-63).

Time of registration.

- Registration may take place *at any time* during the continuance of the partnership *firn.* Where the firm intends to institute a suit in a court of law to enforce rights arising from any contract, registration must be effected before the suit is instituted otherwise the court shall not entertain the suit.
- **Registration may also be effected even after a suit has been filed by the firm but in that case it is necessary to withdraw the suit, get the firm registered and then file a fresh suit**. Registration of the firm subsequent to the institution of the suit cannot by itself cure the defect.

CA SAHIL GROVER

CONSEQUENCES OF NON-REGISTRATION (SECTION 69)

- Under the English Law, the registration of firms is compulsory. Therefore, there is a penalty for non-registration of firms. But the Indian Partnership Act does not make the registration of firms compulsory nor does it impose any penalty for non-registration.
- However, **under Section 69**, non-registration of partnership gives rise to a number of disabilities which we shall presently discuss. Although registration of firms is not compulsory, yet the consequences or disabilities of non-registration have a persuasive pressure for their registration. **These disabilities briefly are as follows:**

i. No suit in a civil court by a partner against the firm or other co-partners:

- If any dispute arises among the partners or between a partner and the firm or between a partner and ex-partners, and the dispute .i.s based upon the rights arising from contract *(i.e.,* partnership deed) or upon the rights conferred by the Partnership Act, then a partner of an unregistered firm cannot institute a suit to settle such disputes.
- However, criminal proceedings can be brought by one partner against the other(s). Thus, if a partner steals the property of the firm or puts fire to the buildings of the firm, any partner can prosecute him for the same.

ii. **No suit in a civil court by firm or other co-partners against third party:**

- The firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firm.
- In other words, a registered firm can only file a suit against a third party and the persons suing have been in the register of firms as partners in the firm.
- **Third party can sue the firm:** In case of an unregistered firm, an action can be brought against the firm by a third party.

iii. **No relief to partners for set-off of claim:**

If an action is brought against the firm by a third party, then neither the firm nor the partner can claim any set-off, if the suit be valued for more than Rs 100 or pursue other proceedings to enforce the rights arising from any contract. **Thus, if a third party sues the firm to recover a sum of money, the firm cannot claim a set-off, *i.e.,* the firm cannot say that the third party also owes some money to the firm and the same should be adjusted against the claim in question.**

EXCEPTIONS:

Non-registration of a firm does not, however effect the following rights:

1. The right of third parties to sue the firm or any partner.
2. The right of partners to sue for the dissolution of the firm or for the settlement of the accounts of a dissolved firm, or for realization of the property of a dissolved firm.
3. The power of an Official Assignee or Receiver or the Court, as the case may be, to realise the property of an insolvent partner and to bring an action therefore, if necessary, on behalf of the insolvent
4. The right to sue or claim a set-off if the value of suit does not exceed Rs.100 in value.

Example: A & Co. is registered as a partnership firm in 2015 with A, B and C partners. In 2016, A dies. In 2017, B and C sue X in the name and on behalf of A & Co., without fresh registration. Now the first question for our consideration is whether the suit is maintainable.

Answer As regards the question whether in the case of a registered firm (whose business was carried on after its dissolution by death of one of the partners), a suit can be filed by the remaining partners in respect of any subsequent dealings or transactions without notifying to the Registrar of Firms, the changes in the constitution of

CA.SAHIL GROVER

the firm, it was decided that the remaining partners should sue in respect of such subsequent dealings or transactions even though the firm was not registered again after such dissolution and no notice of the partner was given to the Registrar.

The test applied in these cases was whether the plaintiff satisfied the only two requirements of Section 69 (2) of the Act namely,

(i) the suit must be instituted by or on behalf of the firm which had been registered;

(ii) the person suing had been shown as partner in the register of firms.

In view of this position of law, the suit is in the case by B and C against X in the name and on behalf of A & Co. is maintainable.

Now, in the above example, what difference would it make, if in 2017 B and C had taken a new partner, D, and then _led a suit against X without fresh registration?

Where a new partner is introduced, the fact is to be notified to Registrar who shall make a record of the notice in the entry relating to the firm in the Register of firms. Therefore, the firm cannot sue as D's (new partner's) name has not been entered in the register of firms. It was pointed out that in the second requirement, the phrase "person suing" means persons in the sense of individuals whose names appear in the register as partners and who must be all partners in the firm at the date of the suit.

DISSOLUTION OF FIRM

The Indian Partnership Act distinguishes between:
(a) Dissolution of firm, and
(b) Dissolution of partnership.
Section 39 provides that the dissolution of partnership between all the partners of a firm is called the **'dissolution of the firm.'**

- Thus, the dissolution of firm means the discontinuation of the jural relation existing between all the partners of the firm.
- But when only one or more partners retires or becomes incapacitated from acting as a partner due to death, insolvency or insanity, the partnership, i.e. the relationship between such a partner and other is dissolved, but the rest may decide to continue. In such cases, there is in practice, no dissolution of the firm. The particular partner goes out, but the remaining partners carry on the business of the firm, it is called '**dissolution of partnership.'**
- In the case of dissolution of the firm, on the other hand, the whole firm is dissolved. The partnership terminates as between each and every partner of the firm.

DISSOLUTION OF FIRM VS. DISSOLUTION OF PARTNERSHIP

S.	Basis of Difference	Dissolution of Firm	Dissolution of Partnership
1.	Continuation of business	It involves discontinuation of business in partnership.	It does not affect continuation of business. It involves only reconstitution of the firm.
2.	Winding up	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and requires only revaluation of assets and liabilities of the firm.
3.	Order of court	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
4.	Scope	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.

CA SAHIL GROVER

5.	Final closure of books	It involves final closure of books of the firm.	It does not involve final closure of the books.

MODES OF DISSOLUTION OF A FIRM (SECTIONS 40-44)

The dissolution of partnership firm may be in any of the following ways:

1. DISSOLUTION WITHOUT THE ORDER OF THE COURT OR VOLUNTARY DISSOLUTION:

It consists of following four types:

(i) Dissolution by agreement (Section 40):

A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners. Partnership is created by contract, it can also be terminated by contract. 'Contract between the partners' means a contract already made.

(ii) Compulsory dissolution (Section 41):

A firm is compulsorily dissolved under any of the following circumstances:

a) When all the partners, or all the partners but one, are adjudged insolvent; or

b) When some event has happened which makes it unlawful for the business of the firm to be carried on *or for* the partners to carry it on in partnership *(e.g.,* when any partner, who is a citizen of a foreign country, becomes an alien enemy because of the declaration of war between his country and India).

Where, however, a firm is carrying on more than one adventures or undertakings, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures or undertakings.

Example: A firm is carrying on the business of trading a particular chemical and a law is passed which bans on the trading of such a particular chemical. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.

(iii) Dissolution on the happening of certain contingencies (Section 42):

Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies-

a) if constituted for a fixed term, by the expiry of that term;
b) if constituted to carry out one or more adventures or undertakings, by the completion thereof;
c) by the death of a partner; and
d) by the adjudication of a partner as an insolvent

The partnership agreement may provide that the firm will not be dissolved in any of the aforementioned circumstances. Such a provision is valid.

(iv) Dissolution by notice of partnership at will (Section 43):

1. Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.
2. If the date is mentioned, the firm is dissolved as from the date mentioned in the notice as the date of dissolution, or if no date is so mentioned, as from the date of the communication of the notice.

2. DISSOLUTION BY THE COURT (SECTION 44):

Dissolution of a firm by the Court is necessitated when there is a difference of opinion between the partners regarding the matter of dissolution. For example, where one of the partners has become insane, some of the partners may be willing to continue the firm and share profits with the insane partner, while the other partner(s) may be insisting on the

CA.SAHIL GROVER

dissolution of the firm. Obviously in these circumstances intervention by the Court becomes necessary. On receiving the petition for the dissolution of the firm the Court is not bound to decree/order dissolution and it enjoys complete discretion in the matter. It may or may not order for the dissolution of the firm depending upon the merits of each case.

Section 44 enumerates the various grounds on which a petition may be made to the court for the dissolution of the firm. The Section lays down that at the suit of a partner, the Court *may* dissolve a firm on any of the following grounds:

(a) Insanity/unsound mind: Where a partner (not a sleeping partner) has become of unsound mind, the court may dissolve the firm on a suit of the other partners or by the next friend of the insane partner. Temporary sickness is no ground for dissolution of firm.

(b) Permanent incapacity: When a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner, then the court may dissolve the firm. Such permanent incapacity may result from physical disability or illness etc.

(c) Misconduct: Where a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of business, the court may order for dissolution of the firm, by giving regard to the nature of business. **It is not necessary that misconduct must relate to the conduct of the business. The important point is the adverse effect of misconduct on the business**. In each case nature of business will decide whether an act is misconduct or not.

(d) Persistent breach of agreement: Where a partner other than the partner suing, **wilfully or persistently** commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conduct himself in matters relating to the business that it is not reasonably practicable for other partners to carry on the business in partnership with him, then the court may dissolve the firm at the instance of any of the partners.

Following comes in to category of breach of contract:

- Embezzlement,
- Keeping erroneous accounts
- Holding more cash than allowed
- Refusal to show accounts despite repeated request etc.

Example: If one of the partners keeps erroneous accounts and omits to enter receipts or if there is continued quarrels between the partners or there is such a state of things that destroys the mutual confidence of partners, the court may order for dissolution of the firm.

(e) Transfer of interest: Where a partner other than the partner suing, has transferred the whole of his interest in the firm to a third party or has allowed his share to be charged or sold by the court, in the recovery of arrears of land revenue, the court may dissolve the firm at the instance of any other partner. Thus Transfer or assignment of partner's interest does not by itself dissolve the firm. But the other partners may apply to the Court to dissolve the firm if such a transfer occurs.

(f) Continuous/Perpetual losses: Where the business of the firm cannot be carried on except at a loss in future also, the court may order for its dissolution.

(g) Just and equitable grounds: Where the court considers any other ground to be just and equitable for the dissolution of the firm, it may dissolve a firm. The following are the cases for the just and equitable grounds-

(i) Deadlock in the management.
(ii) Where the partners are not in talking terms between them.
(iii) Loss of substratum.
(iv) Gambling by a partner on a stock exchange.

CA.SAHIL GROVER

CONSEQUENCES OF DISSOLUTION (SECTIONS 45 - 55)

1. **Liability for acts of partners done after dissolution (Section 45):**
   - Notwithstanding the dissolution of a firm, the partners continue to be liable as such to third parties for any act done by any of them which would have been an act of the firm if done before the dissolution, ***until public notice is given of the dissolution.***
   - The notice may be given by the firm or any partner.
   - It must be given to the Registrar of Firms, in case of registered firms, in the local Official Gazette and in at least one vernacular newspaper circulating in the district where the firm's principal place of business is situated **(Sec. 72).**

   Example:

   X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the dissolution. In such a case, Y also would be liable for the amount because no public notice was given.

   - However, there are **exceptions to the rule stated in above example** i.e. even where notice of dissolution has not been given, there will be no liability for subsequent acts in the case of:
     a) the estate of a deceased partner,
     b) an insolvent partner, or
     c) a dormant partner, i.e., a partner, who was not known as a partner to the person dealing with the firm.
2. **Right of partners to have business wound up after dissolution (Section 46):**
   On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representative, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights.
3. **Continuing authority of partners for purposes of winding up (Sec. 47):**After the dissolution of the firm the authority of each partner to bind the firm, and other mutual rights and obligations of the partners, continue so far as may be necessary for the following two purposes:
   a) to wind up the affairs of the firm, *e.g.,* disposing of the property, realising amount due from debtors and paying to creditors and so on; and
   b) to complete transactions begun but unfinished at the time of the dissolution, *e.g.,* taking delivery of the goods ordered before dissolution and paying for them.

   The firm, however, is not bound by such acts of a partner who has been adjudicated insolvent.

4. **Personal profits earned after dissolution (Section 50):**

- Where a firm is dissolved by the death of a partner and the surviving partners or the surviving partners along with the representatives of the deceased partner carry on business of the firm, any personal profits by them, before the firm is fully wound up, must be accounted for by them to other partners.
- Thus, a lease expiring on the death of a partner, which is renewed by the surviving partners, before final winding up, belongs to the partnership.
- **This section has to be read with Section 53** which provides that in the absence of an agreement to the contrary, each partner or his representative is entitled to restrain (by injunction) other partners from carrying on a similar business in the name of the firm or from using the property of the firm for their own benefit till the affairs of the firm are completely wound up.

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5. **Right to impose restrictions:**

- In the absence of an agreement to the contrary, each partner or his representative is entitled to restrain the other partners from carrying on a similar business in the name of the firm or from using the property of the firm for their own benefit, until the affairs of the firm have been completely wound up.
- However, where a partner or his representative has bought the goodwill of the firm he can use the firm name. **(Sec. 53).**
- Further, the partners in anticipation of or upon dissolution of the firm, can agree that some of all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be valid and not void on the ground of restraint of trade, if the restrictions imposed are reasonable. **(Sec. 54)**

6. **Return of premium on premature dissolution (Section 51):**
Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term, such a partner shall be entitled to repayment of 'rateable amount of premium' for the unexpired period except where the dissolution has been caused:
   a) by the death of a partner;
   b) by the misconduct of the partner so admitted; or
   c) by mutual agreement of all the partners containing no provision for the return of premium.

The partner paying the premium gets a proportionate part of the premium where the partnership is dissolved:
(1) Without the fault of either party; or
(2) owing to the fault of both; or
(3) on account of the fault of the partner receiving the premium; or
(4) due to the insolvency of the partner receiving the premium, where the partner paying the premium was unaware of the others embarrassing circumstances at the time of entering into the partnership.

7. **Rights where partnership contract is rescinded for fraud, etc. (Sec. 52).**
A contract of partnership like any other contract may be rescinded on the ground of fraud or misrepresentation. The partner misled also has a right to claim damages for fraud. This Section grants the following further rights to the partner thus rescinding the contract:
   a) He has a right of lien on the surplus of the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contribution by him.
   b) He is entitled to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm.
   c) He has also the right to claim indemnity from the partners guilty of the fraud or misrepresentation against all the debts of the firm.

8. **Settlement of partnership accounts (Section 48):**

- The settlement of accounts between partners upon dissolution of a firm is to be **affected in the manner provided for in the partnership agreement**.
- **In the absence of any agreement** between the partners regarding the method by which accounts of the partnership are to be settled on its dissolution, **the following rules stated in Section 48 of the Partnership Act shall apply:**
  1. Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.

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2. The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:
   i. In paying the debts of the firm to third parties.
   ii. In paying to each partner rateably what is due to him from the firm for advances as distinguished from capital.
   iii. In paying to each partner rateably what is due to him on account of capital.
   iv. The residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Example: X and Y were partners sharing profits and losses equally and X died. On taking partnership accounts, it transpired that he contributed Rs.6,60,000 to the capital of the firm and Y only Rs.40,000. The assets amounted to Rs.2,00,000. The deficiency (Rs.6,60,000 + Rs.40,000 – Rs.2,00,000 i.e. Rs.5,00,000) would have to be shared equally by Y and X's estate.

If in the above example, the agreement provided that on dissolution the surplus assets would be divided between the partners according to their respective interests in the capital and on the dissolution of the firm a deficiency of capital was found, then the assets would be divided between the partners in proportion to their capital with the result that X's estate would be the main loser.

9. Payment of firm debts and of separate debts (Section 49):

Where both debts due from the firm and debts due from a partner in his individual capacity exist, the following rules stated in **Section 49,** as to settlement of such debts shall apply:

a) The **property of the firm** shall be applied for payment of the firm's debts first, and if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him.
b) the **separate property of any partner** shall be applied first in the payment of his separate debts and surplus, if any, in the payment of debts of the firm.

10. Sale of Goodwill after Dissolution (Sec. 55):

The rules relating to sale of goodwill upon dissolution of a firm are as follows:

1. While winding up the affairs of the firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets, and it may be sold either separately or alongwith other property of the firm.
2. After the sale of goodwill any partner of the dissolved firm
   (i) can carry on a business competing with that of the buyer of goodwill, and
   (ii) can advertise such business.
   In the absence of a contract to the contrary, the seller of goodwill, that is, partners of the dissolved firm cannot
   (i) use the firm name,
   (ii) represent themselves as carrying on the business of the old firm, and
   (iii) cannot solicit the customers of the old firm.
3. **Agreement in restraint of trade:** Any partner of the dissolved firm may make an agreement with the buyer that such partner will not carry on a business similar to that of the firm within a specified period or within specified local limits, provided the restrictions imposed are reasonable.

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MODE OF GIVING PUBLIC NOTICE (SECTION 72)

A public notice under this Act is given-

a) *Where it relates to the retirement or expulsion of a partner from a registered firm, or to the dissolution of a registered firm, or to the election to become or not to become a partner in a registered firm by a person attainting majority who was admitted as a minor to the benefits of partnership*:-

by notice to the Registrar of Firms under section 63, and by publication in the Official Gazette and in at least one vernacular newspaper circulation in the district where the firm to which it relates has its place or principal place of business, and

b) *in any other case:*

by publication in the Official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business.

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