Partnership Fundamentals

1. **Section 4 of the Indian Partnership Act 1932** defines partnership as 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'.

2. Partnership, from the legal viewpoint, is **not a separate legal entity** from its partners which means partner's private assets can be used to pay off the firm's debts. In other words, partners have **Unlimited Liability**.

3. **Section 464** of the Companies Act empowers the Central government to prescribe the maximum number of partners but it cannot be more than 100.
   CG has prescribed **maximum partners to be 50** under Rule 10 of the Companies (Miscellaneous) Rules, 2014.

4. It can be oral or written. An oral agreement is equally valid as written.

5. The clauses of partnership deed can be altered with the consent of all the partners. The deed should be properly drafted and prepared as per the **provisions of the 'Stamp Act' and register with the Registrar of Firms.**

6. It is not mandatory to share the losses but profit sharing is mandatory.

7. Each partner in the partnership is the principal as well as agent for all other partners – Mutual Agency. Relationship of mutual agency is so important that one can say that there would be no partnership, if the element of mutual agency is absent.

8. Minor can be admitted only for the benefits of the firm i.e., to share the profits of the business only. Minor partner will not share the losses of the business.

9. LLP is an incorporated partnership formed and registered under the **Limited Liability Partnership Act, 2008** with limited liability of the partners. The Indian Partnership Act, 1932, shall not be applicable to Limited Liability Partnership

10. Provisions of Indian Partnership Act, 1932

When there is no agreement between the partners i.e., In the absence of Partnership Deed or if the partnership deed is silent or there is no oral agreement, then the provisions of Indian Partnership Act, 1932 shall apply

S.No.	Matters	Provisions of Indian Partnership Act,1932
1)	Sharing of profits/losses	To be shared equally by partners
2)	Interest on capital	No Interest on capital allowed
3)	Interest on drawings	No interest on drawings charged
4)	Interest on Loan by partner *(Loan given by Partner)*	6% p.a. is paid to the partners *(No interest if loan given by firm to partner)*
5)	Remuneration to partner	Not allowed to any partner
6)	Admission of partner	Consent of all the partners required

11. If a partner derives any profit for himself/herself from any transaction of the firm or from the use of the property or business connection of the firm or the firm's name, he/she shall account for the profit and pay it to the firm.

12. If a partner carries on any business of the same nature as and competing with that of the firm, he/she shall account for and pay to the firm, all profit made by him/her in that business.

13. Interest on capital is generally provided for in two situations:
(i) when the partners contribute unequal amounts of capitals but share profits equally, and
(ii) where the capital contribution is same but profit sharing is unequal.

14. **Under Fixed Method,** the partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital. The partners' current account on the other hand, may show a debit or a credit balance.

15. In case of Guarantee of Profits, following order is followed:
    a. Guarantee by partner to the firm
    b. Guarantee by firm to the partner
    c. Guarantee by partner to the partner

Valuation of Goodwill

16. Goodwill is an intangible Asset and not a fictitious asset.

17. **Valuation is Subjective**: Valuation of goodwill depends on the assumptions of the valuer so there is no one method to calculate the goodwill, the value depends on the valuer. Therefore, the method by which goodwill is to be calculated, may be specifically decided between all the partners.

18. As per Accounting Standard 26:
    a. Purchased goodwill is recorded in the books and not self-generated goodwill.
    b. Purchased goodwill should be written off as early as possible, but where it is to be written- off in more than one accounting year, it should be written off in a period not exceeding 10 years.

19. Average Profit method is based on the assumption that a new business will not be able to earn any profits during the first few years of its operations.

20. Weighted Average profit method is used when there is an increasing or decreasing trend in the profits.

21. **It is desirable to value goodwill on the basis of the excess profits and not the actual profits.**
*The excess of actual profits over the normal profits is termed as '**super profits**'*

Admission of a Partner

22. According to the **Section 31 of Indian Partnership Act 1932** unless it is otherwise provided in the partnership deed a new partner can be admitted only when the existing partners unanimously agree for it.

23. After admission, the new partner gets the following two rights:
    a. Right to share the future profits of the firm, for which he/she brings share of Goodwill
    b. Right to share in the assets of the firm, for which he/she brings Capital

24. The following categories of individuals cannot be admitted as a new partner:
    a. Persons of unsound mind/Lunatic persons
    b. Insolvent persons
    c. Any other person who has been disqualified by law

Retirement/Death of a Partner

25. A partner may retire from the firm:
    a. If there is an agreement to that effect, or
    b. In case of no agreement, if all the partners given consent to the retirement, or
    c. If the partnership is at will (No fixed period), by giving a written notice to the remaining partners of his decision to retire.

26. Liability of a Retiring Partner:
    a. <u>Acts done before Retirement</u>: Retiring partner remains liable for all the acts of the firm, conducted before his/her retirement. However, retiring partner may be discharged from his/her liability by an agreement between him/herself, third party and the continuing partners.
    b. <u>Acts after the retirement</u>: A retiring partner continues to be liable to the third parties for the acts of the firm even after retirement until a **public notice** of retirement is given.

27. The outgoing partner's account is settled as per the terms of partnership deed i.e., in lumpsum immediately or in various instalments *with or without interest* as agreed or partly in cash immediately and partly in instalment at the agreed intervals.

28. In the absence of any agreement, **Section 37 of the Indian Partnership Act, 1932** is applicable, which states that the outgoing partner has an option to choose from the following:
    a. Interest @ 6% p.a. from the date of retirement till the date of payment
    b. Share of profit which has been earned with his/her money
    Share in Profit = (Outstanding balance of outgoing partner/ Capital of all the partners + balance of outgoing partners) * profit earned from the date of retirement/death.

Dissolution of Partnership Firm

29. Dissolution of the firm necessarily brings in dissolution of the partnership. However, dissolution of partnership would not necessarily involve dissolution of firms.

30. Modes of Dissolution of a Firm

Dissolution of a firm takes place in any of the following ways:

a. **Dissolution by Agreement:** A firm will be dissolved if all the partners agree to dissolve the firm or as per the terms of partners agreement.
b. **Compulsory Dissolution:** A firm is dissolved compulsory in the following cases:
    i. When all the partners or all excepting one partner becomes insolvent or of unsound mind.
    ii. When the business becomes unlawful or illegal
    iii. When all the partners excepting one decide to retire from the firm
    iv. When all the partners or all excepting one partner died.
c. **On happening of an Event:** A firm can also be dissolved on happening of the following events, if the partnership agreement so provides:
    i. If the partnership was formed for a fixed period and that term has expired,
    ii. If the partnership was formed to complete one or more ventures and those ventures are completed
    iii. On the death of a partner
    iv. If one of the partners is adjudicated as insolvent.
d. **By Notice:** In case of partnership at will, the firm may be dissolved if any one of the partners gives a notice in writing to the other partners.
e. **Dissolution by Court:** At the suit of a partner, the court may order a partnership firm to be dissolved on any of the following grounds:
    i. When a partner or partners becomes of unsound mind
    ii. When a partner or partners becomes permanently incapable of performing his/her duties as a partner
    iii. When the business of the firm cannot be carried on except at a loss
    iv. When a partner is guilty of misconduct which is likely to adversely affect the business of the firm
    v. When a partner persistently commits breach of partnership agreement;
    vi. When a partner has transferred the whole of his interest in the firm to a third party;
    vii. When, on any ground, the court regards dissolution to be just and equitable.

31. Difference between Dissolution of Firm and Dissolution of Partnership

Basis	Dissolution of Firm	Dissolution of Partnership
Termination of Business	The business of the firm is closed	The business is not terminated
Settlement of Assets & Liabilities	Assets of the firm are sold and liabilities are settled and if any balance remains then it is shared between the partners	Assets & Liabilities are revalued and new balance sheet is revalued.
Court's Intervention	A firm can be dissolved by the court's order.	Court does not intervene because partnership is reconstituted by mutual agreement.
Economic Relationship	Economic relationship between the partners comes to an end.	Economic relationship between the partners continues in a changed form.
Closure of books	The books of accounts are closed	Does not require because the business is not terminated.

32. As per **section 48** of the Indian Partnership Act, 1932:

***Application of Assets**:* The assets of the firm, including any sum contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

i. In paying the debts of the firm to the third parties (Secured creditors are paid first and then unsecured creditors)

ii. In repaying the partners' loan or advances (in case the balance amount is not adequate enough to pay off such loans and advances, they are to be paid proportionately)

iii. In paying to each partner proportionately what is due to him on account of capital

iv. the residue, if any, shall be divided among the partners in their profit- sharing ratio

33. Payment of Firms' Debts and Private Debts (Section 49)

Firms' Debts – Debts which the firm owes to the outsiders

Private Debts – Debts which a partner owes in his personal capacity

Following rules as mentioned in Section 49 of Indian Partnership Act, 1932, shall apply:

a. Property of Firm - The property of the firm shall be applied first in the payment of debts of the firm and then the surplus, if any, shall be divided among the partners as per their claims, which can be utilized for payment of their private liabilities

b. Private Property of Partners - The private property of any partner shall be applied first in payment of his private debts and the surplus, if any, may be utilized for payment of the firm's debts, in case the firm's liabilities exceed the firm's assets.

Note: It may be noted that the private property of the partner does not include the personal properties of his wife and children. Thus, if the assets of the firm are not adequate enough to pay off firm's liabilities, the partners have to contribute out of their net private assets (private assets minus private liabilities).