

# THE INDIAN PARTNERSHIP ACT, 1932

## Definition of Partnership:

Section 4 of the Indian Partnership Act, 1932 defines partnership as:

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

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”.

## Features of Partnership:

- Association of two or more persons:** There should be atleast two persons to form a partnership. If the number of partners gets reduced to one by any reason e.g. death or insolvency of a partner, it would cease to be a partnership.  
Only persons recognized by law can enter into partnership. Therefore, a firm cannot be a partner in another firm; since it is not a person recognized by law. Also, a **minor cannot be a partner** in a firm, but with the consent of all partners, a minor may be admitted to the benefits of partnership. About the maximum number of partners in a firm, the Indian Partnership Act is silent; but Sec. 464 of the **Companies Act, 2013 read with the Companies Rules, 2014 has put a maximum limit of 50 partners** in firm.
- Agreement:** Partnership is created by an agreement between parties. The agreement may be express (written or oral) or implied. As partnership is a type of contract, **all the essential elements** of a valid contract must be present in a Partnership Contract.
- Business:** Partnership can be formed only for the purpose of carrying on some business. An association created for charitable, religious and social purposes are not partnership.  
As per section 2(b) of the Partnership Act, 1932 the term ‘**business**’ **includes** every trade, occupation and profession.
- Sharing of profits:** *Prima facie* sharing of profits is the essence of partnership. But, sharing of profits **is not the final conclusive evidence** of partnership.  
Sharing of profits also implies sharing of losses. The ratio in which profits and losses will be shared is based on agreement amongst the partners.  
*For example, a manager as a part of remuneration, may be given a share in profit of the business. He does not thereby become a partner.*
- Mutual Agency:** Mutual Agency is the **true test of partnership**. Mutual agency means that a **partner is both an agent as well a principal** of all the other partners. Like an agent, a partner can, bind other partners by his acts and like a principal, a partner shall be bound by acts of other partners. This is the cardinal principle of partnership law. **[KD Kamnath & Co.]**

**Mode of determining existence of Partnership [Sec. 6]**

1. **Real Relation is the basis:** Section 6 provides that in determining whether a group of persons is or is not a firm, or whether a person is or is 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.
2. **Agreement:** Partnership is created by agreement. The relation of partnership arises from contract and not from status. Members of Hindu Undivided family carrying on family business are not partners in such business.
3. **Sharing of profits is not the conclusive evidence:** Sharing of profit is an essential element of partnership. But it is only a *prima facie* evidence and not conclusive evidence.

**Cases where there is sharing of Profits, but no partnership:**

- a) **Joint owners sharing gross returns** arising from property held by them are not partners.  
*For example, co-owners of a land who share the rent derived from the land are not partners because there does not exist any business.*
- b) A partnership is **not created even if** a share of profit is received- (because no Mutual Agency is created between them)
  - by a lender of money to persons engaged or about to engage in any business; or
  - by a servant or agent as remuneration; or
  - by a widow or child of a deceased partner, as annuity, or
  - by a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof.
4. **Existence of Mutual Agency – True Test:** The true test of partnership lies in existence of **mutual agency relationship** i.e. the capacity of a partner to bind other partners by his acts done in Firm’s name and be bound by the acts of other partners. This unique feature distinguishes a partnership from Co-ownership or simple agreement for sharing profits.

*Cox v. Hickman:* A trader carried on his business under the supervision of his creditors. The object of carrying on the business was to pay them off out of the profits of the business. It was held that no partnership existed between the trader and the creditor.

**Difference between Partnership and Joint Hindu Family (HUF):**

Basis of Difference	Partnership	Joint Hindu Family
<b>Creation</b>	Partnership comes into existence by an agreement.	Joint Hindu Family is created by status or operation of law.
<b>Regulating Law</b>	It is governed by Indian Partnership Act, 1932.	It is governed by Hindu Law.
<b>Admission of new members</b>	No person can be admitted to an existing firm without the consent of all the other partners.	A person becomes a member in HUF by birth.
<b>Minor Member</b>	A minor cannot become partner in a firm but he can be admitted to the	A minor becomes a co-parcener right from his birth.

	benefits of the firm.	
<b>Number of members</b>	Partnership Act is silent about the maximum number of partners in the firm, but section 464 of the Companies Act, 2013 read with Companies Rules, 2014 has put a limit of 50 partners.	There is no limit on maximum number of co-parceners in Joint Hindu Family.
<b>Authority for active participation</b>	Each partner can participate in the business of the firm and bind the other partners by his acts.	In Joint Hindu Family this authority rests with Karta only. However, other members can also be allowed by Karta to take part in family business
<b>Liability of members</b>	In partnership, the liability of all the partners is unlimited; they are personally liable to third parties for the debts of the firm.	In Joint Hindu Family only Karta's liability is unlimited, the other co-parceners liability is limited only to their shares in the family property.
<b>Rights to demand accounts</b>	Each partner has a right to inspect and copy the account books and, on severing connections with the firm, he can demand even the account of the past dealings.	The co-parceners have no right to ask for the account of past dealings, they can ask for the position of the existing assets only.
<b>Death of a member</b>	Partnership is dissolved on the death of any partner.	The Joint Hindu Family continues to operate even after the death of a co-parcener.
<b>Share in Business</b>	In partnership firm, each partner has defined share by virtue of an agreement between the partners.	In a HUF, no co- parceners has a definite share. His interest is fluctuating one.

**Difference between Partnership and Joint Stock Company:**

<b>Basis of Difference</b>	<b>Partnership</b>	<b>Joint Stock Company</b>
<b>Legal status</b>	A partnership firm has no existence apart from its members.	A company is a separate legal entity distinct from its members.
<b>Regulating Law</b>	It is governed by Indian Partnership Act, 1932.	It is governed by Companies Act, 2013 and Companies Rules, 2014.
<b>Mode of creation</b>	Partnership is created by an agreement.	Company is created by law. It comes into existence only after being registered under the law.
<b>Number of membership</b>	Partnership Act is silent about the maximum number of partners, but	There is no limit on the maximum number of partners in a public company.

	section 464 of the Companies Act, 2013 read with companies Rules, 2014 has put a limit of 50 partners.	A private company may have maximum of 200 members but not less than 2 and may have any number of members but not less than 7.
<b>Extent of liability</b>	Liability of every partner is unlimited.	Liability of a member or shareholder is limited to the extent of unpaid money on the share capital.
<b>Perpetual Succession</b>	Unless there is contract to the contrary, a firm is dissolved on the death, retirement or insolvency of any partner.	A company enjoys a perpetual succession. The death or insolvency of any or even all the partners does not effect on the existence of the company.
<b>Mutual Agency</b>	Every partner is an agent of the other partners.	A member of a company is not an agent of other members.
<b>Property</b>	The firm's property is "joint estate" of all the partners.	The property of the company is separate from that of its members.
<b>Transfers of Interest</b>	A partner cannot transfer his interest without consent of all other partners	A shareholder, subject to restrictions contained in articles, can freely transfer his share.
<b>Management</b>	All the partners have right to take part in day to day affairs of the firm.	Only Board of Directors is entitled to manage company's affairs.
<b>Registration</b>	Registration of partnership is not compulsory. It is optional for the partners.	Registration of company is compulsory under the Companies Act, 2013.
<b>Winding up</b>	A partnership firm can be dissolved at any time if all the partners agree.	A company, being a legal person is either winding up by the National Company law tribunal or its name is struck off by the Registrar of Companies.

### Kinds of Partnership:

1. **Partnership at will [Sec. 7]:** Where there is no provision made between the partners for the duration of their partnership, the partnership is 'partnership at will'.
2. **Partnership for Fixed period:** Where provision is made by contract for the duration of the partnership, the partnership is called 'partnership for fixed period'.
3. **Particular partnership:** When a person becomes a partner with another person in any **particular adventures or undertakings**, the partnership is called 'particular partnership'.
4. **General Partnership:** Where a partnership is constituted with respect to the **business in general**, it is called a general partnership.

## Types of Partners:

1. **Active /Ostensible partner:** A person who is a partner by an agreement and **actively engaged** in the conduct of the business of the firm is known as an active or ostensible partner. He is the **agent of other partners**, in the ordinary course of the business. In the event of his **retirement, he must give a public notice** in order to free himself from liabilities for acts of other partners done after his retirement.
2. **Sleeping or dormant partner:** He is a partner by agreement but does not take active part in the conduct of the business. He is **neither active nor known to the outsiders** as a partner. He like other partners, invests capital, shares in the profits/losses of the business and are liable to third parties for all the acts of the firm. He is **not required to give public notice of his retirement** from the firm.
3. **Nominal partner.** A partner who **lends his name** to the firm, without having any interest in it, is called a nominal partner. Neither he **invests** in the business of the firm, **nor takes part** in the conduct of the business of the firm. He is **not entitled to share the profits** of the firm. But he is **liable to third parties** for all the debts of the firm.
4. **Partner in profits only.** A partner who is entitled to share **profits only without being liable for the losses** is known as partner for profits only. **But, he is liable for all the debts** of the firm.
5. **Sub-partners.** When a partner agrees to share his profits derived from the firm with a third person, that third person is known as a sub-partner. A sub-partner is in **no way connected with the firm** and cannot represent himself as a partner of the firm. He has **no rights** against the firm nor is he liable for the acts of the firm. Also, such partners are **not counted** for the limits of partners in a firm.
6. **Partner by Estoppel or Holding Out [Sec. 28]:** The doctrine (principle) of ‘holding out’ is based on the principal of ‘Estoppel’ which says that where a person by his words or conduct has willfully led another person to believe that certain set of circumstances or facts exists, and that other person has acted on that belief, then **subsequently he is stopped from denying the truth** of such statements. The doctrine of holding out also requires certain type of affirmative or positive act on the part of the person being represented.  
The doctrine of ‘holding out’ is applicable in the case of partnership also. Where a person who is not partner but **knowingly by statement, whether oral or written or by conduct makes another person to believe that he is a partner** and the another person, in good faith and believing on such statement or conduct enters into a contract or transaction with the firm.

*For example, X and Y are partners. X introduces A, a manager, as his partner to Z. A remained silent. Z, a trader believing A as partner supplied 100 Washing Machine to the firm on credit. After expiry of credit period, Z did not receive amount of Washing machine sold to firm. Z filed a suit against X and A for recovery of price. Here A, the manager is also liable for the price because he becomes a partner by holding out.*

## REGISTRATION OF FIRMS

Registration of firm is **not compulsory** under the Indian Partnership Act, 1932. It is upon the partners to decide whether they want their firm to be registered or not. But, by creating **certain disabilities by which an unregistered firm suffers**, the Indian Partnership Act made it desirable to get the firm registered. However, **registration does not create partnership**; it is only a reliable evidence of existence of partnership.

### Procedure for Registration [Sec. 58 and 59]

A partnership firm **may be registered at any time** by sending to the 'Registrar of Firms' of the area in which the business of the firm is situated, **an application in the prescribed form and accompanied by prescribed fee** stating:

1. firm name,
2. principal place of the business of the firm,
3. names of any other places where the firm carries on business,
4. names in full and addresses of the partners, and
5. date when each partner joined the firm,
6. duration of the firm, if any, specified in the partnership deed.

The statement must be **signed by all the partners**, or by their agents specially authorized in this behalf, and **duly verified**.

When the 'Registrar of Firms' is satisfied that the provisions of section 58 have been duly complied with, he registers the firm by **recording an entry of the statement in the 'Register of Firms'**, and shall issue the Certificate of registration. [Sec. 59]

When an **alteration** is made in the name of the firm or in the location of its principal place of business, Sec. 60 requires that the information be sent to the registrar.

### Consequences of Non- Registration [Sec. 69]

Section 69 of the Partnership Act imposes certain limitations on an unregistered firm. Following consequences will result from the non- registration of the firm:

1. **No suit by Partners:** A partner of an unregistered firm cannot sue the firm or any of his present or past co- partner of the firm to enforce a right (a) arising from a contract, or (b) conferred by the Partnership Act.
2. **No suit by a Firm:** An unregistered firm cannot file a suit against a third party to enforce any right arising from contract.
3. **No right of set off:** An unregistered firm or any partner thereof cannot claim a set-off of an **amount exceeding ₹ 100** in a proceeding instituted against the firm by a third party to enforce a right arising from a contract.

#### Exceptions:

Non registration of firm does NOT however affect the following:

1. The right of third parties to sue the firm or any partner.
2. The right of the firm to institute a suit or claim of set off not exceeding ₹ 100.

3. The right of partners to sue for the dissolution of the firm or for settlement of the accounts of a dissolved firm, or for realization of the property of dissolved firm.
4. The power of an Official Assignee, Receiver of Court to release the property of an insolvent partner and to bring an action.
5. The rights of the firm to having a place of business in India.
6. The rights of an unregistered firm to bring a suit against third parties to enforce a right arising otherwise than out of a contract, e.g., for enforcing a trademark.
7. A partner can bring a suit for damages for misconduct against another partner.

### **Rights of Partners:**

#### **Under section 12:**

- (a) **Right to take part in the conduct of business:** Every partner can participate in the conduct and management of the business of the firm. If a partner is **wrongfully deprived of the right** of participation of the management of the business of the firm, **he has remedies like** a suit for injunction against the partners or dissolution of the firm. However, the right is available **only if there is no contract to the contrary** between the partners.
- (b) **Right to be consulted:** Where any difference arises between the partners, it shall be determined by views of majority of them and every partner has the right to express his opinion and be heard in all matters affecting the business of the firm. But, no change in the nature of business and reconstitution of the firm can be effected without the consent of all the partners.
- (c) **Right to have access to books:** Every partner has the right to access, inspect and copy any of the books of the firm. The right must, however, be exercised bonafide.

#### **Under section 13:**

- (a) **Right to remuneration:** No partner is entitled to any remuneration, other than his share of profits. But this rule can be varied by an express agreement or by a course of dealings, in which event the partner will be entitled to remuneration. Thus, 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 same.
- (b) **Right to share profits equally:** Unless otherwise agreed, every partner shall share the profits of the business of the firm equally. There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed to the capital of the firm.
- (c) **Right to claim interest on capital:** Normally, no interest is allowed on the capital contributed by the partners. But, if the partnership agreement provides or; any trade or custom to that effect exists, then interest on capital shall be payable only out of the profits. It means in case of loss, interest on capital will not be allowed.
- (d) **Right to interest on advances:** If a partner has advanced any amount to the firm beyond capital, he will be entitled to interest thereon at 6% per annum.

- (e) **Right to be indemnified:** A partner has to be indemnified by the firm in respect of all expenses and liabilities incurred by him in the ordinary and proper conduct of business and 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 in his own circumstances.

**Under other sections:**

- (a) **Right to use partnership property [Sec. 15]:** Every partner is, as a rule, a joint owner of the partnership property and is entitled to hold and apply the same exclusively for the purpose of the business.
- (b) **Right of a partner to act as an agent of the firm:** Every partner for the purpose of the business of the firm is the agent of the firm [Sec. 18]. Further, subject to the provisions of the Partnership Act, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm [Sec. 19].
- (c) **Right in emergency:** A partner has the right in an emergency to do all such acts as are reasonably necessary for protecting the firm from loss. [Sec. 21].
- (d) **Right to stop the admission of a new partner [Sec. 31]:** Every partner is entitled to prevent the introduction of a new partner into a firm. As per rules, unless otherwise agreed, no new partner can be admitted without the consent of all the partners.
- (e) **Right to retire [Sec. 32]:** A partner has a right to retire (a) with the consent of all the other partners or (b) in accordance with an express agreement between the partners, or (c) where the partnership is at will, by giving notice to all the other partners of his intention to retire.
- (f) **Right not to be expelled [Sec. 33]:** Every partner has a right to continue in the partnership. He cannot be expelled from partnership by majority of partners unless such power is conferred by partnership agreement and is exercised in good faith and for the benefit of the firm.
- (g) **Right to do competing business [Sec. 36]:** Every outgoing partner has a right to carry on a competing business. But where he has been restrained by a reasonable agreement from carrying on a similar business for a specified period of time within specified local limits, he cannot do so. Where he carries on such competing business, he shall not
- use the firm name or
  - solicit the firm's customers or
  - in any way represent himself as carrying on the business of the firm.
- (h) **Right to share profits after retirement [Sec. 37]:** Unless otherwise agreed, an outgoing partner has a right to claim a share in the profits of the firm or claim interest @ 6% per annum on his share in the property of the firm till his account is finally settled. This rule is also applicable in case of the death of a partner.

**Duties of Partners:**

1. **General duties of a partner (Sec. 9):** Partners are bound (a) to carry on the business of the firm to the great common advantage, (b) to be just and faithful to each other, (c) and to



the firm render true accounts and full information of all things affecting the firm to any partner or his legal representative.

2. **Duty to Indemnify for loss caused by fraud (Sec. 10):** Every partner shall indemnify the firm for loss caused to it by his fraud in the conduct of the business of the firm.
3. **To attend diligently.** It is the duty of every partner to attend to his duties diligently in the conduct of the firm's business.
4. **Not to carry any other business.** Where there is a restraint in the contract, the partners shall not carry on any other business while he continues to be a partner [Sec. 11(2)].
5. **Not to claim remuneration.** A partner is not entitled to receive any remuneration in any form for taking part in the conduct of the business. However, some remuneration can be allowed to the working partners provided there is a specific agreement to that effect [Sec. 13(a)].
6. **No personal profits:** A partner shall account for profits and pay it to the firm, which he derives for himself from - any transaction of the firm, or from the use of firm's property, or business connection or use of firm's name [Sec. 16(a)]. If a partner carries on any business competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business [Sec. 16(b)].
7. **Not to assign his share.** Where a partner makes such an assignment, the partnership may be dissolved.
8. Unless otherwise agreed, to **contribute equality to the losses** of the firm.
9. To indemnify the firm for any loss caused by his willful neglect in the conduct of the business of the firm [Sec. 13].

#### **Property of the Firm [Sec. 14]**

Partners are joint owners of the property of the firm (unless there is an agreement to the contrary) and it **should be held and used exclusively for the purposes of the firm** by the partners. Hence, it becomes necessary to ascertain what constitutes the property of the firm. Normally the partners, by an agreement, are free to determine as to what shall be the property of the firm and what shall be treated as a separate property of one or more of the partners.

According to Sec. 14, when there is no contract to the contrary, the **property of the firm includes:**

- (i) all properties, rights and interests originally brought to the stock of the firm,
- (ii) the property acquired by purchase or otherwise by or for the firm,
- (iii) the property acquired with money belonging to the firm, and
- (iv) the goodwill of the business of the firm.

However, if a partner's property is used for the purpose of the business of the firm, it does not automatically become the property of the firm. It can become the property of the firm only if the partners show an intention to make it so.

### **Implied Authority of a Partner [Sec. 19]:**

The authority of a partner to bind the firm may be express or implied. The authority conferred on a partner by mutual agreement (oral or written) is called 'express authority'.

But, where there is no agreement or where the partnership agreement is silent, the act of a partner which is done to **carry on, in the usual way, business of the kind carried** on by the firm, binds the firm. This authority of partner is called 'implied authority of a partner'.

Following conditions must be fulfilled to fall within the scope of the implied authority:

- **The act done by the partners must relate to the normal business of the firm.** If it is of a nature which is not common in the type of business carried on by the firm, it will not bind the firm even if it has been done in the name of the firm.

*For example, a partner of a firm dealing in readymade garments places an order for liquor worth ₹ 50,000 in the name of the firm. As this act does not relate to the normal business of the firm, it will not fall within the scope of implied authority. The firm, therefore, will not be bound by it.*

- **The act must have been done in the usual way of carrying on the firm's business.** The act should be such as is usual in the type of business carried on by the firm. What is usual and what is unusual depends on nature of business and usage of trade.

Buying and selling of goods, drawing and accepting bills of exchange, taking loan, etc., are considered as normal activities in case of a trading concern. But, in case of a professional concern e.g. a firm of solicitors, consultants, etc. taking loan is not considered to be an usual activity.

*For example, 'A', 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, for it is no part of the ordinary business of a solicitor to draw, accept or endorse negotiable instruments.*

*For example, 'X' and 'Y' are partners in a trading business. Goods were sold on credit to 'Z'. Later on, 'X' received the amount from 'Z' on behalf of the firm. 'Y' does not know of this receipt and 'X' utilises this amount for his personal use. Receiving money from debtors is an act done in the usual course of business. Hence, the firm cannot claim the amount from 'Z' on the plea that 'X' had no authority to receive the amount.*

- **The act must be done in the firm's name or in some manner implying an intention to bind the firm.**

*For example, 'A' and 'B' are partners in a stationery business. 'A' buys on credit certain quantity of pencils for a wholesaler in the firm's name. He uses these pencils for the family. Since this act is of the kind usually done in the stationery business and is done in the firm's name, it will bind the firm.*

### **Acts within the implied authority of a partner:**

In a trading firm, the implied authority of a partner shall **normally include:**

- (i) purchasing, on behalf of the firm, goods in which the firm deals or which are used in the firm's business;
- (ii) selling the goods of the firm;
- (iii) receiving payments of the debts due to the firm and giving receipt therefor;
- (iv) settling accounts with third parties dealing with the firm;
- (v) employing servants necessary for carrying on the firm's business;
- (vi) borrowing money on behalf of the firm;

- (vii) pledging goods of the firm as security for the purpose of getting loans;
- (viii) drawing, accepting and endorsing negotiable instruments on behalf of the firm; and
- (ix) employing solicitor to defend action against the firm.

**Acts outside the implied authority of a partner [Sec. 19(2)]:**

Section 19(2) provided that in the absence of any usage or custom of trade to the contrary, the implied authority of a partner **does not enable him to:**

- (i) submit a dispute relating to the business of the firm to arbitration;
- (ii) compromise or relinquish any claim or portion of the claim by the firm;
- (iii) withdraw a suit or proceedings filed on behalf of the firm;
- (iv) admit any liability in a suit or proceedings against the firm;
- (v) acquire immovable property on behalf of the firm;
- (vi) transfer immovable property belonging to the firm; and
- (vii) open a bank account on behalf of the firm in partner's own name;
- (viii) enter into partnership on behalf of the firm.

**Restriction and Extension of Implied Authority [Sec. 20]:**

The partners, by mutual agreements can restrict or extend the implied authority of a partner.

Notwithstanding any restriction, any act done by the partner on behalf of the firm which falls within his implied authority, binds the firm, unless the person with whom he is dealing knows the restriction or does not know that he is dealing with a partner of the firm.

**Partner's authority in an Emergency [Sec. 21]:**

In an emergency, a partner will have an authority to **do all such acts to protect the firm from loss, as would be done by a man of ordinary prudence** in his own circumstances. These acts bind the firm even though they do not form part of the partners' implied authority.

*For example, the partners of a trading firm by an express contract decided that no partner would have the authority to sell goods of the firm above the value of ₹ 10,000 without consulting all other partners. Owing to a sudden slump in market, the prices, crashed. One partner, in order to save the firm from loss, sold all the stock worth ₹ 1,00,000 without consulting any other partner. The firm shall be bound by such act of the partner.*

**Effect of Admissions by a Partner [Sec. 23]:**

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.

*For 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 of 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 this loss.*

### Effect of Notice to Acting Partner [Sec. 24]

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.

*For example, P, Q, and R are partners in 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 dealing 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. The only exception would lie in the case of fraud, active or tacit.*

### Liability to Third parties [Sec. 25 to 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.  
An act of a firm means any act or omission by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm.
2. **Liability of the firm for wrongful acts of a partner [Sec. 26]:** Where, by the wrongful act or omission of a partner acting 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 therefore to the same extent as the partner.

*Blair v Bromley: A and B are partners as solicitors. C, a client, entrusted some money to B to be invested on a specific security. B made away with the money. A was however ignorant of the transaction. Nevertheless he was held liable for it is within the ordinary scope of a solicitor's business to receive money to be invested on specific securities.*

3. **Liability of firm for misapplication by partners [Sec. 27]:** Where
  - (i) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or
  - (ii) 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, then the firm is liable to make good the loss.

*Devaynes v Noble: A partner of a firm of bankers disposed of certain securities deposited with the firm by a customer for safe custody. It was held that all the partners of the firm were liable.*

### Minor Partner [Sec. 30]:

Partnership is the result of an agreement and a minor cannot enter into an agreement. A minor cannot be bound by an agreement. So, a minor cannot become a partner in a firm. But, Section 30 of The Indian Partnership Act, 1932 provides that **with the consent of all the partners** a minor can be **admitted to the benefits** of partnership.

#### Rights of Minor partner:

- He has right to such share of profits and property of the firm as may have been agreed upon.
- He can access to, inspect and copy the accounts (but not books) of the firm.

- When he is not given his due share of profit, he has a right to file a suit for his share, but only when he is severing his connection with the firm and not otherwise.
- On attaining majority, he has a right to opt to become a partner in the firm.

### **Liabilities of Minor partner:**

#### **Before attaining majority:**

- The liability of the minor is confined **only to the extent of his share in the profits and property** of the firm. But he is **neither personally liable nor is his private estates** are liable for the debts of the firm.
- He **cannot be declared insolvent**, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee.

#### **On attaining majority:**

- **Decision:** On attaining majority the minor partner has to decide **within six months** whether he shall continue in the firm or leave it. These six months run **from the date of attaining his majority or from the date when he first comes to know that he had been admitted to the benefits of partnership; whichever date is later.**
- **Public Notice:** He shall give public notice of his intention to become or not to become a partner in the firm. If he fails to give a public notice, he shall be **deemed to have become a partner** in the firm on the expiry of the said six months.

#### **If he elects to become a partner:**

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

#### **Elects not to become a partner:**

- His rights and liabilities continue to be those of a minor partner up to the date of the notice.
- His share is not liable for any acts of the firm done after the date of the public notice.
- He is entitled to sue the partners for his share of the property and the profits in the firm.

### **Reconstitution of a Firm:**

A partnership firm is said to be reconstituted when any of the following changes occurs and the firm continues:

#### **1. Admission of a partner [Sec. 31]:**

Subject to Section 30 (which deals with minor partner), a person may be admitted as a new partner either —

- (i) with the consent of all the existing partners, or
- (ii) in accordance with a contract already entered into between the existing partner.

**Byrne v. Reid (1902):** It was held that a partner cannot prevent a person from being admitted into the partnership if in the terms of the partnership deed such admission is not denied. The presence of clause in partnership deed amounts to the consent of partners.

### **Liability of Incoming Partner:**

An incoming partner is not liable for any act of the firm done before he became a partner.

It means that if by mutual agreement the new partner agrees with the old partners to be liable for the past liabilities of the firm, the creditors of the firm do not get any right to proceed against the new partner for recovery of their past debts.

New partner is liable for the acts of the old firm only, if –

- (i) the new firm, including the incoming partner who joins it, assumes the liabilities of the old firm, and
- (ii) the creditors accept the new firm as their debtor and discharge the old firm from its liability.

## **2. Retirement of a partner [Sec. 32]:**

A partner may retire from a firm –

- (i) with the consent of all the other partners (such consent may be expressed or implied),
- (ii) in accordance with an express agreement by the partners, or
- (iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

### **Liability of Retired Partner:**

- (i) A retiring partner may be discharged from liability to any third party for any acts of firm done before retirement -
  - a) by an agreement **with** such third party and the partners of the reconstituted firm (principle of novation), or
  - b) there is an implied agreement **by a course of dealing** between such third party and the reconstituted firm, after the third party had knowledge of the retirement.
- (ii) A retired partner along with other partners **continues to be liable to third parties for any act done after the retirement**, which would have been an act of the firm if done before retirement, **until a public notice is given** of the retirement by the retired partner or any partner of the re-constituted firm. This provision is based on the Principle of holding out.
- (iii) However, the retired partner **is not liable for the acts of the firm done after his retirement**, if the persons dealing with the firm do not know that he was a partner as such (i.e. in case of retirement of sleeping or dormant partner).

*For example, C and I were partners in a business. They dissolved the partnership but no public notice was given of the dissolution. After the dissolution, C ordered goods from T using the firm's old letter-head which showed that I was a partner. T did not know that I was a partner before the dissolution. It was held that, I was not liable to T as a retired partner (who was earlier sleeping or dormant partner) is not required to give public notice of his retirement to persons who are ignorant of his being a partner in the firm.*

**Vishnu Chandra v. Chandrika Prasad:** It was held that if a partner wants to dissociate from the partnership business, in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from partnership. At that event of retirement, partnership business will not come to the end.

**3. Expulsion of a partner [Sec. 33]:**

A partner may be expelled from a firm:

- (i) by majority of the partners, and
- (ii) the power to expel must be conferred upon the partners by a contract between them, and
- (iii) the power must be exercised in good faith.

The test of good faith is

- a) that the expulsion must be in the interest of the partnership
- b) that the partner to be expelled is served with a notice; and
- c) that he is given an opportunity of being heard.

Even where there is a provision in the partnership agreement that a partner may be expelled on the happening of an event, e.g., misconduct by a partner, and the partner is guilty of misconduct, the power of expulsion must be exercised by the majority in good faith.

Expulsion of partner, otherwise than in good faith, is null and void.

Rights and liabilities of expelled partner are same as that of retired partner as discussed above.

**Irregular expulsion:** Where the expulsion of a partner takes place without the satisfaction of the conditions given above, the expulsion is irregular. The expelled partner may in such a case either

- a) Claim re- instatement as a partner, or
- b) Sue for the refund of his share of capital and profits in the firm.

An irregular expulsion is wholly ineffectual and inoperative. The expelled partner, in such case, does not cease to be a partner.

**4. Insolvency of a partner [Sec. 34]:**

- Where a partner in a firm is adjudicated insolvent, he ceases to be partner on the date on which the order of adjudication is made, irrespective of whether the firm is dissolved or not.
- When under a contract between the partners, the firm is not dissolved by the insolvency of a partner, estate of such partner is not liable for the acts of the firm.
- Also, firm is also not liable for any act of the insolvent partner done after the date of the order of adjudication.

**5. Death of a partner [Sec. 35]**

Firm is generally dissolved on the death of any of its partners. But, if the partnership agreement provides that on the death of any partner, the firm will not be dissolved, the remaining partners can continue with the firm's business.

In such case, the estate of the deceased partner shall be held liable only for those acts of the firm which were done during the lifetime of the deceased partner. He shall not be liable for any act of the firm done after the date of his death.

**Bagel v. Miller (1903):** *M was a partner in a firm. The firm ordered goods in M's lifetime but delivery was made after M's death. It was held that, M's estate was not liable for the price in an action for the goods sold and delivered as there was no debt due in respect of the goods in M's lifetime.*

No public notice is required on the death of a partner.

## 6. Transfer of partner's interest [Sec. 29]:

A partner may transfer his interest in the firm by sale, mortgage or charge. The transfer may be absolute or partial. It does not, however, entitle the transferee, during the continuance of the firm:

- To interfere in the conduct of the business of the firm, or
- To require accounts or to inspect the books of the firm.

He is entitled 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.

If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled to receive the transferring partner's share in the assets of the firm. For the purpose of ascertaining that share, he is entitled to an account as from the date of dissolution.

### Revocation of Continuing Guarantee by Change in Firm [Sec.38]

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

*Neel Comul Mookerji v Bipro Das:* A became surety to the firm of the N C Mookerji for Bipro Das conduct a cashier to firm. The firm was reconstituted and named as N. Mookerji and Sons. It was held that A was not liable for B's defalcation subsequent to the change by virtue of Sec. 38.

### Exceptions to the general rule that an agreement in restraint of trade is void under the Partnership Act:

Agreements in restraint of trade are valid in following situations -

- (i) A partner shall not carry on any business other than that of the firm **while he is a partner** [Sec.11]
- (ii) **Outgoing partner** shall not carry on similar business for a specified period or within specified local limits [Sec. 36].
- (iii) **On dissolution of the firm**, partners may agree that some or all of them will not carry on a business similar to that of firm within a specified period or within specified local limits [Sec 54].
- (iv) Upon the **sale of the goodwill of the firm**, any partner may agree 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 local limits [Sec. 55].

The restrictions imposed should be **reasonable**. What is reasonable depends on the character and nature of business or its customers.



**Dissolution of Firm vs. Partnership:**

The Indian Partnership Act makes a distinction between dissolution of partnership and dissolution of firm.

Dissolution of partnership simply means a change in the relation of the partners. Such a change is usually caused when a firm is reconstituted, i.e., when a new partner is admitted or when an existing partner retires, dies, becomes insolvent or is expelled. The dissolution of partnership may or may not involve the dissolution of a firm.

Dissolution of a firm means the dissolution of complete partnership between all the partners of a firm. It occurs when there is **complete breakdown of relationship between all the partners**.

When a firm is dissolved, it necessarily involves the dissolution of partnership.

**Difference between Dissolution of Firm and Dissolution of Partnership:**

Basis of difference	Dissolution of Firm	Dissolution of Partnership
<b>Continuation of Business</b>	It involves discontinuation of business in partnership.	It does not involve discontinuation of business. It involves only reconstitution of firm by way of admission, retirement, death or insolvency.
<b>Winding up</b>	It involves winding up of the firm and requires realization of assets and settlement of liabilities.	It involves only reconstitution and required only revaluation of assets and liabilities of the firm.
<b>Order of court</b>	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
<b>Scope</b>	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.
<b>Final closure of books</b>	It involves final closure of books of accounts.	It does not involves final closure of books of accounts.

**Modes of Dissolution of Firm [Sec. 39]:**

The dissolution of a firm may take place either without the order of the court or by an order of the court.

**Dissolution without the Order of Court or Voluntary Dissolution:**

It consists of following:

1. **Dissolution by mutual agreement (Sec. 40):** Firm may be dissolved –
  - (i) with the consent of all the partners, or
  - (ii) in accordance with the contract, express or implied, between them.
2. **Compulsory dissolution (Sec. 41):** Firm is automatically dissolved, if
  - (i) all the partners, or all but one partner, of the firm are declared **insolvent** or **die**, or
  - (ii) some event takes place which makes it **unlawful for the business** of the firm to be carried on.

*For example, a firm is carrying on the business of trading in liquor and a law is passed by which trading in liquor is prohibited. The business of the firm becomes unlawful and so the firm will have to be compulsorily dissolved.*

**Note:** If a firm is carrying on more than one businesses, the illegality of one or more shall not necessitate the dissolution of the firm. The firm can carry on those ventures which remain lawful.

3. **Dissolution on the happening of certain contingencies (Sec. 42):** In the absence of a contract to the contrary, a firm will be dissolved on:
- (i) the expiry of the fixed term, where the firm is constituted for a fixed term;
  - (ii) completion of one or more adventures or undertakings, where the firm is constituted for such adventures or undertakings;
  - (iii) death of a partner; or
  - (iv) adjudication of a partner as insolvent.
4. **Dissolution by notice of partnership at will (Sec. 43):** When a **partnership is at will**, the firm may be dissolved by any partner **by giving notice in writing to all the other partners** of his intention to dissolve the firm. If in the notice, some specific date is mentioned, the firm is dissolved from that date. But, if no date has been mentioned, the firm is dissolved from the date when the notice is communicated.

**Note:** Notice once given, cannot be withdrawn without the consent of all other partners

#### **Dissolution by Order of the Court [Sec. 44]:**

The Court may, at the suit of a partner, dissolve a firm on the following grounds:

1. **Insanity:** Where a partner has become of unsound mind, the Court may dissolve the firm on **petition of any of the other partners or by the next friend of the insane partner.**
2. **Permanent incapacity:** The court may order for dissolution of partnership, if a partner becomes permanently incapable of performing his duties as a partner. Application in such case shall be made by any of the other partners, and not by the incapacitated partner.
3. **Misconduct:** If a partner is guilty of conduct which is likely to affect the carrying on of the business of the firm prejudicially, the Court may order dissolution. Suit in such case can only be brought by the other partners.

*For example, 'A' and 'B' are partners in a firm. 'A' has adulterous relations with 'B's wife. This is a sufficient ground for the compulsory dissolution of the firm [Abbot v. Crump, (1870)]. The conduct of 'A', though not committed in the actual business, is likely to affect prejudicially the carrying on the business so far as 'A' and 'B' are concerned, because this destroys mutual confidence.*

The following acts have been held to be sufficient ground for the dissolution of a firm:

- (a) Gambling by a partner on a stock exchange, though such gambling may in no way be connected with the business of the firm.
- (b) Persistent refusal or neglect by a partner to attend to the business.
- (c) Taking away of partnership books by a partner.

**Note:** 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.

4. **Persistent breach of agreement:** If a partner willfully and persistently commits breach of the partnership agreement regarding management or otherwise conducts himself in such a way that it is not reasonably practicable for the other partners to carry on business in partnership with him, the Court may order dissolution. The suit for dissolution can be brought by a partner other than the guilty partner.

*For example, Embezzlement, keeping erroneous accounts, holding more cash than allowed, refuse to show accounts despite repeated request, continuous refusal by a partner to attend to his duties in the partnership business have been held to be sufficient reasons.*

5. **Transfer of interest:** The Court, at the instance of any other partner, may dissolve the firm when a partner has in any way,
- transferred the whole of his interest in a firm to a third party; or
  - allowed his share to be charged on account of a decree passed by a court towards payment of liabilities of that partnership; or
  - allowed his share to be sold in the recovery of arrears of land revenue.
6. **Perpetual losses:** When the firm is continuously suffering losses and it is apparent that in future also the business cannot be carried on except at a loss, the court may order for the dissolution of the firm at the instance of any partner.
7. **Any other just and equitable ground:** If, on any other ground it can be proved to the satisfaction of the Court that it is just and equitable to dissolve the firm, the Court may order dissolution of the firm.

For example,

- Deadlock in the management,
- Loss of the substratum of the business,
- Partners not on speaking terms,
- Gambling by a partner on a stock exchange.

### **Consequences of Dissolution: [Sec. 45 to 55]:**

#### **Rights of Partner on Dissolution:**

- Right of partner to have business wound up after dissolution of firm [Sec. 46]:** On the dissolution of a firm every partner or his representative is entitled 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.
- Payment of firm debts and separate debts [Sec. 49]:** Where there are joint debts due from the firm and also separate debts due from any partner-
  - Firm's assets shall be applied first in the payment of firm's debts, then the surplus, if any, shall be applied in the payment of partner's debts to the extent to which the concerned partner is entitled to share in the surplus; and
  - Partner's private property shall be applied first in the payment of his private debts and the surplus, if any, in the payment of firm's debts if the firm's liabilities exceed the firm's assets.

3. **Return of premium on premature dissolution [Sec. 51]:** Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiry of such term (otherwise than by the death of a partner), he shall be entitled to repayment of the premium or of such part thereof.

In determining the part of premium, regard shall be had to –

- the terms upon which he became a partner and
- the length of time during which he was a partner.

However, no premium or part thereof shall be repaid, if the dissolution is –

- due to his own misconduct, or
- pursuant to an agreement containing no provision as to return of premium.

4. **Right to restrain from use of firm name or firm property [Sec. 53]:** In the absence of contract to contrary, after dissolution of firm, any partner or his representative may restrain any other partner or his representative from carrying on a similar business in the firm name or from using firm's property for his own benefit, until the affairs of the firm are completely wound up. However, where any partner or his representative has bought the goodwill of the firm, he shall have the right to use the firm name.

### **Liabilities of Partner on dissolution:**

1. **Liability for acts of partners done after dissolution [Sec. 45]:** The partners continue to be liable to third parties for any act done by any of them which would have been the act of firm if done before dissolution, until public notice is given of the dissolution.

The estate of a partner

- who dies, or
- who is adjudicated an insolvent, or
- who was not known to the person dealing with the firm to be a partner (i.e. sleeping or dormant partner) retires from the firm;

is not liable u/s 45 for acts done after the date on which he ceases to be a partner.

### **Analysis of section 45:**

Section 45 has two fold objectives:

- (i) To protect third parties dealing with the firm who had no notice of prior dissolution;
- (ii) To protect partners of a dissolved firm from liability towards third parties.

*Example: X and Y who carried on business in partnership for several years, executed on 1<sup>st</sup> January, a deed dissolving the firm from the date, but failed to give a public notice of the dissolution. On 10<sup>th</sup> January, X borrowed in the firm's name a certain sum of money from Mr. K who was ignorant about the dissolution. In such a case, Y will also be liable for the amount due to Mr. K because no public notice was given.*

However, there are exceptions to the rule stated in the example, i.e. even where no notice of dissolution has been given, the partners will not be liable for the subsequent acts in the case of:

- a) a deceased partner;
- b) an insolvent partner;
- c) a dormant partner (sleeping partner) i.e. a partner, who was not known as a partner to the person dealing with the firm.

2. **Continuing authority of partners for the purposes of winding up [Sec. 47]:**

- The authority to bind the firm, other mutual rights and liabilities of the partners continue, in so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of dissolution.
- Firm is not bound by the acts of a partner who has been adjudicated insolvent.
- However, the person who has, after the adjudication, represented himself or knowingly permitted himself to be represented as a partner of the insolvent, will be liable for his acts (on grounds of holding out).

**Settlement of Accounts after dissolution [Sec. 48]:**

In settling the accounts of the firm after dissolution, the **following rules shall be applicable**, subject to an agreement between the partners:

- (i) Losses (including deficiencies of capital) shall be paid first out of profits of the firm, next out of capital and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits;
- (ii) The assets of the firm shall be applied (i.e. used) in the following manner and order :
  - (a) in paying the **debts of firm** to third parties;
  - (b) in paying **partner's loans and advances** made to the firm;
  - (c) in paying each partner rateably what is due to him on account of his **capital**; and
  - (d) if any **residue** is left it shall be **distributed among the partners** in the proportion in which they were entitled to share **profits**.

**Mode of giving public notice [Sec. 72]**

A public notice is required to be given where it relates:

- to the **retirement** of a partner from a registered firm, or
- to the **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 **attaining majority who was admitted as a minor** to the benefits of partnership.

The public notice is given by way of—

- notice **to the Registrar of Firms** (not required where the firm is not registered), and
- publication in the **Official Gazette**, and
- publication in **at least one vernacular (local) newspaper** circulating in the district where the firm, to which it relates has its place or principal place of business.