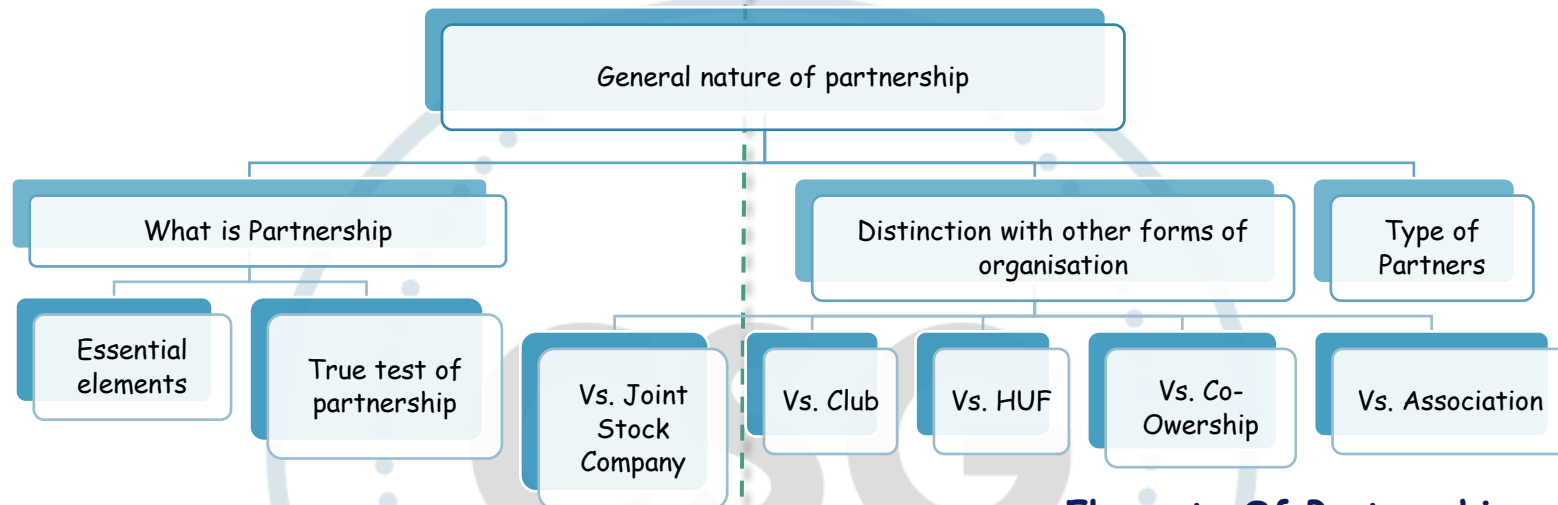


4

The Indian Partnership Act, 1932

Unit-1: General Nature of Partnership



Definition Of 'Partnership', 'Partner', 'Firm' And 'Firm Name' (Section 4)

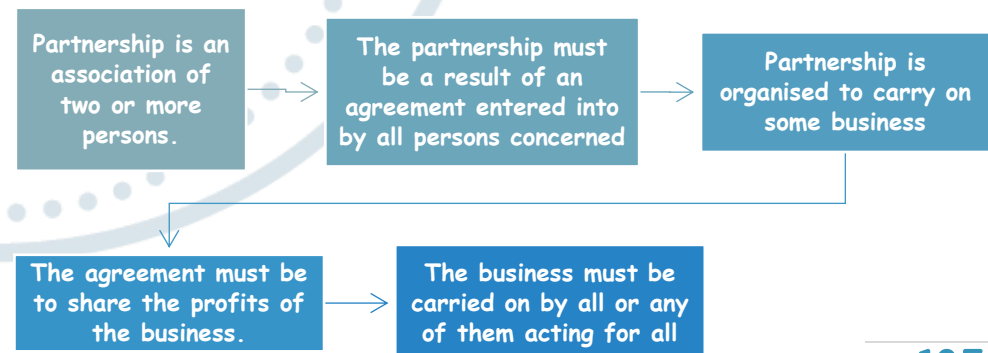
'Partnership' is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

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**'.



Elements Of Partnership

The definition of the partnership contains the following five elements which must co-exist before a partnership can come into existence.



We shall now discuss the aforesaid elements one by one.

1. Association of Two Or More Persons: Partnership is an association of 2 or more persons. Again, only persons recognized by law can enter into an agreement of partnership. Therefore, a firm, since it is not a person recognized in the eyes of law cannot be a partner. Again, a minor cannot be a partner in a firm, but with the consent of all the partners, may be admitted to the benefits of partnership.



The partnership Act is silent about the maximum number of partners but **section 464** of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm.

2. Agreement: It may be observed that partnership must be the result of an agreement between two or more persons. There must be an agreement entered into by all the persons concerned. This element relates to voluntary contractual nature of partnership. Thus, the nature of the partnership is voluntary and contractual. An agreement from which relationship of Partnership arises may be express. It may also be implied from the act done by partners and from a consistent course of conduct being followed, showing mutual understanding between them. It may be oral or in writing.

3. Business: In this context, we will consider two propositions. First, there must exist a business. For the purpose, the term 'Businesses include every trade, occupation and profession. 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.



4. Agreement to Share Profits: The sharing of profits is 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. Partners must agree to share the profits in any manner they choose. But an agreement to share losses is not an essential element. It is open to one or more partners to agree to share all the losses. However, in the event of losses, unless agreed otherwise, these must be borne in the profit-sharing ratio.



Example: Co-owners who share amongst themselves the rent derived from a piece of land are not partners, because there does not exist any business.

Example: No charitable institution or club may be floated in partnership [A joint stock company may, however, be floated for non-economic purposes].

Example: X and Y buy certain bales of cotton which they agree to sell on their joint account and to share the profits equally. In these circumstances, X and Y are partners in respect of such cotton business.

5. Business Carried on by All or Any of Them Acting for All: The business must be carried on by all the partners or by anyone or more of the partners acting for all. This is the cardinal principle of the partnership Law. In other words, there should be a binding contract of mutual agency between the partners.

An act of one partner in the course of the business of the firm is in fact an act of all partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. 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. 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.

Example: A, B and C are partners in ABC Associates, a partnership firm. If A made certain purchases for the purpose of business from Mr. K, then Mr. K can recover the money from A, B or C as all partners are liable for any act done on behalf of firm.

In KD Kamath & Co.

The Supreme Court has held that the two essential conditions to be satisfied are that:

(1) there should be an agreement to share the profits as well as the losses of business; and

(2) the business must be carried on by all or any of them acting for all, within the meaning of the definition of 'partnership' under **section 4**.

The fact that the exclusive power and control, by agreement of the parties, is vested in one partner or the further circumstance that only one partner can operate the bank accounts or borrow on behalf of the firm are not destructive of the theory of partnership provided the two essential conditions, mentioned earlier, are satisfied.

Note: -The 'Partnership Agreement' is also known as 'Partnership Deed'.

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.

<p>1. Agreement:</p>	<p>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</p>
<p>2. Sharing of Profit:</p>	<p>The sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such person's partners. 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</p>

2. Sharing of Profit:

carrying 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.

As discussed earlier, sharing of profit is an essential element to constitute a partnership. But it is only a prima facie evidence and not conclusive evidence, in that regard. The sharing of profits or of gross returns accruing from property by persons holding joint or common interest in the property would not by itself make such person's partners. 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 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.

2. Sharing of Profit:

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. Dasyran Murzamull, 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 Deput.

Partnership Distinguished from Other Forms of Organisation

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.

Transfer of shares		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 off by the Registrar of Companies.
Number of memberships	According to section 464 of the Companies Act, 2013, the number of partners in any association shall not exceed 100.	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

Number of memberships		also be formed by one person known as one person Company.
Duration of existence	However, the Rule given under the Companies (Miscellaneous) Rules, 2014 restrict the present limit to 50.	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, etc.
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.

Basis of Difference	Partnership	Club
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

Management		or female member of the family.
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.

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 business in the	In a partnership, each partner has a defined share by virtue of an agreement between the partners.	In a HUF, no coparceners have 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.

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.

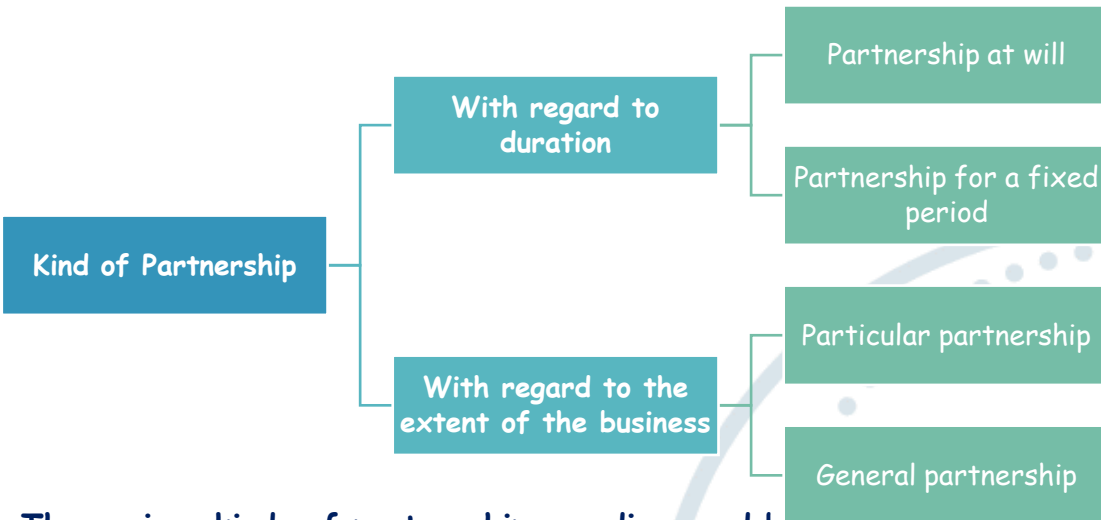
Implied agency	A partner is the agent of the other partners.	A co-owner is not the agent of other co-owners.
Nature of interest	There is community of interest which means that profits and losses must have to be shared.	Co-ownership does not necessarily involve sharing of profits and losses.
Transfer 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.

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 evolves out of social cause and 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:

1. no fixed period has been agreed upon for the duration of the partnership; and
2. 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.

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:** A partnership may be organized for the prosecution of a single adventure as well as for the conduct of a continuous business. Where a person becomes a partner with another person in any particular adventure or undertaking the partnership is called 'particular partnership'. A partnership, constituted for a single adventure or undertaking is, subject to any agreement, dissolved by the completion of the adventure or undertaking.

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. General partnership is different from limited liability 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 verbally. 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 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.

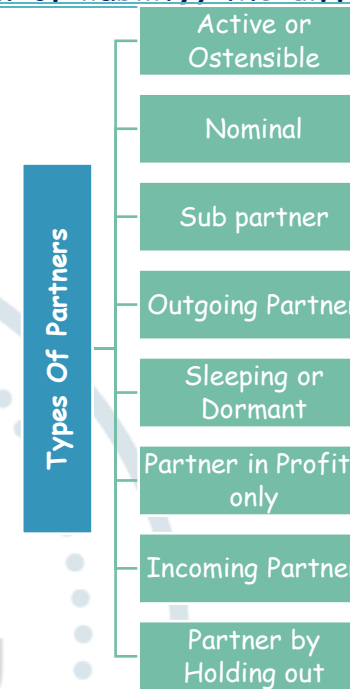
Partnership deed may contain the following information: -

1. Name of the partnership firm.
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.

A partnership firm may add or delete any provision according to the needs of the firm.

Types Of Partners

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



Active or Actual or Ostensible partner:

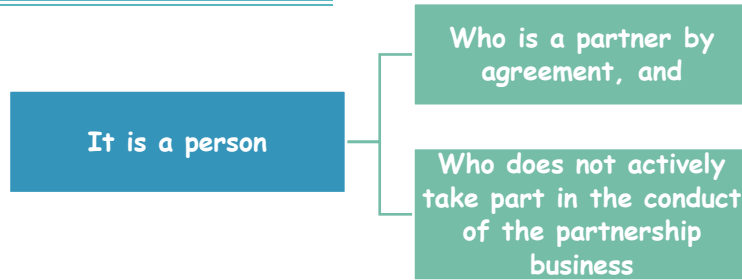
It is a person

Who has become a partner by agreement, and

Who actively participates in the conduct of the partnership

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 absolve himself of liabilities for acts of other partners done after his retirement.

Sleeping or Dormant Partner:



They are called as 'sleeping' or 'dormant' partners. 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.

Nominal Partner: 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 invests 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.

Lend his name to the firm

Without having any real interest in firm

Not entitled to share the profits

Does not take part in the conduct of the business

Liable to third parties for all acts of the firm

Partner in profits 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 and also liable to the third parties for all acts of the profits only.



Entitled to share the profits only

Not liable for the losses

Liable to the third parties for all acts of the profits only

Incoming partners: A person who is admitted as a partner 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.

Example: Mr. A joined as a partner on 10th September, 2021 in a firm MNQ Associates which was existing from 10th July, 2017. Mr. A will not be liable for any acts of the firm done before his date of joining i.e. 10th September, 2021.



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.

Partner by holding out (Section 28): Partnership by holding out is also known as partnership by estoppel. Where a man holds himself out as a partner, or allows others to do it, he is then stopped from denying the character he has assumed and upon the faith of which creditors may be presumed to have acted

When a person represent himself, or

Knowingly permits himself,

to be represented as a partner in a firm (when in fact he is not)

he is liable, like a partner in the firm

to anyone who on the faith of such representation has given credit to the firm.

Example: A partnership firm consisting of P, Q, R and S. S retires from the firm without giving public notice and his name continues to be used on letterheads. Here, S is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.

A person may himself, by his words or conduct have induced others to believe that he is a partner or he may have allowed others to represent him as a partner. The result in both the cases is identical.

Example: 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**).

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'.

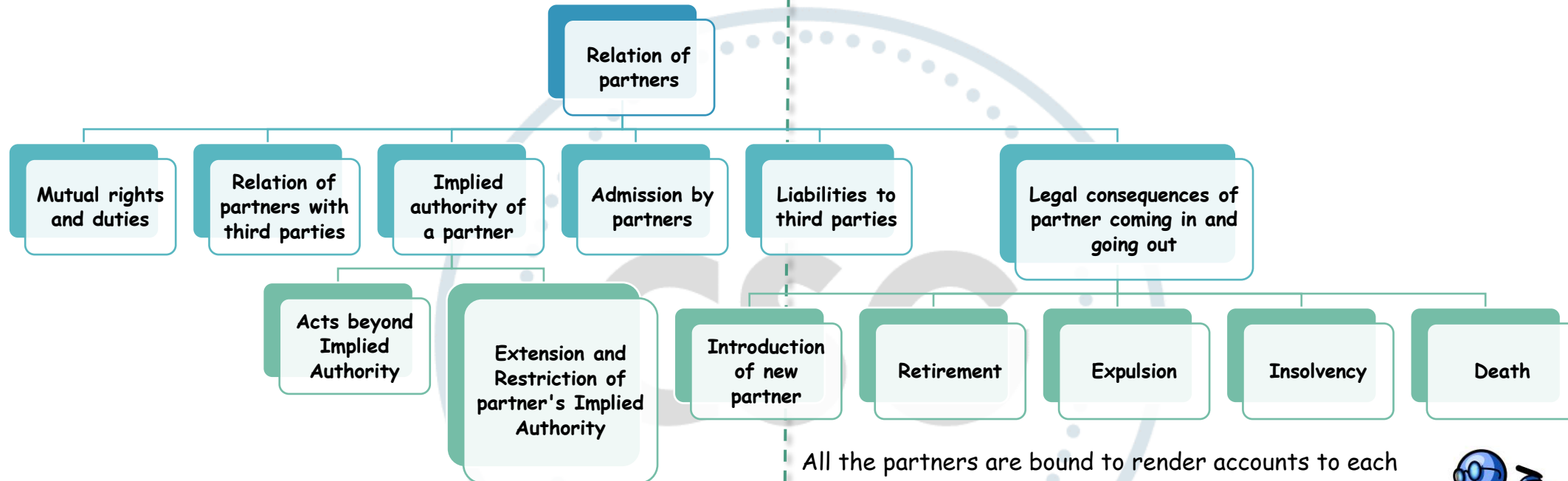
You must also note that for the purpose of fixing liability on a person who has, by representation, led another to act, it is not necessary to show that he was actuated by a fraudulent intention.

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.

4

The Indian Partnership Act, 1932

Unit - 2: Relations of Partners

Relation Of Partners To One Another

The Partnership Act contains various provisions regulating the relationship between partners.

1. General Duties of Partners (Section 9): The partners should carry business of the firm to the greatest common advantages and later, they should render to any partner or his legal representative's full information of all things affecting the firm. A partner must observe the utmost good faith in his dealings with the other partners.

All the partners are bound to render accounts to each other but where some of the accounts are kept by one of them, prima facie he would be the proper person to explain and give full information about them.

Example: In a transaction between partners for the sale and purchase of a share in the business, if one of them is better acquainted with the accounts than the other, it is his duty to disclose all material facts.



2. Duty to Indemnify for Loss Caused by Fraud (Section 10): The partner, committing fraud in the conduct of the business of the firm, must make good the loss sustained by the firm by his misconduct and the amount so brought in the partnership should be divided between the partners.



An act of a partner imputable to the firm or the principles of agency, which is a fraud on his co-partners, entitles the co-partners as between themselves, to throw the whole of the consequences upon him.

3. Determination of Rights and Duties of Partners by Contract Between the Partners (Section 11): (1) 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.



(2) Agreements in restraint of trade- Notwithstanding anything contained in section 27 of the Indian Contract Act, 1872, such contracts may provide that a partner shall not carry on any business other than that of the firm while he is a partner.

Partnership is a relation eminently depending on the consent of the parties, not only for its existence, but for the terms of the agreement in all things consistent with its essential nature and purpose; and an agreement to become partners in the first instance, or to vary the terms at any time, need not be manifested in any particular form.

4. 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.
- (e) in the event of the death of a partner, his heirs or legal representatives or their duly authorised agents shall have a right of access to and to inspect the copy of any of the books of the firm.

(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 co-extensive.

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.

(iv) Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]: In the event of the death of a partner, his heirs or legal representatives or their duly authorised agents shall have a right of access to and to inspect and copy any of the books of the firm.

5. 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;

(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;

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

(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 you 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.



(iv) Interest on advances [Section 13(d)]: Suppose a partner makes an advance to the firm in addition to the amount of capital to be contributed by him, in such a case, the partner is entitled to claim interest thereon @ 6% per annum. While interest on capital account ceases to run on dissolution, the interest on advances keeps running even after dissolution and up to the date of payment.

(v) Right to be indemnified [Section 13(e)]: Every partner has the right to be indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business of the firm as well as in the performance of an act in an emergency for protecting the firm from any loss, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.

(vi) Right to indemnify the firm [Section 13(f)]: A partner must indemnify the firm for any loss caused to it by wilful neglect in the conduct of the business of the firm.

Partnership Property (Section 14)

1. The Property of The Firm (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**' is a concept which is very easy to understand but difficult to define. 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 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.

2. Application of The Property of The Firm (Section 15): **Section 15** provides that the property of the firm shall be held and used exclusively for the purpose of the firm. In partnership, there is a community of interest which all the partners take in the property of the firm. But that does not mean that 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.



According to **section 17**, subject to contract between the partners-

(a) after a change in the firm: Where a change occurs in the constitution of a firm, 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;

(b) after the expiry of the term of the firm: Where a firm constituted for a fixed term continues to carry on business after the expiry of that term, the mutual rights and duties of the partners remain the same as they were before the expiry, so far as they may be consistent with the incidents of partnership at will; and

(c) where additional undertakings are carried out: where a firm constituted to carry out one or more adventures or undertakings carries out other adventures or undertakings are the same as those in respect of the original adventures or undertakings.

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.

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 transaction 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.

Rights And Duties of Partners After a Change in The Firm (Section 17)

Before going into rights and duties, we should first know how a change may take place in the constitution of the firm. It may occur in one of the four ways, namely,

Where a new partner or partners come in

Where some partner or partners go out, i.e., by death or retirement

Where the partnership concerned carries on business other than the business for which it was originally formed

Where the partnership business is carried out on after the expiry of the term fixed for the purpose.

Relation Of Partners to Third Parties

1. Partner to Be an Agent of The Firm (Section 18):

You may recall that a 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). This definition suggests that any of the partners can be the agent of the others.

Section 18 clarifies this position by providing that, subject to the provisions of the Act, a partner is the agent of the firm for the purpose of the business of the firm. The partner indeed virtually embraces the character of both a principal and an agent.

So as far as he acts for himself and in his own interest in the common concern of the partnership, he may properly be deemed a principal and so far, as he acts for his partners, he may properly be deemed as an agent.

The principal distinction between him and a mere agent is that he has a community of interest with other partners in the whole property and business and liabilities of partnership, whereas an agent as such has no interest in either.

The rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. It is applicable only to the act done by partners for the purpose of the business of the firm.

2. Implied Authority of Partner as Agent of The Firm (Section 19):

Subject to the provisions of **section 22**, 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.

The authority of a partner to bind the firm conferred by this section is called his "**implied authority**".

(2) In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to-

- (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 proceedings filed on behalf of the firm;
- (e) admit any liability in a suit or proceedings against the firm;
- (f) acquire immovable property on behalf of the firm;
- (g) transfer immovable property belonging to the firm; and
- (h) enter into partnership on behalf of the firm.

Mode of Doing Act to Bind Firm (Section 22): In order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm.

At the very outset, you should understand what is meant by "**implied authority**". You have just read that every partner is an agent of the firm for the purpose of the business thereof. 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 deal with the implied authority of a partner. The impact of these Sections is that 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, provided that the act is done in the firm name, or any manner expressing or implying an intention to bind the firm. Such an authority of a partner to bind the firm is called his implied authority.

It is however subject to the following restrictions:

1. 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.
2. 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)**].
3. 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, a partner has implied authority to bind the firm by all acts done by him in all matters connected with the partnership business and which are done in the usual way and are not in their nature beyond the scope of partnership. You must remember that an implied authority of a partner may differ in different kinds of business.

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. **Section 19(2)** contains the acts which are beyond the implied authority of the partners.

3. Extension and Restriction of Partners' Implied Authority (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.

Example: A, a partner, borrows from B 1,000 in the name of the firm but in excess of his authority, and utilizes the same in paying off 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 absolve 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.

4. Partner's Authority in An Emergency (Section 21): According to **section 21**, 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 Admissions by A Partner (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.

Effect Of Notice to Acting Partner (Section 24)

The notice to a partner, who habitually acts in business of the firm, on matters relating to the affairs of the firm, operates as a notice to the firm except in the case of a fraud on the firm committed by or with the consent of that partner.

Thus, the notice to one is equivalent to the notice to the rest of the partners of the firm, just as a notice to an agent is notice to his principal. This notice must be actual and not constructive. It must be received by a working partner and not by a sleeping partner. It must further relate to the firm's business. Only then it would constitute a notice to the firm.

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. The only exception would lie in the case of fraud, whether active or tacit.

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 To Third Parties (Section 25 To 27)

The question of liability of partners to third parties may be considered under different heads. These are as follows:

1. Liability of A Partner for Acts of The Firm (Section 25): The partners are jointly and severally responsible to third parties for all acts which come under the scope of their express or implied authority. This is because that all the acts done within the scope of authority are the acts done towards the business of the firm.



The expression 'act of firm' connotes 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. Again, 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):

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.

If the act in question can be regarded as authorized and as falling within either of the categories mentioned in **Section 26**, the fact that the method employed by the partner in doing it was unauthorized or wrongful would not affect the question. Furthermore, 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 partner was also held responsible for the same.

3. Liability of Firm for Misapplication by Partners (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 be 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

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)

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:

(i) During the continuance of partnership, such transferee is not entitled:

- (a) to interfere with the conduct of the business,
- (b) to require accounts, or
- (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.

(ii) 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**, which we will discuss hereinafter, 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.

Minors Admitted to The Benefits of Partnership (Section 30)

You have observed that a minor cannot be bound by a contract because a minor's contract is void and not merely voidable.

Therefore, a minor cannot become a partner in a firm because partnership is founded on a contract. Though a minor cannot be a partner in a firm, he can nonetheless be admitted to the benefits of partnership under **Section 30** of the Act. In other words, he can be validly given a share in the partnership profits. When this has been done with the consent of all the partners then the rights and liabilities of such a partner 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.

Legal Consequences of Partner Coming in And Going Out (Section 31 - 35)

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:

(i) Introduction of a Partner (Section 31): As we have studied earlier, subject to a contract between partners and to the provisions regarding minors in a firm, no new partners can be introduced into a firm without the consent of all the existing partners.

Rights and liabilities of new partner: The liabilities of the new partner ordinarily commence from the date when he is admitted as a partner, unless he agrees to be liable for obligations incurred by the firm prior to the date. The new firm, including the new partner who joins it, may agree to assume liability for the existing debts of the old firm, and creditors may agree to accept the new firm as their debtor and discharge the old partners. The creditor's consent is necessary in every case to make the transaction operative. Novation is the technical term in a contract for substituted liability, of course, not confined only to case of partnership.

But a mere agreement amongst partners cannot operate as Novation. Thus, an agreement between the partners and the incoming partner that he shall be liable for existing debts will not ipso facto give creditors of the firm any right against him.

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.

(c) Minor cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the Official Receiver/Assignee (which means minor can recover his share in the firm on proportionate basis from 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 with regard to the firm. If he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

(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:

(i) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

(ii) 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:

(i) His rights and liabilities continue to be those of a minor up to the date of giving public notice.

(ii) His share shall not be liable for any acts of the firm done after the date of the notice.

(iii) He shall be entitled to sue the partners for his share of the property and profits. It may be noted that such minor shall give notice to the Registrar that he has or has not become a partner.

(ii) Retirement Of a Partner (Section 32): (1) 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.

(2) A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the reconstituted firm, and such agreement may be implied by a course of dealing between the third party and the reconstituted firm after he had knowledge of the retirement.

(3) Notwithstanding the retirement of a partner from a firm, he and the partners continue to be liable as partners to third parties for any act done by any of them which would have been an act of the firm if done before the retirement, until public notice is given of the retirement: Provided that a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

(4) Notices under **sub-section (3)** may be given by the retired partner or by any partner of the reconstituted firm.

In Vishnu Chandra Vs. Chandrika Prasad [Supreme Court]

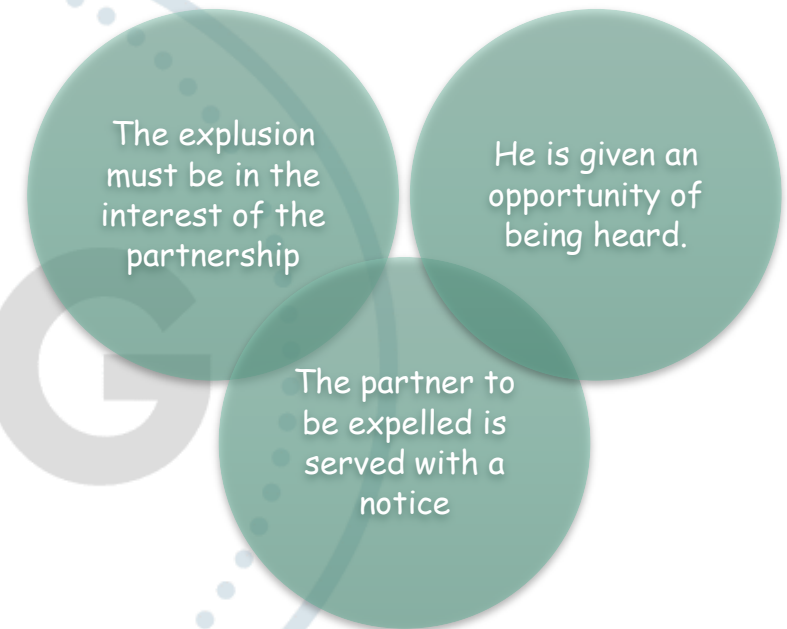
The Supreme Court in **Vishnu Chandra Vs. Chandrika Prasad**, held that the expression 'if any partner wants to dissociate from the partnership business', in a clause of the partnership deed which was being construed, comprehends a situation where a partner wants to retire from the partnership. The expression clearly indicated that in the event of retirement, the partnership business will not come to an end.

Example: Mere retirement of a partner, who was the tenant of the premises in which the partnership business was carried out, would not result in assignment of the tenancy rights in favour of the remaining partners even though the retiring partner ceases to have any right, title or interest in the business as such.

- (iii) Expulsion Of a Partner (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 bona fide interest of the business of the firm.

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



If a partner is otherwise expelled, the expulsion is null and void. It may be noted that under the Act, 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.

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.

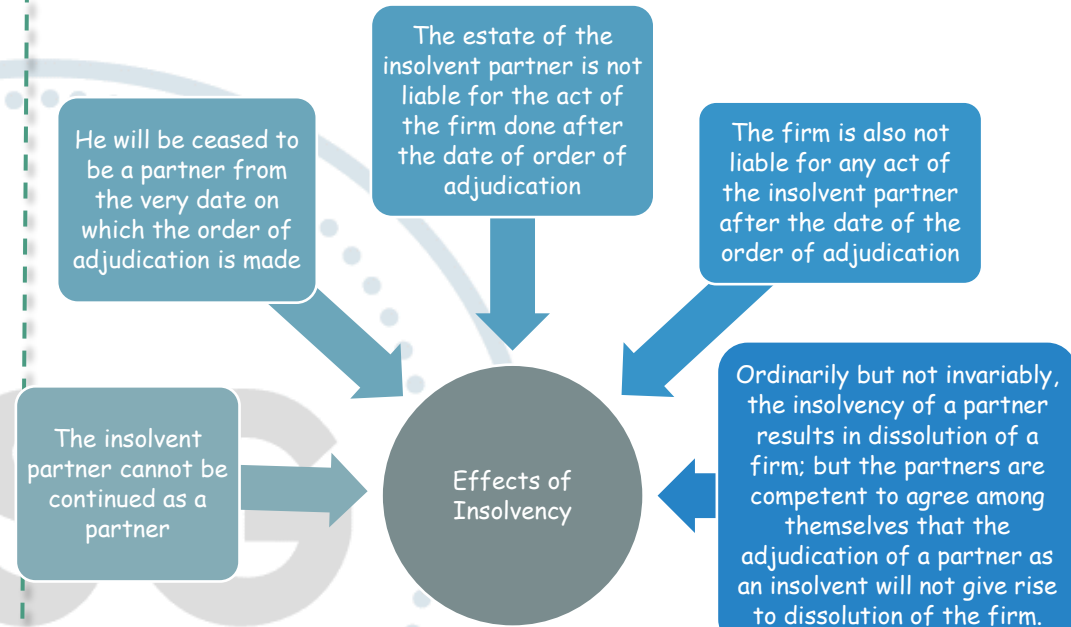
If all these conditions are not present, the expulsion is not deemed to be in Bonafede interest of the business of the firm.

Thus, according to the test of good faith as required under **Section 33(1)**, expulsion of Partner B is not valid. In this context, you should also remember that 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.

(iv) Insolvency Of a Partner (Section 34):

(1) Where a partner in a firm is adjudicated as an insolvent, he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is hereby dissolved.

(2) Where under a contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made.



(v) Liability Of Estate of Deceased Partner (Section 35): Ordinarily, the effect of the death of a partner is the dissolution of the partnership, but the rule in regard to the dissolution of the partnership, by death of partner is subject to a contract between the parties and the partners are competent to agree that the death of one will not have the effect of dissolving the partnership as regards the surviving partners unless the firm consists of only two partners.

(v) Liability Of Estate of Deceased Partner (Section 35): Ordinarily, the effect of the death of a partner is the dissolution of the partnership, but the rule in regard to the dissolution of the partnership, by death of partner is subject to a contract between the parties and the partners are competent to agree that the death of one will not have the effect of dissolving the partnership as regards the surviving partners unless the firm consists of only two partners. In order that the estate of the deceased partner may be absolved from liability for the future obligations of the firm, it is not necessary to give any notice either to the public or the persons having dealings with the firm.

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 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)

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- 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 Outgoing Partner In Certain Cases To Share Subsequent Profits (Section 37)

According to **section 37**, Where any member of a firm has died or otherwise ceased to be partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to 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 or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm:

Provided that whereby contract between the partners, an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, is not entitled to any further or other share of profits; but if any partner assuming to act in exercise of the option does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

Example: 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: 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.

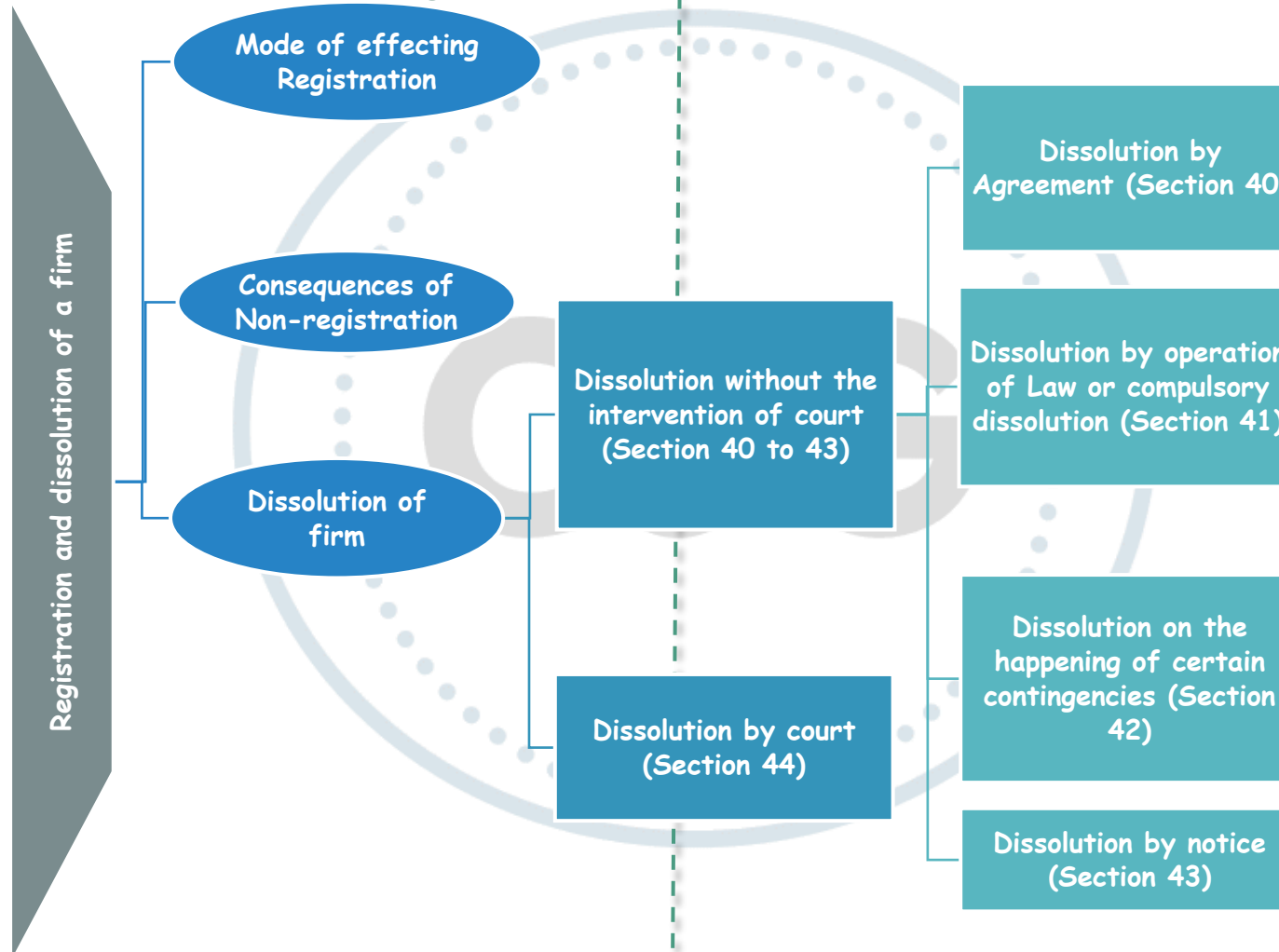
Revocation Of Continuing Guarantee By Change In Firm (Section 38)

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.

4

The Indian Partnership Act, 1932

Unit - 3: Registration and Dissolution Of A Firm



Registration Of Firms

Application For Registration (Section 58):

(1) The registration of a firm may be affected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating-



- | |
|---|
| (a) The firm's name |
| (b) The place or principal place of business of the firm, |
| (c) The names of any other places where the firm carries on business, |
| (d) the date when each partner joined the firm, |
| (e) the names in full and permanent addresses of the partners, and |
| (f) the duration of the firm. |

The statement shall be signed by all the partners, or by their agents specially authorised in this behalf.

(1) Each person signing the statement shall also verify it in the manner prescribed.

(2) A firm name shall not contain any of the following words, namely: -

Note: '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.

Registration (Section 59): 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. 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. Registration may also be affected even after a suit has been filed by the firm but in that case, it is necessary to withdraw the suit first and get the firm registered and then file a fresh suit.

Late Registration on Payment of Penalty (Section 59a-1):

If the statement in respect of any firm is not sent or delivered to the Registrar within the time specified in **subsection (1A) of section 58**, then the firm may be registered on payment, to the Registrar, of a penalty of one hundred rupees per year of delay or a part thereof.

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 firm's 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 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.
(ii) 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 ` 100 or pursue other proceedings to enforce the rights arising from any contract.
(iii) Aggrieved partner cannot bring legal action against another partner or the firm:	A partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. But such a person may sue for dissolution of the firm or for accounts and realization of his share in the firm's property where the firm is dissolved.
(iv) Third party can sue the firm:	In case of an unregistered firm, an action can be brought against the firm by a third party. 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.

	<ol style="list-style-type: none"> The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action. The right to sue or claim a set-off if the value of suit does not exceed ₹100 in value. The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for accounts of the firm or to realise the property of the firm.
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Example: A & Co. is registered as a partnership firm in 2017 with A, B and C partners. In 2018, A dies. In 2019, 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.

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 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 2019 B and C had taken a new partner, D, and then filed 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 (Sections 39 - 47)

According to Section 39 of the Indian Partnership Act, 1932, the dissolution of partnership between all partners of a firm is called the 'dissolution of the firm'.

Thus, the dissolution of firm means the discontinuation of the legal 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

Basis	Dissolution of Firm	Dissolution of Partnership
Continuation of business	It involves discontinuation of business in partnership.	It does not affect continuation of business. It involves only reconstitution of the firm.
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.
Order of court	A firm may be dissolved by the order of the court.	Dissolution of partnership is not ordered by the court.
Scope	It necessarily involves dissolution of partnership.	It may or may not involve dissolution of firm.

Final closure of books	It involves final closure of books of the firm.	It does not involve final closure of the books of the firm.
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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): Section 40 gives right to the partners to dissolve the partnership by agreement with the consent of all the partners or in accordance with a contract between the partners. 'Contract between the partners' means a contract already made.

(ii) Compulsory dissolution (Section 41):

A firm is compulsorily dissolved

- by the adjudication of all the partners or of all the partners but one as insolvent; or
- by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

However, when more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and 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-

- Where the firm is constituted for a fixed term, on the expiry of that term
- Where the firm is constituted to carry out one or more adventures or undertaking, then by completion thereof
- by the death of a partner, and
- by the adjudication of a partner as an insolvent.

(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) In case date is mentioned in the Notice: The firm is dissolved as from the date mentioned in the notice as the date of dissolution, or in case no date is so mentioned, as from the date of the communication of the notice.

2. Dissolution by The Court (Section 44):

Court may, at the suit of the partner, dissolve a firm on any of the following ground:

(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. Example: A, B and C are partners in a firm. A has severe infection and got typhoid. Due to this, he was not able to conduct business for few weeks. This kind of illness cannot be treated as the ground for dissolution.
(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. <u>Following comes in to category of breach of contract:</u> <ul style="list-style-type: none"> ➤ 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 due by the partner, the court may dissolve the firm at the instance of any other partner.
(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.

Consequences Of Dissolution (Sections 45 - 55)

Consequent to the dissolution of a partnership firm, the partners have certain rights and liabilities, as are discussed:

(a) Liability for acts of partners done after dissolution (Section 45):

Section 45 has two-fold objectives

1. It seeks to protect third parties dealing with the firm who had no notice of prior dissolution and
2. It also seeks to protect partners of a dissolved firm from liability towards third parties.

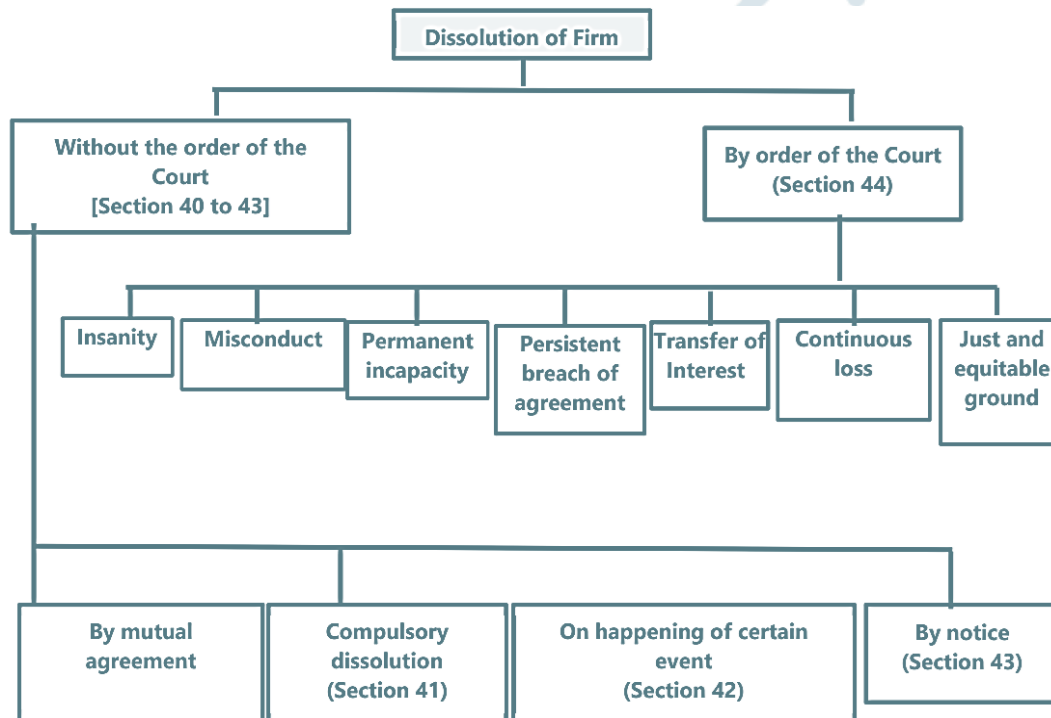
Example: X and Y who carried on business in partnership for several years, executed on December 1, a deed dissolving the partnership from the date, but failed to give a public notice of the dissolution. On December 20, X borrowed in the firm's name a certain sum of money from R, who was ignorant of the 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.

(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.



(b) 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.

(c) Continuing authority of partners for purposes of winding up (Section 47):

After the dissolution of a firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners, continue notwithstanding the dissolution, 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 the dissolution, but not otherwise:

Provided that the firm is in no case bound by the acts of a partner who has been adjudicated insolvent; but this proviso does not affect the liability of any person who has after the adjudication represented himself or knowingly permitted himself to be represented as a partner of the insolvent.

(d) Mode of Settlement of partnership accounts (Section 48):

In settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed:

(i) 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;

(ii) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, must be applied in the following manner and order:

(a) in paying the debts of the firm to third parties;

(b) in paying to each partner rateably what is due to him from capital;

(c) in paying to each partner rateably what is due to him on account of capital; and

(d) 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 6,60,000 to the capital of the firm and Y only 40,000. The assets amounted to 2,00,000. In such situation, the deficiency ($6,60,000 + 40,000 - 2,00,000$ i.e. 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.

(e) Payment of firm debts and of separate debts (Section

49): Where there are joint debts due from the firm and also separate debts due from any partner:

(i) the property of the firm shall be applied in the first instance in payment of the debts of the firm, and if there is any surplus, then the share of each partner shall be applied to the payment of his separate debts or paid to him;

(ii) 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.

