

IV

U N I T

INDIAN PARTNERSHIP ACT, 1932

nikhila.jr.05@gmail.com 10/10/2024
13:00
TAMMANN



1

CHAPTER

GENERAL NATURE OF A PARTNERSHIP

LONG ANSWER QUESTIONS:

Q.1 Define Partnership. Discuss the essential elements of Partnership.

[Dec. 2021, 3 + 3 = 6 Marks]

Ans. Section 4 of the Indian Partnership Act, 1932, lays down that “*Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all.*”

All the following elements must be present if an association of persons is to be called a partnership:

1. Association of two or more persons

There must be at least two persons to form a partnership. As far as the maximum number of partners, in a firm is concerned, the Partnership Act is silent. However, Section 464 of the Indian Companies Act, 2013 lays down that where the firm is carrying any business, the number of partners should not exceed 50 (It can be increased upto 100). If the number of maximum partners exceeds this limit, the partnership becomes an illegal association of persons.

2. Agreement between persons

According to Section 5 of the Indian Partnership Act, the relation of *partnership arises from contract and not from status*. Thus, the members of a Hindu Joint Family carrying on a business, or the co-owners of a business are not ‘partners’ because HUF and co-ownership are created by operation of law and not by contract. The agreement of partnership may be expressed or implied.

3. Business

Partnership can be formed only for the purpose of carrying on some business. **Section 2(b) of Partnership Act says that the term ‘business’ includes every trade, occupation or profession.** Thus, an association created primarily for charitable, religious and social purposes is not regarded as partnership.

4. Sharing of Profits

The division of profits is an essential condition of the existence of a partnership. The sharing of profits is only a *prima facie* evidence of the existence of partnership, and this is not the conclusive test of it.

5. Business carried on by all or any of them acting for all. (Mutual Agency)

The underlying or cardinal principle which governs partnership is the mutual agency relationship amongst the partners. It means each partner is the agent of the firm as well as of the other partners. The business of the firm may be carried on by all the partners or by any of them acting for all. Thus, a partner is both an agent and a principal. He can bind the other partners by his acts and is also bound by the acts of the other partners. The law of partnership is regarded as an extension of the general law of agency.

Q.2 “The true test of partnership is mutual agency”. Comment. What are the instances of non-partnership interests ? [MTP Nov. 2019]

OR

‘Whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm’. Explain the mode of determining existence of partnership as per the Indian Partnership Act, 1932.

OR

What is the conclusive evidence of Partnership ? State the circumstances when partnership is not considered between two or more parties.

[May 2018, 4 Marks] [May 2019, 4 Marks]

OR

“Sharing in the profits is not conclusive evidence in the creation of partnership”. Comment. [Dec. 2021, 4 Marks]

Ans. According to Sec. 4, there are 4 essential elements of partnership:

1. That it is the result of an agreement, between two or more persons.
2. That it is formed to carry on a business.
3. That the persons concerned agree to share the profits of the business.
4. That the business is to be carried on by all or any of them acting for all.

Further According to **Sec. 6 in determining whether a group of persons is or is not a firm or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.**

If all the relevant facts taken together show that all the four essential elements are present, the group of persons doing business together will be called a partnership.

The relevant factors to be considered for determining whether there is partnership are the conduct of parties, the mode of doing business, who controls the property, the mode of keeping accounts, correspondence, the manner of distribution of profits, etc. of the four elements, the third element, viz., sharing of profits is important but not conclusive. In the following cases there is no partnership even though there is sharing profits:

- (a) A creditor taking a share of profits in lieu of interest and part-payment of principal.
- (b) An employee getting a share of profits as remuneration.
- (c) Share of profits given to workers as bonus.
- (d) Share of profits given to the widow or children of deceased partners as annuity.
- (e) Share of profits given to a previous owner of the business as the consideration for the sale of the goodwill.

In all the above cases the fourth essential element of partnership viz., mutual agency, is absent. A creditor or any employee, or the widow and children of deceased partners cannot bind the firm by any act done on behalf of the firm. Only those who have authority to bind the firm by their actions can be called partners. Thus, the *most important test of partnership is agency and authority*. This is the cardinal principle of partnership law. If this element of mutual agency is absent, then there will be no partnership.

SHORT QUESTIONS:

Q.3 "Partnership arises from contract and not from status." Comment.

Ans. "Partnership arises from contract and not from status".

That partnership is the result of a contract and cannot arise by status is sufficiently emphasised by section 4 itself by use of the words "partnership is the relation between the persons who have agreed to share the profits of a business". It is clear from the definition that the partnership is of contractual nature. It springs from an agreement. The same point is further stressed by the opening words of Section 5 that the relation of partnership arises from contract and not from status.

Thus if on the death of the sole proprietor of a business the legal heirs decide to continue to carry on the business, they cannot be called as partners because there is no agreement between them. Similarly members of Joint Hindu Family business carrying on a family business cannot be treated as partners because a person becomes the member of the business by birth and not by agreement. Sec. 5

On the death of a partner, his legal heirs do not automatically become the partners of the firm. If the surviving partners agree to admit the legal heirs into partnership, then a fresh agreement to that effect will have to be made. Thus

from the above it is clear that partnership always arises out of a contract and not from status.

Q.4 What are the types of partnerships, under the Indian Partnership Act, 1932 ? [Jan. 2021, 2 Marks]

OR

What do you mean by 'Partnership for a fixed period' as per the Indian Partnership Act, 1932? [June 2022, 2 Marks]

Ans. Partnership can be classified as below:—

1. Partnership at will (Sec. 7)

A partnership is called a partnership at will—

- (i) When the partnership is not for a fixed period of time and
- (ii) When no provision is made as to when and how the partnership will come to an end.

If either of these provisions exist, it is not partnership at will. The essence of partnership at will is that it is open to either partner to dissolve the partnership by giving notice in writing to all other partners.

The firm is then dissolved from the date mentioned in the notice as the date of dissolution, and if no such date is mentioned, then from the date of the communication of the notice (Sec. 43)

If a partnership is to be dissolved by mutual agreement only, then it will not be a partnership at will.

2. Particular partnership (Sec. 8)

A particular partnership is one which is formed for a particular adventure or a particular undertaking. Such a partnership is usually dissolved on the completion of the adventure or undertaking. For example, forming a partnership for construction of a bridge.

3. Partnership for a Fixed period

Where a provision is made by a contract for the duration of the partnership, the partnership is called as a partnership for a fixed period. Such partnership comes to an end after the expiry of the fixed period.

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 particular partnership, the liability of the partners extends only to that particular adventure or an undertaking but it is not so in case of a general partnership.

Q.5 What constitutes Partnership Property under the provisions of the Indian Partnership Act, 1932?

Ans. What constitutes a partnership property, depends upon the agreement between the partners. It is open to the partners to agree among themselves as to what is to be treated as the property of the firm and what is to be separate property of one or more partners. They can convert by mutual agreement,

partnership property into separate property of an individual partner and *vice versa*. In the absence of any such agreement, the property of the firm according section 14, means—

- (i) property originally brought into the common stock of the firm by the partners;
- (ii) property acquired in the course of the business with money belonging to the firm;
- (iii) the goodwill of the firm.

Unless the contrary intention appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm.

Subject to contract between partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business.

Q.6 Who can become a partner in a firm ?

Ans. According to the definition of partnership in section 4, a partnership is an agreement. All those persons who are competent to contract can become partners. As per section 11 of Contract Act, a person is competent to contract if he is a major, of sound mind and is not disqualified from contracting by any law. Thus a partner must fulfil the conditions of section 11. However, a minor u/s 30 of the Partnership Act, can be admitted to the benefits of the partnership firm with the consent of all the partners.

Q.7 What is a Partnership deed? State the contents, contained therein.

[MTP & RTP, Nov. 2018]

[MTP, May 2018, MTP Nov. 2020]

Ans. Partnership is created out of an agreement which may be oral or written. However it is advisable to have the partnership agreement in writing to avoid future disputes. The document containing the terms and conditions as to the relationship of partners to each other is called a partnership deed. It should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899.

The partnership deed usually contains provisions relating to the following :—

- (a) Name of the firm,
- (b) Duration of partnership,
- (c) Nature of business,
- (d) Place where business is to be carried on,
- (e) Capital brought in by each individual partner,
- (f) Property of the firm,
- (g) Proportions of profits and losses of each partner,
- (h) Rights and duties of partners,

- (i) Provisions for accounts, audit, keeping of account books,
- (j) Drawings by partners and specially by a working partner,
- (k) Dissolution of the firm,
- (l) Retirement of a partner,
- (m) Settlement of accounts, division of assets, profits etc., upon dissolution,
- (n) Arbitration clause in case of dispute.

Q.8 Who is a nominal partner under the Indian Partnership Act, 1932? What are his liabilities ? [Jan. 2021, 2 Marks]

Ans. Nominal Partner: A nominal partner is one who lends his name to the firm without having any real pecuniary interest in the business of the firm. He neither contributes capital nor does he share the profits/losses of the firm. He does not even take part in the conduct of the business of the firm. However he shall be liable to the third parties for all the acts of the firm, just like the rest of the partners. He shall also be bound to give a public notice of his retirement from the firm in order to free himself from the liability for the future acts of the firm, done after his retirement.

Q.9 Who is a partner by holding out?

Ans. A partner by holding out is a person who is not actually a partner in the firm, but allows himself to be represented as a partner of the firm. Such a person shall be held liable as a partner by a third party who acts on the faith of such a representation & enters into a contract with the firm. A partner by holding out will be held liable for the debts of the firm incurred to the third party on the faith of this false representation that he was actually a partner in the firm. A partner by holding out has no right in the firm.

Q.10 Who is a partner by estoppel ?

Ans. When a person represents himself as a partner of a firm through his conduct or behaviour, when he is actually not a partner, then such a person is regarded as a partner by estoppel. Such a person shall be liable for all the contracts entered into by the third parties with the firm, on the faith of such representation. Such a person shall be stopped from denying his being a partner in the firm, in the event of devolution of liability. Further a partner by estoppel has no rights in the firm, in the capacity of a partner.

DIFFERENCES:

Q.11 Differentiate between the following:—

- (i) Partnership & Company
- (ii) Partnership & HUF
- (iii) Partnership & Co-ownership

[RTP, May 2018],
[Dec. 2022, 4 Marks]

Ans. (i) Distinction between Company & Partnership Firm

Basis	Company	Partnership Firm
1. Formation	A company comes into existence only after registration under the Companies Act.	A partnership is formed by mutual agreement of all the partners. Registration is not compulsory.
2. Legal Status	A company has a separate legal entity distinct from its members.	A partnership is collection of individuals. It does not have a separate legal entity.
3. Number of Members	(i) The minimum number of persons required to form a company is 2 for private company (other than One Person Company) and 7 for public co. (ii) There is no maximum limit to the number of members in the case of public company. A private company cannot have more than 200 members.	(i) The minimum number of persons required to form a partnership is 2. (ii) As per Companies Act, 2013 the number of partners in a partnership firm carrying on any business should not exceed 50 persons. (limit as currently prescribed)
4. Liability of Members	The liability of the members is limited.	The liability of partners is unlimited.
5. Agency of Members	A shareholder is not an agent of the company nor he is agent of other shareholders.	Every partner is the agent of the firm and his partners for the purposes of the business of the firm.
6. Transfer of shares	Shares can be transferred without the consent of other members. In a private company there are restrictions on transfer of shares.	No partner can transfer his share or interest in the firm without the consent of his co-partners.
7. Stability	A company has perpetual succession. The death or insolvency of a member does not affect its existence.	A partnership comes to an end on the death and insolvency of its partners.
8. Management	There is separation of ownership from management. The shareholders do not actually take part in the management of the company. The Board of Directors manage the company.	A partnership firm is managed by partners themselves.
9. Powers	The general powers of the company are regulated by Memorandum of Association. It is difficult to change the objects.	The partnership agreement (deed) regulates the mutual rights and duties of partners only.
10. Statutory Obligations	A company is required to comply with various statutory obligations. Such as compulsory audit, the	A partnership firm is not required to comply with any such statutory obligation.

Basis	Company	Partnership Firm
	holding of the meetings, the keeping of proper account books and registers, filing of annual returns etc.	
11. Interest	A member has no interest in the assets of the company.	A partner has an interest in assets of the partnership.

(ii) **Distinction between Partnership and Joint Hindu Family.**

There are some common features in partnership and Joint Hindu Family. Both are forms of business organization and there is sharing of profits. The important points of distinction are :—

1.	<i>Mode of creation</i>	The partnership is created by agreement, whereas joint family is established by law. A person becomes a member of a joint family by birth.
2.	<i>Death</i>	Death of a partner brings about dissolution of partnership. But the death of a member of a Joint Hindu Family does not give rise to dissolution of the family business. HUF has continuity till its partition.
3.	<i>Mutual Agency</i>	In a partnership, every partner can bind the firm by his acts. However, in HUF, only the Karta has the authority to contract on behalf of HUF.
4.	<i>Management</i>	In a joint family, only Karta has the right to manage the business. In partnership, all the partners have the right to take part in the management of the firm. Note: The amendment in the Hindu Succession Act, 2005, entitled all adult members, whether male or female, to become coparceners in a HUF. They enjoy equal rights of inheritance due to this amendment. On 1st February, 2016, Justice Najmi Wazari, in a judgment allowed the eldest female coparcener of an HUF to become the Karta.
5.	<i>Liability</i>	The liability of partners in a partnership concern is unlimited, joint and several. The liability of members of a joint Hindu family except the Karta is limited only to the extent of their share in the business of the family.
6.	<i>Calling for accounts</i>	On the partition of joint family a member is not entitled to ask for the accounts of the family business. But a partner can bring a suit against the firm for account on the dissolution of the firm.
7.	<i>Registration</i>	Registration of partnership is essential for the maintenance of suits both against the partners as well as outsider but a joint family business need not be registered at all.
8.	<i>Number of members</i>	In a partnership the number of partners is limited to 50, but in the case of joint family business there is no such restriction.
9.	<i>Minor's position</i>	A minor can be a member of a Hindu joint family, but a minor cannot be a partner in a firm. However, he can be admitted to the benefits of partnership with the consent of all the partners.

10.	<i>Governing Law</i>	A partnership is governed by the Indian Partnership Act, 1932, while joint Hindu family is governed by Hindu Law.
11.	<i>Share in Business</i>	Share in a partnership is defined by an agreement between partners. However, in HUF, share of coparceners is not definite. His interest is fluctuation which is capable of being enlarged by deaths in the family and diminished by births.

(iii) Distinction between Partnership and Co-Ownership.

Co-ownership's like joint purchasers, co-tenants, co-heirs are different from partnerships. Co-owners may share profits, by virtue of their status and not by virtue of a contract; One co-owner is not the agent of other co-owner; co-owner may transfer his shares to a stranger but a partner cannot do so. The following are the points of distinction:

1. Formation

Partnership always arises out of contract. Co-ownership may arise either from agreement or by the operation of law, such as by inheritance.

2. Sharing of profits

In a partnership, profit must have to be shared, but in the case of a co-ownership, it does not necessarily involve sharing of profits.

3. Agency

In a partnership, a partner is the agent of the other partners, but in the case of co-ownership, a co-owner is not the agent of other co-owners.

4. Lien

A partner has a lien on the partnership property for outlay or expenses or a loan advanced to the firm, whereas a co-owner has no such lien.

5. Transfer of interest

A share in the partnership may be transferred only with the consent of all other partners. Co-owner may transfer his interest in the property without the consent of other co-owners.

CASE STUDIES:

Q.12 R is not a partner in a particular firm. But, he represents himself or knowingly permits himself to be represented as a partner of that particular firm to Sanjay, who on the faith of such representation gives credit to the firm. Is R liable as a partner in the firm?

Ans. Partner by estoppel/holding out is one represents himself or knowingly permits himself to be represented as a partner in a firm, where in fact he is not as such a partner. When a third party on the faith of such a representation contracts with the alleged firm, then such a person shall be held liable as a partner by estoppels/holding out, to such a third party.

In the given case R, not being a partner, represents himself/knowingly represents himself to be a partner in the firm and Sanjay on the faith of such representation gives credit to the firm.

Thus applying the above stated provisions R shall be regarded as a Partner by estoppels/holding out and he shall be liable in respect of this contract.

Q.13 A, B and C are partners in a firm carrying on money leading business. D, a customer, deposits his jewellery with the firm for safe custody. A and B sell this jewellery and misappropriate the money C, being a sleeping partner, have no knowledge about this sale. Now, D files a suit against all the three partners. Can C be held liable? Give reasons.

Ans. According to the provisions of the Indian Partnership Act, 1932, a sleeping or a dormant partner shall have the same liabilities as the active partners, even though he does not take part in the conduct of business of partnership firm. Thus a dormant partner shall be liable for the acts of the firm to the third parties.

In the given case, A, B, the other partners of the firm have misappropriated the jewellery received by them from their customer D, in the ordinary course of conduct of business of the firm.

Thus applying the above stated provisions, D is rightfully entitled to sue all the three partners, including Mr. C, the dormant partners, irrespective of the fact that he had no knowledge of such misappropriation.

Q.14 Ratan Tata, a retired businessman of repute, assumed the honorary presidentship of the business of XYZ & Associates, a partnership firm, carrying on the business of trading in steel pipes, on the request of the partners. Mr. Warren Buffet lent a sum of ₹ 50,00,000 to the firm, relying on Ratan Tata's association with the firm. Later the firm defaulted in repayment of the loan. Warren Buffet decides to sue Ratan Tata & the other partners. Comment on the validity of his decision in the context of the provisions of the Indian Partnership Act, 1932.

Ans. When a person by his express words or conduct represents himself to be a partner in the firm, where in fact he is not as such a partner then if a third party on the faith of such representation contracts with the alleged firm, then such a person shall be held liable as partner by holding out to such a third party.

In the given case Ratan Tata assumes the honorary presidentship of XYZ & Associates and thereby, his conduct, represents himself as a partner in the said firm. Warren Buffet lends a sum of ₹ 50,00,000 relying on this representation.

Therefore applying the above stated provisions it can be concluded that Ratan Tata will be regarded as a Partner by Holding out despite holding honorary presidentship and shall be held liable along with the other partners by Warren Buffet. Thus the action actions of Warren Buffet are legal & valid under the provision of the Indian Partnership Act, 1932.

Q.15 Anand and Ravi are carrying on business in partnership. In the partnership deed it is provided that neither of the partners should borrow money except with the consent of both. Anand borrowed a sum of ₹ 10,000 from Suresh for the business of the firm without the consent of Ravi. Is the firm liable? Give reasons for your answer.

Ans. According to the provisions of the Indian Partnership Act, 1932, a firm shall be bound by the acts of a partner done within the scope of his implied authority provided the following conditions are satisfied:

- ◆ The act must be done in the name of the firm
- ◆ The act must be performed by a partner of the firm in the capacity of partner acting within the scope of his apparent authority
- ◆ The act must relate to the ordinary course of business of the firm
- ◆ The act must be done in the usual way.

If an act is so performed then it shall be binding on the firm. Further if the act falls beyond the scope of the partner's real authority, on account of restrictions imposed on his authority by virtue of the partnership deed, the act shall be binding on the firm, provided the third party had no knowledge of the restrictions & had acted in a *bona fide* manner.

Thus in the give case firm shall be liable for the amount borrowed by Anand from Suresh for the business of the firm even though the deed expressly provides for the exercise of borrowing power only with the consent of both the partners, provided Suresh had no knowledge of the terms of the deed in this respect.

Q.16 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. Advice Z whether he can recover the amount from X and A under the Indian Partnership Act, 1932. [RTP Nov. 2019]

Ans. Hint: A partner by holding out is one who is not actually a partner in the firm, but allows himself to be represented as a partner in the firm. Such a person shall be liable to third party who contracts with the firm on the faith of such representation.

A is a partner by holding out and Z, the third party who contracted with the firm on the faith of such representation can sue both X & A for the recovery of price.

Q.17 State whether the following are partnerships:

- (i) A and B jointly own a car which they used personally on Sundays and holidays and let it on hire as taxi on other days and equally divide the earnings.
- (ii) Two firms each having 12 partners combine by an agreement into one firm.
- (iii) A and B, co-owners, agree to conduct the business in common for profit.
- (iv) Some individuals form an association to which each individual contributes ₹ 500 annually. The objective of the association is to produce clothes and distribute the clothes free to the war widows.
- (v) A and B, co-owners share between themselves the rent derived from a piece of land.
- (vi) A and B buy commodity X and agree to sell the commodity with sharing the profits equally.

[Dec. 2021, 6 Marks]

Ans. (i) No: In case of partnership, 2 or more persons carry on a common lawful business as mutual agents, to share profits & losses arising therefrom. Sharing of earnings arising out of a jointly owned property does not amount to partnership.

Thus the given arrangement, where A & B jointly own a car and equally divide the hire earnings, does not amount to partnership.

(ii) No: Formation of partnership requires an association between 2 or more persons who are recognized by law. Two partnership firms cannot combine to form one firm, since firm does not have a separate entity & therefore firms cannot enter into partnership. However the partners of two firms are competent to enter into partnership.

Thus in the given case there is no partnership as two firms cannot agree to combine to form one firm.

(iii) Yes: When 2 or more persons agree to carry on a common business, acting as mutual agents, with a view to share profits & losses arising therefrom then such an agreement amounts to partnership.

Thus in this case where A & B who are co-owners, agree to conduct business in common to share profits, it amounts to partnership, provided, they have mutual agency.

(iv) No: Partnership is formed for the purpose of carrying on a common lawful business and sharing profits & losses arising therefrom. Thus partnership cannot be formed for the purpose of carrying on charitable activities.

Thus the association formed for the objective of producing clothes & distribute the same free of cost to war widows, is not partnership.

(v) No: Co-ownership does not amount to partnership. Co-owners can share the income arising from their jointly owned assets, but that does not necessarily make them partners, since the essential of mutual agency is missing.

Thus A & B, co-owners who are sharing rent from a plot of land co-owned by them, are not partners and this association does not amount to partnership.

(vi) Yes: A partnership is formed by 2 or more persons for the purpose of carrying on a common lawful business as mutual agents and sharing profits & losses arising therefrom. However for an activity to be classified as business there must be regularity of transactions.

Thus the agreement between A & B to buy and sell X commodity with a view to share profits will be classified as partnership provided there is a regularity of transactions so as to constitute business.

nil 1 "jr" 005 @g' ail.cc 101-0. -1102 1
13 TAXMANN



RELATIONS OF PARTNERS

LONG ANSWER QUESTIONS:

Q.1 Explain the rights of a partner, under the Indian Partnership Act, 1932.

OR

What are the rights of partners with respect to conduct of the business of a firm as prescribed under the Indian Partnership Act, 1932?

[June 2023, 4 Marks]

Ans. Rights of partners

Subject to contract between the partners, the Partnership Act confers the following rights upon the partners of a firm:

1. Right to take part in the conduct of the business [Sec.12(a)]

Every partner has a right to take part in the conduct of the business of the firm. The partners among themselves, may agree to entrust the work of management to one or more of them.

2. Right to be consulted [Sec.12(c)]

Every partner has a right to be consulted and heard before any matter is decided. Ordinary matters may be decided by majority opinion but matters of fundamental nature would require unanimity.

The matters which are to be decided by unanimous consent of all the partners are discussed below :—

(i) *Nature of business [Sec. 12].*

(ii) *Admission of a partner [Sec. 31(1)] .*

(iii) *Transfer by a partner of his interest in the firm [Sec. 29].*

(iv) *Admission of a minor to the benefits of partnership [Sec. 30(1)].*

3. Right to access to books [Sec.12(d)]

Every partner has a right to have access, to inspect and copy any of the records and books of the firm.

4. Right to share the profits [Sec. 13(b)]

Every partner has right to share equally in the profits earned and to contribute equally to the losses sustained by the firm. This provision

is irrespective of the amount of capital contribution made or business expertise offered. However, they may agree to share the profits in some other ratio.

5. *Right to interest on Capital [Sec. 13(c)]*

Every partner has right to interest on capital, if so agreed, out of profits only.

6. *Right to interest on advances [Sec. 13(d)]*

A Partner is entitled to receive interest at 6% p.a. on any advance, in excess of the agreed amount of capital, made for the purposes of the business.

7. *Right to indemnity [Sec. 13(e)]*

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

8. *Right to prevent the introduction of new partner [Sec. 31(1)]*

Every partner is entitled to prevent the admission of a new partner into the firm.

9. *Right to retire [Sec. 32(1)]*

A partner to retire from the firm (a) with the consent of all other partners, or (b) in accordance with the terms of the deed, or (c) by giving a notice to all other partners, of his intention to retire.

10. *Right not to be expelled [Sec. 33]*

Every partner has right to continue in the partnership and not to be expelled from the firm.

11. *Right to carry on competing business after retirement [Sec. 36(1)]*

Every outgoing partner has a right to carry on a competitive business under certain conditions.

12. *Right to dissolve the firm [Sec. 43]*

Where the partnership is at will, the firm may dissolve by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

Q.2 What are the duties conferred on the partners under the Indian Partnership Act, 1932 ?

Ans.

1. *General Duties of Partners:*

Section 9 of Partnership Act lays down that all the partners are bound:

- (i) to carry on the business of the firm to the greatest common advantage,
- (ii) to be just and faithful to each other, and

(iii) to render to any partner or his legal representative the true accounts and

(iv) to render full information of all things affecting the firm.

2. Duty to indemnify for loss caused by fraud:

According to Section 10 of Partnership Act, every partner shall indemnify (reimburse or pay back) the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

3. Duty to attend diligently to his duties [Sec. 12(b)]:

Every partner is bound to attend diligently to his duties in the conduct of the business.

4. Duty to work without remuneration [Sec. 13(a)]:

A partner is normally not entitled to receive any remuneration for taking part in the business of the firm. However if the partnership agreement provides or business custom allows, a partner can be given remuneration.

5. Duty to contribute to the losses [Sec. 13(b)]:

The partners shall contribute equally to the losses sustained by the firm without regard to the capital contribution made by the firm.

6. Duty to indemnify for wilful neglect [Sec. 13(f)]:

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

7. Duty to use firm's property exclusively for the firm [Sec. 15]:

Subject to contract between the partners, the property of the firm shall be held exclusively for the purposes of the business of the firm.

8. Duty to account for personal profits derived [Sec. 16(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 in the firm's name, he shall account for that profit and pay it to the firm.

9. Duty not to compete with the business of the firm [Sec. 16(b)]:

No partner can carry on a business which is competing with that of the firm without the consent of the other partners, otherwise the partner carrying on such a business will have to account for and pay to the firm all profits made by him in that business.

10. Not to assign (transfer) his interest in the firm [Sec. 29]:

It is the duty of a partner not to assign his interest in the firm to a stranger (outsider) without the consent of all other partners.

Q.3 What is meant by “implied authority”? What are the statutory restrictions on implied authority as stipulated in the Indian Partnership Act, 1932 ?

OR

In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do certain acts. State the acts which are beyond the implied authority of a partner under the provisions of the Indian Partnership Act, 1932.

[MTP Nov. 2018, RTP May 2019], [July 2021, 6 Marks]

Ans. Meaning of implied authority

Meaning of Implied Authority: The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied. Where the authority to a partner to act is expressly conferred by an agreement it is called express authority. It is implied when the law presumes certain powers exercisable by every partner unless negated by a contract to the contrary.

According to Sec.19(1) of the Act, “the act of a partner which is done to carry on, in the usual way business of the kind carried on by the firm ” is called Implied Authority of partner. It is subject to the following 3 conditions:

- (1) The act done by the partner must relate to the normal business of the firm and must be within the scope of the business of the firm. For example, if the partner of a firm dealing in electronic goods, purchases some wine in the name of the firm, the firm would not be liable.
- (2) The act must be done in the usual way *i.e.*, in the normal course. What is usual way of carrying on the business, will depend on the nature of the business, customs and usages in that kind of business and circumstances of each particular case.
- (3) The act must be done in the name of the firm, or in any other manner expressing or implying an intention to bind the firm, by the partner in the capacity of a partner.

Limitation on Implied authority or Statutory Restrictions on Implied Authority [Sec. 19(2)]

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

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

Q.4 What is the position of a minor as a partner in the firm, under the provisions of the Indian Partnership Act, 1932 ? [MTP Nov. 2018],

[Nov. 2018, 6 Marks], [MTP July 2021]

OR

Can a minor become a partner in a partnership firm? Justify your answer and also explain the rights of a minor in a partnership firm.

[June 2022, 4 Marks]

Ans. According to Sec.11 of the Indian Contract Act, an agreement by or with a minor is void. As such, he is incapable of entering into a contract of partnership. But with consent of all the partners for the time being, a minor may be admitted to the benefits of partnership.

The position of a minor partner may be studied, under two heads:

1. Position before attaining majority

(i) Rights:

(a) He has a right to such share of the property and of profits of the firm as may have been agreed upon.

(b) He has also a right to have access to and inspect and copy any of the accounts, but not books of the firm. [Sec. 30(2)]

(c) When he is not given his due share of profit, he has a right to file a suit for his share of property of the firm. But he can do so only, if he wants to sever his connection with the firm. [Sec. 30(4)].

(ii) **Liabilities:** The liability of the minor partner is confined only to the extent of his share in the profits and property of the firm. Over and above this, he is neither personally liable nor is his private estate liable.

2. Position on attaining majority

On attaining majority, a minor who has been admitted to the benefits of partnership, must give a public notice of his intention to become or not to become a partner in the firm. The public notice must be given by him in this instance within 6 months of his attainment of majority or acquiring knowledge that he had been admitted to the benefits of partnership, whichever date is later.

If he fails to give a public notice he is deemed to have become a partner in the firm on the expiry of the said six months [Sec. 30(5)]

(i) Where he elects to become a partner:

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

(b) His share in the property and profits of the firm is the share to which he was entitled as a minor partner [Sec. 30(7)];

(c) He is entitled to all rights & is bound by all the duties of a partner.

(ii) *Where he elects not to become a partner:*

- (a) His rights & liabilities continue to be those of a minor upto the date of the public notice;
- (b) His share is not liable for any acts of the firm done after the date of the public notice;
- (c) He is entitled to sue the partners for his share of the property and profits in the firm.

Q.5 Discuss the rights and liabilities of an outgoing partner under the Indian Partnership Act, 1932. [RTP Nov. 2019]

Ans.

Rights and liabilities of an outgoing partner

The following are the rights & liabilities of an outgoing partner:—

(I) Rights of an outgoing partner

An outgoing partner possesses following rights:

(a) Right to carry on competing business

An outgoing partner has the right to carry on the business competing with that of the firm, and he may advertise such business (Sec. 36). But section 36 imposes some, restrictions on his activities in order to prevent unfair competition with the firm. The restrictions imposed upon outgoing partner are:

- (a) he may not use firm's name,
- (b) he may not represent himself as carrying on the business on behalf of the firm, or
- (c) he may not solicit the customers or the persons who were already dealing with the firm before he left the firm. The above restrictions are subject to a contract to the contrary.

However, the firm may enter into an agreement with the retiring partner not to carry on competing business, then he will not be entitled to carry competitive business & such an agreement will not be treated to be in restraint of trade provided reasonable restrictions have been imposed on the outgoing partner & the restriction intend to safeguard the interest of the firm.

(b) Right to share subsequent profit in certain cases

As per section 37, in case the accounts of the outgoing partners continue to remain unsettled and the remaining partners continue to run the business, such a partner is entitled to receive his share of profit or interest at the rate of 6% p.a. on the amount of his share in the firm. Alternatively he may claim such share in the subsequent profits of the firm as is attributable to his share in the capital employed in the business of the firm [on account of non-settlement of accounts.]

(II) Liabilities of an outgoing partner

These may be classified into two stages.—

(a) Liability for acts done before leaving the firm

A retiring partner is liable for the acts done and debts incurred before his retirement, but he may be exempted from this liability in case of an agreement made by him with the third party and the remaining partners of the reconstituted firm.

(b) Liability for acts done after leaving the firm

In case of retirement of a partner, a public notice is essential to this effect. If it is not given, the retiring partner will continue to be liable to third parties for the acts of the firm even after his retirement. A public notice is not essential in case of sleeping or deceased partner who is not known to be partner, and so as such will not be liable for future acts, of the firm.

SHORT QUESTIONS :**Q.6 What is the liability of the firm, for misapplication by partners ?**

[Nov. 2020, 4 Marks]

Ans. Liability of firm for misapplication by Partners. (Sec. 27)

Where - (a) a partner acting within in his apparent authority receives money or property from a third party and misapplies it or

(b) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.

Q.7 State the modes by which a partner may transfer his interest in the firm in favour of another person under the Indian Partnership Act, 1932.

What are the rights of such a transferee ?

[MTP May 2018], [RTP Nov. 2018]

& [MTP May 2019, RTP July 2021]

Ans. According to the provisions of section 29 of the Indian Partnership Act, 1932, a share in the partnership is transferable like any other property. But since the partnership relationship is based on good faith and mutual confidence, the assignee of a partner's interest by sale, mortgage or otherwise cannot enjoy the same rights & privileges as the original partner. Further the transfer of interest of a partner in the firm can be done only with the consent of all the other partners. The rights of such a transferee are as follows :—

(a) During the continuance of partnership

During the continuance of partnership, such transferee is entitled to receive the share of the profits of the transferring partner. However, he is bound to accept the profits as agreed to by the partners *i.e.* he cannot challenge the accounts.

A transferee of a Partner's share is not entitled:

- (a) to interfere with the conduct of the business.
- (b) to require accounts or
- (c) to inspect books of the firm.

(b) On the dissolution of the firm

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, to an account as from the date of the dissolution.

Q.8 List the acts which are considered to fall within the scope of implied authority of a partner.

Ans. The implied authority of a partner generally includes the following acts :

- (i) To purchase goods for the purpose of the business of the firm on cash or credit
- (ii) To effect sale of the goods of the firm on cash or credit basis.
- (iii) To settle the accounts with debtors & creditors of the firm within the scope of his authority.
- (iv) To receive payments from the debtors of the firm, on behalf of the firm and issue receipts with respect to the same.
- (v) To engage or hire employees or servants for the purpose of conduct of business of the firm.
- (vi) To hire the services of an attorney to maintain or defend a suit in relation to the business of the firm.
- (vii) To borrow money for the purpose of the business of the firm.
- (viii) To pledge the goods of the firm as a security for the borrowings on behalf of the firm & for the purpose of business of the firm.
- (ix) To draw, accept, endorse or negotiate any P/N, B/E or cheque in the name & on behalf of the firm.

Q.9 How can a partner be admitted in the firm? What are the rights and liabilities of a newly introduced partner ?

Ans. A partner can be admitted into a partnership firm only with the consent of all the partners. The share in the profits of the firm to which the incoming partner shall be entitled to, alongwith his rights and duties shall be fixed by way of mutual agreement at the time of his admission.

Rights of an incoming Partner : Thus an incoming partner on his admission shall be entitled to the share in profits and property of the firm as fixed by way of mutual agreement at the time of his admission.

Further he shall be entitled to all such rights of a partner as conferred by the Indian Partnership Act, 1932, unless the same have been restricted by a contract to the contrary with the existing partners.

Liabilities of an incoming partner :—

- (i) Generally an incoming partner is not liable for the acts of the firm, done prior to his admission.
- (ii) However in the following instances the incoming partner shall be liable for the acts of the firm done before his admission :—
 - (a) If the incoming partner assumes liability for the past debt by novation that is by tripartite agreement between the creditor; the existing partners & the incoming partner.
 - (b) a minor who had been admitted to the benefits of partnership shall be liable for all the acts of the firm done since he was admitted to the benefits, if he decides to become a partner on attaining majority.
- (iii) An incoming partner shall be liable for all the acts of the firm, done after his admission.

Q.10 What are the legal consequences of Insolvency of a Partner ?**[RTP Nov. 2019]**

Ans. The following are the legal consequences of the insolvency of a partner :—

- (i) A partner who is adjudicated as insolvent ceases to be a partner in the firm on the date on which the order of adjudication is made by the Court.
- (ii) Ordinarily but not invariably, the insolvency of a partner results in the dissolution of the firm from the date of the order of adjudication. Thus subject to a contract between the partners, the firm is dissolved on the date of adjudication.
- (iii) If a contract to the contrary exists and the firm continues to carry on business with the remaining partners after the insolvency of one, then the estate of the insolvent partner shall not be liable for any of the acts of the firm, done after the date of the order.
- (iv) The firm is also not liable for any of the acts of the insolvent partner done after the date of order of adjudication.
- (v) In case the firm is not dissolved, the share of the insolvent partner, in the firm, shall vest in the Official Assignee or Receiver.
- (vi) Further no public notice is required to be given on the insolvency of a partner.

Q.11 What are the legal consequences of Death of a partner ?

Ans. The following are the legal consequences of Death of a Partner :—

- (i) In the absence of a contract to the contrary, the death of a partner results in dissolution of the firm.
- (ii) Where under a contract, a firm is not dissolved on the death of a partner, the estate of the deceased partner shall not be liable for the acts of the firm done after his death.

- (iii) However the estate of the deceased partner shall be liable for the acts of the firm done prior to his death except the following :—
- (a) For the money borrowed by surviving partners so as to pay for the goods ordered during the life time of the deceased partner.
 - (b) For the goods ordered during the life time of the deceased partner but delivered after his death.
- (iv) Further no public notice is required on the death of a partner.

Q.12 What is the provision related to the effect of notice to an acting partner of the firm as per the Indian Partnership Act, 1932?

[May 2019, 2 Marks]

Ans. According to the provisions of Section 24 of the Indian Partnership Act, 1932, notice to an acting partner with respect to any matter relating to the affairs of the firm, operates as a notice to the firm, except in case of fraud committed by that partner or with the connivance/consent of that partner.

Thus the notice to an active partner serves as a notice to the rest of the partners just as a notice to the agent operates as a notice to the Principal. However for the notice to be binding on all the other partners, it must be an actual notice (not constructive), received by an active partner (& not a dormant partner) & relate to the business of firm.

Q.13 Discuss the provision regarding personal profit earned by a partner under the Indian Partnership Act, 1932.

[May 2019, 2 Marks]

Ans. According to the provisions of section 16 of the Indian Partnership Act, 1932, subject to contract between the partners:—

- (a) If a partner derives any profits for himself from any transaction of the firm or from the use of the property or business connection of the firm or from the name of the firm, 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, then he shall be liable to account for and pay to the firm all profits made by him in that business.

Q.14 When the continuing guarantee can be revoked under the Indian Partnership Act, 1932?

[Nov. 2019, 2 Marks]

Ans. According to the provisions of section 38 of the Indian Partnership Act, 1932, a continuing guarantee given to a partnership firm or to a third party in respect of the transactions of a firm, is in the absence of a contract to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.

Q.15 What do you mean by Goodwill as per the provisions of Indian Partnership Act, 1932? [Nov 2019, 2 Marks]

Ans. According to the provisions of the Indian Partnership Act, 1932, the property of the firm, in the absence of a contract to the contrary includes the goodwill of the business.

The term goodwill has not been defined in the Act. The term refers to the advantage which is acquired by a firm from the connection it has built up with its customers and the reputation it has gained. It is the value of reputation which a firm establishes overtime due to its efficiency & effectiveness in operations & services and its integrity. This reputation enables the firm to earn more than the normal profits of the industry. It is an intangible asset of the firm & is the whole advantage of the reputation & connection formed with customers together with the circumstances whether of habit or otherwise which tend to make such connection permanent and advantage durable.

Q.16 Comment on 'the right to expel partner must be exercised in good faith' under the Indian Partnership Act, 1932. [Nov. 2020, 2 Marks], [Dec. 2022, 6 Marks]

Ans. According to the provisions of section 33 of the Indian Partnership Act, 1932, a partner may not be expelled from the firm by a majority of partners except by exercise in good faith, of the powers conferred by contract between the partners. It is thus essential that:

- (i) The power of expulsion must have existed in the contract between the partners or expressly stated in the deed;
- (ii) The power of expulsion has been exercised by a majority of the partners and
- (iii) The power of expulsion has been exercised in good faith.

If all the above conditions are satisfied only then the expulsion is treated as valid and effective and in the *bona fide* interest of the business of the firm.

Further for the power of expulsion to have been exercised in good faith, the test of the following is required:

- ◆ The expulsion must be in the interest of the partnership
- ◆ The partner to be expelled is served with a reasonable notice of expulsion &
- ◆ He is given a fair and reasonable opportunity of being heard.

If a partner is expelled otherwise, not only the expulsion is treated as *null* and *void*, but at the same time such an expelled partner shall have a right to proceed against the other partners in a court of law and seek reinstatement as a partner in the firm.

Q.17 Discuss the liability of a partner for the act of the firm and liability of firm for act of a partner to third parties as per Indian Partnership Act, 1932. [Jan. 2021, 4 Marks]

Ans. The liability of the partners and the firm to the third parties is as follows:—

- (i) **Liability of the partner for the acts of the firm:** Every partner is jointly and severally liable for all the acts of the firm, done while he is a partner in the firm. The partners are jointly and severally liable for all the acts done by any of them within the scope of their express or implied authority, in the name of the firm, in the ordinary course of business of the firm and in the usual way. Thus a partner shall be liable for all the acts of the firm, whether of contractual or non-contractual nature, done during his tenure as a partner in the firm.
- (ii) **Liability of the firm for the wrongful acts of a partner:** A firm is liable to the same extent as a partner, for any loss or injury caused to a third party by the wrongful acts or omissions of the partner committed by him while acting in the ordinary course of business of the firm and with the authority from other partners. Thus all the partners shall be liable to the third party for any loss incurred by him due to the negligent acts or omissions of a partner acting in the ordinary course of the business of the firm.
- (iii) **Liability of a firm for misapplication by partners:** Where a partner acting within his apparent authority receives money or any property from a third party and misapplies it or a firm in the course of its business receives money or property from a third party and the same is misapplied by the partner while it is in the custody of the firm, then in both the cases, the firm shall be liable to make good the loss to the third party.

However if the receipt of money or property by one partner is not within the scope of his implied authority, his receipt cannot be regarded as the receipt by the firm and as a consequence the other partners shall not be liable for the same unless they come to be in the possession or control of such money or property.

CASE STUDIES :

Q.18 X, Y and Z are partners in a partnership firm. They were carrying their business successfully for the past several years. Spouses of X and Y fought in ladies club on their personal issue and X's wife was hurt badly. X got angry on the incident and he convinced Z to expel Y from their partnership firm. Y was expelled from partnership without any notice from X and Z. Considering the provisions of the Indian Partnership Act, 1932, state whether they can expel a partner from the firm. What are the criteria for test of good faith in such circumstances?

[May 2018, 4 Marks], [MTP May 2019], [MTP July 2021]

Ans. According to provisions of Section 33 of the Indian Partnership Act, 1932, a partner can be expelled from a firm on the fulfilment of the following conditions :—

- (i) When the power of expulsion of a partner is expressly conferred on the partners in the deed of partnership.
- (ii) The power of expulsion must be exercised by a majority of partners in the interest of the firm.
- (iii) The power of expulsion must be exercised in good faith. Further the power of expulsion is said to have been exercised in good faith only if—
 - (a) The expelled partner has been served with a notice of charges against him
 - (b) The expelled partner has been given a reasonable opportunity of being heard by the other partners
 - (c) The expulsion is in the interest of the firm.

In the given case it is evident that expulsion of Y was not valid since it was not done in good faith.

Thus Y, the expelled partner shall have a right to sue the other partners for reinstatement in the firm.

Q.19 A, B and C are partners of a partnership firm ABC & Co. The firm is a dealer in office furniture. A was in charge of purchase and sale, B was in charge of maintenance of accounts of the firm and C was in charge of handling all legal matters. Recently through an agreement among them, it was decided that A will be in charge of maintenance of accounts and B will be in charge of purchase and sale. Being ignorant about such agreement, M, a supplier supplied some furniture to A, who ultimately sold them to a third party. Referring to the provisions of the Indian Partnership Act, 1932, advise whether M can recover money from the firm.

What will be your advice in case M was having knowledge about the agreement?
[MTP Nov. 2018], [MTP July 2021]

Ans. Hint : The acts of a partner which are performed by him for the purpose of carrying on the business of the firm, in the usual way shall be binding on the firm. Further the partners may by contract between them impose certain restrictions on the implied authority of a partner. However such a restriction shall be effective against a third party provided the third party has knowledge of such a restriction. Thus if any restriction on the implied authority of a partner has been imposed, the firm shall be bound by the act of such a partner which falls outside of the scope of his actual restricted authority provided the third party has no knowledge of such restriction on the authority.

Thus M can recover the money from the firm since he is not aware of the restrictions on the implied authority of A and he is acting in good faith.

However if M had the knowledge of restriction he cannot recover the money from the firm.

Q.20 A, B and C are partners in a firm called ABC Firm. A, with the intention of deceiving D, a supplier of office stationery, buys certain stationery on behalf of the ABC Firm. The stationery is of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own use. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay for the price, on the ground that the stationery was never received by it (firm). Referring to the provisions of the Indian Partnership Act, 1932 decide:—

(i) Whether the Firm's contention shall be tenable?

(ii) What would be your answer if a part of the stationery so purchased by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, about which neither the firm nor the supplier D was aware? [MTP May 2018 & MTP Nov. 2018]

Ans. Hint: The firm is liable for the acts of a partner within the scope of his implied authority. Further if the partner receives any money or property from a third person in the course of business of the firm & misapplies it or where a firm in the course of business receives money or property and the same is misapplied by a partner while in the custody of the firm, the firm shall be liable to compensate the third party.

Further it is a duty of the partner to indemnify the firm for the loss sustained by it due to his fraud or misconduct:

(i) Thus firm's contention is not valid and it shall be bound to pay the price irrespective of the fact of not having received the stationery.

(ii) Where the stationery has been delivered to the firm and then it is used by A for private purpose, then also the firm shall be bound to make payment to D.

In both the above cases the firm can sue A for the loss sustained by it due to A's misconduct.

Q.21 Ram & Co. a firm consists of three partners A, B and C having one third share each in the firm. According to A and B, the activities of C are not in the interest of the partnership and thus want to expel C from the firm. Advise A and B whether they can do so quoting the relevant provisions of the Indian Partnership Act, 1932. [RTP Nov. 2018]

Ans. Hint: Rules with respect to expulsion;

Thus A & B can expel C, provided the power of expulsion is conferred by the partnership deed and the expulsion is being done in good faith, in the interest of the firm, after affording C a reasonable opportunity of being heard and a notice with respect to the same is served on C.

Q.22 Mr. M, Mr. N and Mr. P were partners in a firm, which was dealing in refrigerators. On 1st October, 2018, Mr. P retired from partnership, but failed to give public notice of his retirement. After his retirement, Mr. M, Mr. N and Mr. P visited a trade fair and enquired about some refrigerators with latest techniques. Mr. X, who was exhibiting his refrigerators with the new techniques was impressed with the interactions of Mr. P and requested for the visiting card of the firm. The visiting card also included the name of Mr. P as a partner even though he had already retired. Mr. X supplied some refrigerators to the firm and could not recover his dues from the firm. Now, Mr. X wants to recover the dues not only from the firm, but also from Mr. P. Analyse the above case in terms of the provisions of the Indian Partnership Act, 1932 and decide whether Mr. P is liable in this situation.

[Nov. 2018, 3 Marks], [MTP Nov. 2020]

Ans. According to the provision of the Indian Partnership Act, 1932, when a person represents himself or knowingly permits himself to be represented as a partner in the firm, when in fact he is not, then he is liable like a partner in the firm to anyone who on the faith of such representation has given credit to the firm. Thus when a person by his words or conduct has wrongly induced a third party to believe that he is a partner then he shall be liable as a partner by holding out, to such a party, under the law of estoppel. This rule is also applicable to a former partner who has retired from the firm without giving a proper public notice of his retirement. In such a case a person who even subsequent to the retirement of the partner, gives credit to the firm on the belief that he was a partner, shall be entitled to hold him liable, under the law of estoppel as a partner by holding out.

Thus applying the above provisions in the given case it can be concluded that Mr. P becomes a partner by holding out because he failed to give public notice of his retirement and made representations on behalf of the firm. Thus Mr. X can recover the amount not only from the firm but also from Mr. P under the law of estoppel.

Q.23 Mr. A, Mr. B and Mr. C were partners in a partnership firm M/s ABC & Co., which is engaged in the business of trading of branded furniture. The name of the partners was clearly written along with the firm name in front of the head office of the firm as well as on Letter-head of the firm. On 1st October, 2018, Mr. C passed away. His name was neither removed from the list of partners as stated in front of the head office nor from the letter-heads of the firm. As per the terms of partnership, the firm continued its operations with Mr. A and Mr. B as partners. The accounts of the firm were settled and the amount due to the legal heirs of Mr. C was also determined on 10th October, 2018. But the same was not paid to the legal heirs of Mr. C. On 16th October, 2018, Mr. X, a supplier supplied furniture worth ₹ 20,00,000 to M/s ABC & Co. M/s ABC & Co. could not repay the amount due to heavy losses.

Mr. X wants to recover, the amount not only from M/s ABC & Co., but also from the legal heirs of Mr. C.

Analyse the above situation in terms of the provisions of the Indian Partnership Act, 1932 and decide whether the legal heirs of Mr. C can also be held liable for the dues towards Mr. X. [Nov. 2018, 3 Marks]

Ans. According to section 35 of the Indian Partnership Act, 1932, where under a contract between the partners, the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death. Further, 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 to the persons dealing with the firm.

Thus applying the above stated provisions in the given case, it can be concluded that Mr. X, the supplier may sue M/s. ABC & Co. for the recovery of his dues, but he cannot hold the legal heirs of Mr. C liable, since Mr. C's estate shall not be liable for transactions of the firm made after his death *i.e.* after 1st October, 2018.

Q.24 Ram, Mohan and Gopal were partners in a firm. During the course of partnership, the firm ordered sunrise Ltd. to supply a machine to the firm. Before the machine was delivered, Ram expired. The machine, however, was later delivered to the firm. Thereafter, the remaining partners became insolvent and the firm failed to pay the price of machine to Sunrise Ltd.

Explain with reasons:—

- (i) Whether Ram's private estate is liable for the price of the machine purchased by the firm?**
- (ii) Against whom can the creditor obtain a decree for the recovery of the price? [RTP May 2019]**

Ans. Hint: Where under a contract between the partners, firm is not dissolved by death of a partner, & the remaining partners continue to carry on the business of the firm, then the estate of the deceased partner shall not be liable for any acts of the firm done after his death. Thus the estate of the deceased partner shall not be liable for the liabilities of the firm arising after his death.

In the given case order for supply of machine is given to Sunrise Ltd. by the firm during the lifetime of Ram, which does not result in creation of any liability. The machine is delivered subsequent to death of Ram.

- (i)** Thus Ram's estate shall not be liable for the price of machinery.
- (ii)** The creditor shall have a right of action against the surviving partners & recover the amount from the partnership assets and the partners' assets since they have become insolvent.

Q.25 X, Y & Z carry on business in partnership business as merchants trading between Mumbai & London. Weaton, a merchant in London to whom they sent their consignments secretly allows share of commission which he received upon such consignments in consideration of Z using his influence to obtain consignments for him. Is Z liable to account to the firm the monies so received by him?

Ans. Hint: Duty of the partner to account for any secret profits earned by him in the course of conduct of the business of the firm by virtue of the use of the property or name or connections of the firm. Thus here Z shall be liable to account for the share of commission that he receives from Weaton during the course of conduct of the business of the firm.

Q.26 M/s XYZ & Associates, a partnership firm with X, Y, Z as senior partners were engaged in the business of carpet manufacturing and exporting to foreign counties. On 25th Aug., 2016 they inducted Mr. G an expert in the field of carpet manufacturing as their partner. On 10th Jan., 2018, Mr. G was blamed for unauthorized activities and thus expelled from the partnership by united approval of rest of partners.

- (i) Examine whether action by the partners was justified or not?**
- (ii) What should have the factors to be kept in mind prior to expelling a partner from the firm by other partners according to the provisions of the Indian Partnership Act, 1932? [May 2019, 6 Marks]**

Ans. According to the provisions of section 33 of Indian Partnership Act, 1932, generally a partner cannot be expelled from a firm, except on the fulfilment of the following conditions:

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

Further expulsion is deemed to have been made in good faith only if—

- ◆ the expulsion is in the interest of partnership,
- ◆ the partner to be expelled is served with a notice
- ◆ and he is given a reasonable opportunity of being heard.

In the given case X, Y, Z, the senior partners of M/s. XYZ & Associates expel Mr. G unanimously on the grounds of unauthorised activities.

- (i) Thus applying the above stated provisions it is evident that the action of the partners was not justified, since all the conditions required for the lawful expulsion of Mr. G were not duly complied. Expulsion of Mr. G would have been valid if such a power existed in the contract of partnership & if all conditions of 'expulsion made in good faith' were satisfied.

- (ii) The partners before unanimously expelling Mr. G should have assured that
- the power of expulsion must have existed in the partnership deed;
 - Mr. G. should have been served with a notice of expulsion;
 - Mr. G should have been given an opportunity of being heard.

Q.27 Mahesh, Suresh and Dinesh are partners in a trading firm. Mahesh, without the knowledge or consent of Suresh and Dinesh borrows himself Rs. 50,000 from Ramesh, a customer of the firm, in the name of the firm. Mahesh, then buys some goods for his personal use with that borrowed money. Can Mr. Ramesh hold Mr. Suresh & Mr. Dinesh liable for the loan? Explain the relevant provisions of the Indian Partnership Act, 1932.

[MTP Nov. 2019]

Ans. Hint: An act of a partner, done by him in the name of the firm, in the ordinary course of the business of the firm, & in the usual way, shall be binding on the firm, as such an act falls within the scope of implied authority of the partner. Mahesh has borrowed, the money in the name of the firm acting within the scope of his implied authority & in the usual way. Thus Ramesh can hold the other two partners, Suresh & Dinesh also liable for the loan.

Q.28 Master X was introduced to the benefits of partnership of M/s. ABC & Co. with the consent of all partners. After attaining majority, more than six months elapsed and he failed to give a public notice as to whether he elected to become or not to become a partner in the firm. Later on, Mr. L, a supplier of material to M/s. ABC & Co., filed a suit against M/s. ABC & Co. for recovery of the debt due.

In the light of the Indian Partnership Act, 1932, Explain:

(i) To what extent X will be liable if he failed to give public notice after attaining majority?

(ii) Can Mr. L recover his debt from X?

[Nov. 2019, 6 Marks],

[RTP Nov. 2020]

Ans. According to the provisions of the Indian Partnership Act, 1932, a minor can be admitted to the benefits of partnership with the consent of all the partners. However, on the attainment of majority such a minor must give a public notice of his intention to become or not to become a partner in the firm. Such a public notice must be given by the minor within 6 months of his attaining majority or of his obtaining the knowledge that he had been admitted to the benefits of firm, whichever date is later. Further if he fails to give a public notice within the prescribed time he shall be deemed to be a partner in the firm on the expiry of the said 6 months. In such a case the minor on being deemed as a partner shall become personally liable to the third parties for all the future acts of the firm as well as for all the part acts of the firm done since he was admitted to the benefits of partnership. He shall be entitled to all the rights of a partner &

subjected to all the duties of a partner and his share in the property and profits shall remain similar to what he was entitled to as a minor.

In the given case X, a minor who is admitted to the benefits of M/s. ABC & Corpn. fails to give a public notice within 6 months of his attaining majority. Later Mr. L, a supplier sues the firm for recovery of a debt.

Thus applying the above stated provisions it can be concluded that:—

- (i) X shall be deemed to have become a partner in the firm. As a consequence X can be held personally liable alongwith other partner and his liability shall be unlimited. X shall be liable for all the future acts of the firm as well as those past acts done by the firm since his admission into benefits of the firm.
- (ii) Mr. L can recover his debt from X provided the debt was incurred after he was admitted to the benefits of partnership.

Q.29 A, B and C are partner in a firm. As a per terms of the partnership deed, A is entitled to 20 per cent of the partnership property and profits. A retires from the firm and dies after 15 days. B and C continue business of the firm without settling accounts. What are the rights of A's legal representatives against the firm under the Indian Partnership Act, 1932?
[RTP May 2020]

Ans. According to provisions of section 37 of the Indian Partnership Act, 1932. When a partner dies or otherwise ceases to be a partner and the other partners continue to carry on the business of the firm without any settlement of accounts, then in the absence of a contract to the contrary, the legal representatives of the deceased partner or retired partner are entitled claim either:—

- (i) such share of the profits of the firm earned after death or retirement of the partner which is attributable to the use of his share in the property of the firm or
- (ii) interest @ 6% p.a. on the amount of his share in the property.

Thus applying the above stated provisions it is evident, A's legal representatives shall be entitled to either 20% share of profits as is attributable to A's capital employed or interest @ 6% p.a. on A's share in property.

Q.30 P, Q, R and S are the partners in M/S PQRS & Co., a partnership firm which deals in trading of Washing Machines of various brands.

Due to the conflict of views between partners, P & Q decided to leave the partnership firm and started competitive business on 31st July, 2019, in the name of M/s PQ & Co. Meanwhile, R & S have continued using the property in the name of M/s PQRS & Co. in which P & Q also has a share.

Based on the above facts, explain in detail the rights of outgoing partners as per the Indian Partnership Act, 1932 and comment on the following:

- (i) Rights of P & Q to start a competitive business.
- (ii) Rights of P & Q regarding their share in property of M/s PQRS & Co.

[Nov. 2020, 6 Marks]

Ans. (i) According to the provisions of section 36 of the Indian Partnership Act, 1932, an outgoing partner has the right to carry on a business competing with that of the firm and also to advertise the same, provided no (reasonable) restraint on the same has been expressly provided by an agreement to the contrary, made with a view to safeguard the interest of the firm. However, the outgoing partner may not:

- ◆ use the firm's name,
- ◆ represent himself as carrying on the business on behalf of the firm or
- ◆ solicit the customers of the firm.

In the given case the outgoing partners P & Q started carrying on a competing business in the name of M/s PQ & Co., which is not the name of the firm. Moreover no restriction appears to be imposed on such outgoing partners whereby they may be reasonably restrained from carrying on a competing business.

Thus applying the above stated provisions it can be concluded that outgoing partners, P & Q can validly carry on a competing business as it is in accordance with the requirements of law.

(ii) Section 37 of the Indian Partnership Act, 1932 provides that in case the accounts of the outgoing partners remain unsettled and the remaining partners continue to carry on the business of the firm, such an outgoing partner is entitled to receive any of the following whichever is more beneficial to him:

- ◆ Interest at the rate of 6 % p.a. on the amount of his share in the property of the firm.
- ◆ Alternatively he may claim such share in the subsequent profits of the firm as is attributable to his share in capital employed in the business of the firm.

In the given case as the firm continues to carry on its business as before without settlement of accounts, the outgoing partners P&Q can ask for a share in the subsequent profits made by the firm as attributable to their share in capital employed or alternatively ask for interest @ 6% on their share from the firm, whichever is beneficial for them.

Q.31 M, N and P were partners in a firm. The firm ordered JR Limited to supply the furniture. P dies, and M and N continues the business in the firm's name. The firm did not give any notice about P's death to the public or the persons dealing with the firm. The furniture was delivered to the firm after P's death, fact about his death was known to them at the time of delivery. Afterwards the firm became insolvent and failed to pay the price of furniture to JR Limited.

Explain with reasons:

- (i) Whether P's private estate is liable for the price of furniture purchased by the firm ?
- (ii) Whether does it make any difference if JR Limited supplied the furniture to the firm believing that all the three partners are alive?

[Jan. 2021, 6 Marks]

Ans. According to the provisions of the Indian Partnership Act, 1932, the death of a partner, generally but not invariably, results in the dissolution of the firm. The estate of a deceased partner is liable for the acts of the firm done before his death. However the estate of the deceased partner shall not be liable for the goods ordered before but delivered after the death of the partner since there is no liability/debt due before the death of the partner. Further if the business of the firm is continued to be carried on after the death of the partner (without its dissolution) then estate of the deceased partner is not liable for the acts done after his death. Moreover no public notice is required in case of death of a partner, so as to discharge his estate from the liability for the future acts of the firm.

In the given case M, N and P were partners in a firm and furniture was ordered by the firm to be supplied by JR Ltd. However before the delivery of the furniture P dies. The firm continues its business in the same name as before and furniture is delivered subsequently. Afterwards the firm becomes insolvent and fails to pay the price of the furniture:

- (i) Applying the above stated provisions it is evident that since the furniture was delivered after the death of P, therefore his estate shall not be liable for the same. Moreover the fact of death of P was also known to JR Ltd. at the time of supply of furniture. Thus, since the liability for the price of the furniture accrues after the death of P, his estate shall not be liable.
- (ii) In the light of the provisions stated above it can be concluded that public notice of death is not required to discharge the estate of a deceased partner for the liability for the future acts of the firm. Thus knowledge of death of a partner or ignorance of the same would have no effect on the right of the third party against the estate of a deceased partner. Therefore the rights of JR Ltd. would remain limited to action against the firm and its surviving partners (M & N) only. It will not be entitled to any action against the estate of P, even though it believed all the partners to be alive at the time of supply of furniture.

Q.32 Mr. M is one of the four partners in M/s. XY Enterprises. He owes a sum of ₹ 6 crore to his friend Mr. Z which he is unable to pay on due time. So he wants to sell his share in the firm to Mr. Z for settling the amount. In the light of the provisions of the Indian Partnership Act, 1932, discuss each of the following :

- (i) Can Mr. M validly transfer his interest in the firm by way of sale ?
 - (ii) What would be the rights of the transferee (Mr. Z) in case Mr. M wants to retire from the firm after a period of 6 months from the date of transfer ?
- [July 2021, 6 Marks]**

Ans. (i) According to the provisions of section 29 of the Indian Partnership Act, 1932, a share in the partnership is transferable like any other property but since the partnership relation is based on good faith and 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. Further the transfer of the interest of a partner in the firm can be done only with the consent of all the other partners.

In the given case Mr. M is one of the partners of M/s. XY Enterprise who owes a debt of ₹ 6 crores & desires to sell his share in the firm to his friend Mr. Z for settlement of his liability.

Thus applying the above stated provisions it can be concluded that Mr. M can transfer his interest in the firm, to Mr. Z by way of sale only if consent of all the other partners is obtained for effecting such a transfer.

(ii) During the continuance of partnership the transferee of a partner's share is entitled to receive the share of the profits of the transferring partner. However he is bound to accept the profits as agreed to by the partners and cannot challenge the accounts of the firm. Further the transferee of a partner's share is not entitled to interfere with the conduct of the business or require the accounts of the firm or to inspect the books of account of the firm. However in the event of dissolution of the firm or on the retirement of the transferring partner, the transferee will be entitled:

- ◆ against the remaining partners to receive the share of the assets of the firm to which the transferring partner was entitled and
- ◆ for the purpose of ascertaining the share, to an account asked from the date of dissolution of the firm or retirement of the transferring partner, as the case may be.

Thus applying the above stated provisions it is evident that Mr. Z will be entitled to receive the share of assets of the firm to which Mr. M was entitled to and for the purpose of ascertaining his share, Mr. Z shall have the right to demand the books of account as from the date of retirement.

Q.33 M/s. ABC Associates is a partnership firm since 1990. Mr. A, Mr. B and Mr. C were partners in the firm since beginning. Mr. A, Being a very senior partner of aged 78 years transfers his share in the firm to his son Mr. Prateek, a Chartered Accountant. Mr. B and Mr. C were not interested that Mr. Prateek join them as partner in M/s. ABC Associates. After some time, Mr. Prateek felt that the books of account were displaying only a small amount as profit despite a huge turnover. He wanted to inspect the book of account of the firm arguing that it is his entitlement as a transferee. However, the other partners believed that he cannot challenge the books of account. Can Mr. Prateek, be introduced as a partner if his father wants to get a retirement? As an advisor, help them resolve the issues applying the necessary provisions from the Indian Partnership Act, 1932.

[June 2022, 6 Marks]

Ans. According to the provisions of section 29 of the Indian Partnership Act, 1932, a share in the partnership is transferable like any other property. But since the partnership relationship is based on good faith & mutual confidence,

the assignee of a partner's interest by sale, mortgage or otherwise cannot enjoy the same rights & privileges as the original partner. Further the transfer of interest of a partner in the firm can be done only with the consent of all the other partners. The rights of such a transferee are as follows:

During the continuance of Partnership, such a transferee is entitled to receive the share of the profits of the transferring partner. However, he is bound to accept the profits as agreed to by the partners, *i.e.* he cannot challenge the accounts. Further, a transferee of a partner's share is not entitled to interfere with the conduct of the business or to require accounts or to even inspect the books of account of the firm.

In the given case Mr. A, a senior partner in firm M/s. ABC Associates, decides to transfer his share in the firm, with the consent of the other partners, to his son, Mr. Prateek. The partnership continues even after this transfer of share to Mr. Prateek & he wishes to inspect the accounts.

Thus applying the above stated provisions, it is evident that Mr. Prateek cannot inspect the books of account since he is a mere transferee to the share of his father Mr. A. He is not entitled to any right any other than the right to the share in the profits, as agreed to by the other partners. Further, Mr. Prateek cannot be introduced in the firm as a partner unless all the other partners consent to his admission as a partner in the firm.

Q. 34 P, Q and R are partners in a partnership firm. R retires from the firm without giving public notice. P approached S, an electronic appliances trader, for purchase of 25 fans for his firm P introduced E, an employee of the firm, as his partner to S. S believing E and R as partners supplied 25 fans to the firm on credit. S did not receive the payment for the fans even after the expiry of the credit period. Advise S, from whom he can recover the payment as per the provisions of the Indian Partnership Act, 1932.
[June 2023, 6 Marks]

Ans. According to the provisions of the Indian Partnership Act, 1932, in case of retirement of a partner from the firm, a public notice is required to be given regarding the same. In the event of failure to do so, the retiring partner will continue to be liable for the acts of the firm done even after his retirement and he will held liable as a partner by holding out.

When a person, who is not a partner, allows himself to be wrongfully represented as a partner in the firm, then the person so represented will be held liable as a partner by a third party who acts on the faith of such representation and enters into a contract with the firm. Further such a person will be estopped from denying his being a partner in the event of devolution of such a liability.

In the given case, R retires from the firm without giving a public notice of Retirement and E, an employee in the firm, allows himself to be introduced by P (another partner) as a partner to S, a trader. S, acting in the faith of such representation supplied 25 fans to the firm on credit.

Thus applying the above stated provisions it is evident that, R, who has not given a public notice of retirement shall be held liable as a partner by holding out, in respect of contract with S along with the other partners P & Q. Moreover, E, the employee who allowed himself to be represented as a partner shall be held liable as a partner by estoppel. Therefore S can hold P, Q, R and E liable in respect of his contract.

nikh...jr...05@g...ail.co...02-0...-024
13...TAXIANN



3

CHAPTER

REGISTRATION OF A FIRM & DISSOLUTION OF A FIRM

LONG ANSWER QUESTIONS:

Q.1 What is the procedure of registration of the firm ? Explain.

[RTP May 2019]

OR

Explain about the registration procedure of a partnership firm as prescribed under the Indian Partnership Act, 1932. [June 2023, 6 Marks]

Ans. The registration of a partnership is not compulsory. Therefore an unregistered firm is not an illegal association. But an unregistered firm suffers from certain disabilities and therefore registration is necessary for carrying on business. The following is the procedure prescribed for registration of a firm :—

- ◆ The Registration of a firm may be effected at any time by sending by post or delivering to the Registrar of Firms of the locality, **a statement in the prescribed form and accompanied by the prescribed fee.**
- ◆ The application for registration contains the following particulars; (a) the firm-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 and verified by all the partners* or their agents specially authorised on this behalf.
- ◆ When the Registrar is satisfied that the above provisions have been duly complied with, he shall record an entry of the statement in the Register of Firms and then file the statement. He shall then issue under his hand a certificate of Registration. Any subsequent change or alterations in the Partnership Deed or constitution of the firm must also be registered from time to time.
- ◆ Registration is effective from the date when the Registrar files the statement and makes entries in the Register of Firms and not from the date of presentation of the statement to him.

- ◆ Similarly the date of issue of certificate of registration shall not be regarded as the date from which registration is effective since the act of issue of a certificate is merely a clerical act and for legal purposes the date of filing of all documents along with fees shall be regarded as the date of registration.

Q.2 What are the consequences of Non-registration of a firm? Discuss.
[May 2018, 4 Marks, May 2019, 4 Marks, Nov. 2020, 4 Marks]
[RTP May 2021], [Dec. 2022, 6 Marks]

Ans. Consequences of non-registration [Sec. 69] : Under the Indian Partnership Act, 1932, registration of firm is not compulsory. However, an unregistered firm and the partners thereof suffer from certain disabilities, which are as follows:

Suit between partners and firm [Sec. 69(1)]

A partner of an unregistered firm cannot file a suit against the firm or any partner thereof, for the purpose of enforcing a right arising from contract or a right conferred by the Partnership Act.

Suits between firm & third parties [Sec. 69(2)]

No suit can be filed by or on behalf of an unregistered firm against any third party for the purpose of enforcing a right arising from a contract, unless the firm is registered and the persons suing are registered as partners in the Firm.

Claims of set-off [Sec. 69(3)]

An unregistered firm cannot claim a set-off in excess of ₹ 100 in a suit, filed against the firm by a third party.

Suit by third party against the firm

An unregistered firm and its partners can be sued by third party.

However the following rights remain unaffected by Non-registration:—

1. A partner of an unregistered firm can file a suit for the dissolution of the firm or for accounts of dissolved firm, or for claiming a share in the assets of the dissolved firm.
2. The Official Assignee or Receiver acting for an insolvent partner of unregistered firm may bring a suit for the realisation of the properties of an insolvent partner or further realisation of the property of dissolved firm.
3. An unregistered firm can file a suit or claim a set-off for a sum not exceeding ₹ 100 in value.
4. Non-registration will not affect the enforcement of rights arising otherwise than out of contract e.g. for an injunction against wrongful infringement of a trademark etc.
5. The right of a third party to file a suit against the unregistered firm or its partners remains unaffected.

Q.3 What are the modes for dissolution of firm without the order of the court ?

Ans. A firm may be dissolved without the order of the court on any of the following grounds:

1. By agreement (Sec. 40)

A firm may be dissolved at any time with the consent of all the partners of the firm. Partnership is created by contract, it can also be terminated by contract.

2. By Compulsory Dissolution (Sec. 41)

A firm is dissolved—

- (a) by the adjudication of all the partners or of all the partners but one as insolvent, or
- (b) by the happening of any event which makes the business of the firm unlawful.

3. Dissolution on the happening of certain contingencies (Sec. 42)

Subject to contract between the partners, a firm is dissolved—

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

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

4. Dissolution by notice (Sec. 43)

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

Q.4 What are the grounds for dissolution of the firm at the order of the Court ?

[RTP Nov. 2018] [Nov. 2018, 4 Marks]

OR

Explain the grounds on which court may dissolve a partnership firm in case of any partner files a suit for the same. [June 2022, 4 Marks]

Ans.

Dissolution by the Court (Sec. 44)

At the suit of a partner, the court may dissolve a firm on any one of the following grounds:

A. *Insanity*

If a partner has become of unsound mind. The suit for dissolution in this case can be filed by the next friend of the insane partner or by any other partner.

B. *Permanent incapacity*

If a partner becomes permanently incapable of performing his duties as a partner. Permanent incapacity may arise from an incurable illness like paralysis. The suit for dissolution in this case must be brought by a partner other than the person who has become incapable.

C. *Guilty of misconduct*

If a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business. The suit for dissolution on the ground mentioned in this clause must be brought by a partner other than the partner who is guilty of misconduct.

D. *Persistent breach of agreement*

If a partner wilfully and persistently commits breach of the partnership agreement regarding management or otherwise conducts himself in such a way that it is not reasonably practicable for the other partners to carry on business in partnership with him.

E. *Transfer of whole interest*

If a Partner has transferred the whole of his interest in the firm to an outsider or as allowed his interest to be sold in execution of a decree. Transfer of partner's interest does not by itself dissolve the firm. But the other partners may ask the court to dissolve the firm if such a transfer occurs.

F. *Loss*

If the business of the firm cannot be carried on except at a loss. Since the motive, with which partnerships are formed, is acquisition of gain, the courts have been given discretion to dissolve a firm in cases where it is impossible to make profits.

G. *Just and Equitable clause*

If the court considers it just and equitable to dissolve the firm. This clause gives a discretionary power to the court to dissolve a firm in cases which do not come within any of the foregoing clauses but which are considered to be fit and proper cases for dissolution. For example : In case of deadlock in the management, partners not being on talking terms; speculation by partner on stock exchange, etc., court can order the dissolution of the firm.

Q.5 What are the rights of a Partner on dissolution of a firm ?

Ans. The following are the rights of a partner on the dissolution of a firm:—

1. *Right to have the business wound up [Sec. 46]*

On the dissolution of a firm, a partner has the right:

- (a) to have the business of the firm wound up and the debts of the firm settled out of the property of the firm and
- (b) to have the surplus distributed among the partners according to their rights.

2. *Continuing authority of partners for purpose of winding up [Sec. 47]*

The partners authority to act for the firm and to bind their co-partners continues even after dissolution of the firm for the following two purposes:

- (a) to wind up the affairs of the firm (for example recovering money from debtors)
- (b) to complete transaction begun but unfinished at the time of the dissolution.

3. *Right to share in personal profits earned after dissolution [Sec. 50]*

Every partner has a right to share in any secret profits derived by any partner under any transaction carried out in the firm name or by use of the property or business connection of the firm, after the dissolution but before winding up.

4. *Right to have premium returned on premature dissolution [Sec. 51]*

Where a partner has paid a premium (goodwill) on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term, he shall be entitled to repayment of the whole or a reasonable part of the premium. The amount of repayment will depend upon (a) the terms upon which he became a partner & (b) length of the time during which he was a partner.

5. *Rights where partnership contract is rescinded for fraud or misrepresentation [Sec. 52]*

Where a partner was induced to join the firm by the fraud or misrepresentation of any other partner, the aggrieved partner has the right to rescind the partnership agreement and is entitled: (a) to a lien on, or a right of retention of, the surplus or the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him; (b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and (c) to be indemnified by the partner or partners guilty of fraud or misrepresentation against all the debts of the firm.

6. *Right to restrain the use of firm name or firm property [Sec. 53]*

After a firm is dissolved, every partner, may restrain any other partner:

- (a) from carrying on a similar business in the firm name or
- (b) from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up.

SHORT QUESTIONS :**Q.6 What is the mode of settlement of Accounts of a dissolved firm?****[July 2021, 4 Marks]**

Ans. The partners may lay down their own procedure for the settlement of accounts after dissolution. In the absence of a prior agreement between the partners in this regard, the accounts may be settled in accordance with the provisions provided in sections 48, 49 and 55 of the Indian Partnership Act which are discussed below:

- (i) *Goodwill* shall be included in the assets and it might be sold separately or along with other property of the firm.
- (ii) *Losses*, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, for the balance, the partners shall individually subscribe in their profit sharing ratio.
- (iii) *Assets* of the firm, including partners' contributions to make deficiencies of capital, shall be applied *firstly*, for paying the debts of the firm to third parties,
secondly if there remains any surplus, it shall be utilized in paying each partner the amount of advances given to the firm. Such payments are made in the ratio of advances made by the partners.
thirdly, if still there remains any surplus, it shall be utilized for paying each partner rateably on account of capital.
and *finally*, the residue to be divided amongst partners in their profit sharing ratio.
- (iv) *Payment of firm debts and separate debts*: Where there are debts of the firm as well as individual debts of the partners, then the following rules shall apply:
 - (i) The property of the firm shall be first utilized in payment of the debts of the firm; and if there remains any surplus, then the share of each partner in such surplus shall be applied in payment of his individual debts, or if there is no such individual debt then his share shall be paid to him.
 - (ii) The individual property of any partner shall be applied first in the payment of his individual debts; and if there remains any surplus, it shall be utilized in the payment of the debts of the firm.

Q.7 What are the instances in which Public Notice must be given by a partner as per the Partnership Act? What is the mode of serving a Public Notice?

Ans.

1. The Partnership Act requires that a public notice must be given in each of the following cases:

(a) On minor attaining majority

A minor partner on becoming a major must give public notice of his intention to remain or not to remain a partner. [Sec. 30(5)]

(b) Retirement of a partner

When a partner retires from the firm, he must give public notice to terminate further liability. [Sec. 32(3)]

(c) Expulsion of a partner

When a partner is expelled from the partnership business he must give public notice to terminate further liability. [Sec. 33]

(d) Dissolution of the firm

When a partnership firm is dissolved, the partners of the dissolved firm must give public notice to terminate further liability [Sec. 45(1)]

2. Mode of the Public Notice

According to Sec. 72 the Public Notice becomes effective when the following steps have been taken:

- (a) The notice has been published in the Official Gazette.
- (b) The notice has been published in at least one vernacular newspaper (*i.e.* which is published in Indian language) circulating in the district where the concerned firm has its place or principal place of business.
- (c) If the firm is registered, the notice has been sent to the Registrar of Firms.

Q.8 "Dissolution of a firm is different from dissolution of Partnership". Discuss. [Nov. 2019, 4 Marks]

Ans. Dissolution of firm implies dissolution of partnership, such that not only the relationship between all the partners comes to an end but the business of the firm is also discontinued. In the event of dissolution of the firm, the business ceases to continue and the assets of the firm are realised with a view to settle the liabilities of the firm and surplus if any is distributed among the partners as per their respective interests. Realisation account is prepared on the dissolution of the firm for settlement of liabilities & assets.

On the other hand dissolution of partnership, merely refers to the change in the relationship of partners without resulting in discontinuance of the business of the firm. The relationship are reconstituted and the firm conducts its operations with the existing/remaining partners. The dissolution of partnership may take place in the event of admission of a new partner, retirement or death of a partner, change in profit sharing ratio etc.

Thus dissolution of a firm is a wider term which not only results in dissolution of partnership relation but also in discontinuance of business of the firm.

CASE STUDIES:

Q.9 ABC & Associates, an unregistered firm purchased some goods worth ₹ 2000 from 'R' in whose favour a cheque was issued which was dishonoured. At the same time the firm sold some other goods to 'R' amounting to ₹ 1200. Later 'R' sued some the firm for recovery of ₹ 2000. The firm contended that since 'R' owned ₹ 1200 to the firm, the said amount should be adjusted against the claim of ₹ 2000. Is R's suit maintainable against the firm ? Further comment on the validity of the contention made by the firm.

Ans. Hint: The right of a third party to file a suit against an unregistered firm remains unaffected. Therefore the suit filed by R against the firm is maintainable. An unregistered firm cannot claim a set-off exceeding ₹ 100. Therefore the contention of the firm to set-off ₹ 1200 shall not be held valid. Only a set-off of ₹ 100 shall be permissible.

Q.10 X entered into partnership in an existing firm-RST Associates for a period of 10 years and paid ₹ 5,00,000 as premium. The firm was dissolved after expiry of 3 years because of insolvency of a partner. X now claims the refund of premium. Advise X as to his rights. Would your answer be different if the firm is dissolved on account of misconduct of X?

Ans. Hint: In case of premature dissolution of the firm, the partner paying the premium shall be entitled to claim a refund of unexpired part of premium. Thus in this case X shall be entitled to refund of ₹ 3,50,000 ($5,00,000/10 \times 3 = 1,50,000$; $5,00,000 - 1,50,000 = 3,50,000$) as the unexpired premium.

Refund of premium is not permitted where the premature dissolution of the firm is taking place on account of misconduct of the partner paying the premium. Thus if firm is being dissolved on account of X's misconduct he shall not be entitled to refund of premium.

Q.11 P, X, Y and Z are partners in a registered firm A & Co. X died and P retired. Y and Z filed a suit against W in the name and on behalf of firm without notifying to the Registrar of firms about the changes in the constitution of the firm. Is the suit maintainable? [RTP May 2019]

Ans. Hint : A registered firm can sue a third party. If a partnership firm continues to carry on business after the death of a partner or if a partner retires from the firm, then if the firm is registered, then such changes in constitution of the firm must also be updated from time to time with the Registrar of firm. However non-compliance in this regard does not result in disabilities for the firm since the firm is a registered one. Thus the right of the firm to sue the third party shall remain unaffected even if changes are not notified to the Registrar. Thus the suit is maintainable since the suit is filed in the name & in behalf of firm & the firm is a registered one.



nikn"jr"05@g ail.co i 01-0-11024
13 5-4

