

Lesson 13: Partnership Act, 1932

1. Introduction to Partnership Act, 1932

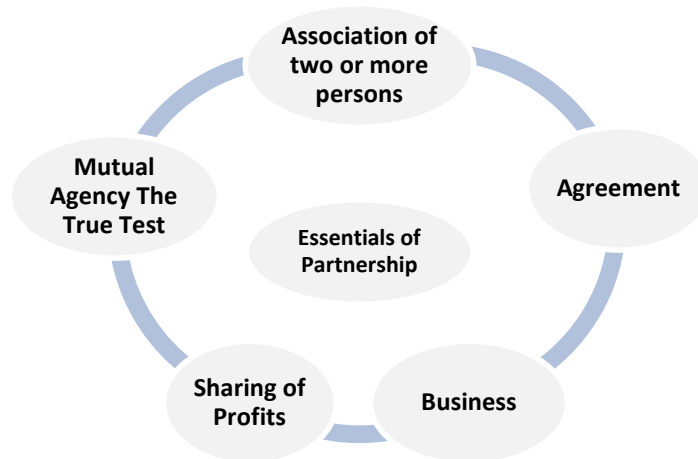
Indian Partnership Act, 1932, came into force **with effect from 1st October, 1932** except Section 69 which came into force on the 1st day of October, 1933.

Note: It extends to the whole of India except the state of Jammu and Kashmir.

2. Definition of Partnership

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

3. Essentials of a Partnership and True Test of Partnership



- **Association of two or more persons:** There must be a contract between two or more persons.
- **Agreement:** Existence of an agreement is essential of partnership. Such an agreement between the partners may be express or implied. Further, the agreement must be a valid agreement and for a lawful object and purpose and between the persons competent to contract.
- **Business:** The term “**business**” is used in the widest sense to cover trade, occupation and profession.
- **Sharing of Profits:** To constitute a partnership firm, the parties must have agreed to carry on a business and to share profits in common.
- **Mutual Agency (The True Test):** Mutual agency is the foundation of partner’s liability. Each partner is both an agent and principal for himself and others.

4. Sharing of Profits is not Conclusive

Sharing of profits is a prima facie evidence of the existence of partnership. This is not the conclusive test of the same. A person may have a share in the partnership profits but still may not be a partner.

Examples:

- *X and Y buy 100 bales of cotton agreeing to divide these between them. X and Y are not partners.*
- *X and Y buy 100 bales of cotton. They agree to sell these bales of cotton for their joint account and each party sharing profits and bearing losses equally. X and Y are partners in respect of such account.*

5. Formation of Partnership

- According to the definition of partnership under the Indian Partnership Act, 1932, there must be an agreement between the partners of a partnership firm. The partnership agreement must comply with all the essentials of a valid contract.
- There must be free consent of the parties who must be competent to contract and the object of partnership should not be forbidden by law/immoral/opposed to public policy.

Two Exceptions:

- A minor may be admitted to the benefits of a partnership with consent of all other partners.
- No consideration is required to create the partnership.

6. Partnership Deed and Contents of Partnership Deed

Partnership Deed	Written document which contains the mutual rights and obligations of partners is known as " partnership deed ".
General Contents of Partnership Deed	<ul style="list-style-type: none">• The firm name and business to be carried on under that name.• Names and addresses of partners.• Nature and scope of business and address(s) of business place(s).• Commencement and duration of partnership.• The capital and the contribution made by each partner.• Provision for further capital and loans by partners to the firm.• Partner's drawings.• Interest on capital, loans, drawings and current account.• Salaries, commission and remuneration to partners.• Profit (or loss) sharing ratio of partners.• Keeping of proper books of accounts, inspection and audit, Bank Accounts and their operation.• Accounting period and the date on which that accounts are prepared.• Rights, powers and duties of the partners.• Provision that death or retirement of a partner will not bring about dissolution of partnership.• Valuation of goodwill on retirement, death, dissolution etc.• Method of valuation of assets (and liabilities) on retirement or death of any partner.• Provision for expulsion of a partner.• Provision regarding allocation of business activities to be performed by individual partners.• Arbitration clause for the settlement of disputes.

7. Classification of Partnership

From the duration point of view, a partnership may be classified into the following two categories:

Particular Partnership (Section 8)	“A person may become a partner with another person in a particular adventure or undertaking”. When two or more persons agree to do business in a particular adventure or undertaking such a partnership is called “ Particular Partnership ”.
Partnership at Will (Section 7)	<p>Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership, the partnership is called “Partnership at Will”.</p> <p>Partnership is deemed to be a “partnership at will” when:</p> <ul style="list-style-type: none">▪ No fixed period has been agreed upon for the duration of partnership, and▪ There is no provision made as to the determination of partnership in any other way.

9. Co-ownership and Partnership

- Partnership is between two persons Co- ownership is not always the result of an agreement: it may arise by the operation of law or from status.
Example: co-heirs of a property.
- Partnership must arise from an agreement. A partner is the agent of the other partners but a co-owner is not the agent of the other co-owner(s).
- Co-ownership does not involve profits and loss but partnership does.
- Co- owner can without the consent of others transfer his rights and interests .On the other hand, partner cannot do so without consent of all other partners so as to make the transferee partner in the firm.
- Partnerships end at death or insolvency. On the other hand, co-ownerships end at death.
- Co-owner has no lien on the property. On the other hand a partner has a lien on the firm property.

10. Hindu Joint Family Firm and Partnership

- Partnership comes into existence by means of a contract between the partners but a Hindu joint family firm arises as a result of status, i.e. by birth in the family.
- The death of a partner dissolves the partnership but the death of a co-parcener does not dissolve the family firm.
- In a Hindu Joint Family Firm, the Karta or manager (who is the head of the family) has implied authority to borrow and bind other members but in a partnership each partner is entitled to do so.
- Every partner is personally liable for the debts of the firm but in Hindu Joint Family Business only the Karta is personally liable

- There is a definite limit to the number of partners but there is no such limit in the case of a Hindu joint family firm.
- A Hindu joint family business is governed by Hindu Law. On the other hand, Indian Partnership Act governs Partnership and excludes Hindu Joint Family Firms.
- A minor is a member of a joint family firm from the very day of his birth by virtue of his status but he is not personally liable. A minor cannot be a partner even if he may be admitted to the benefits of partnership.
- A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts.
- No registration of a Hindu family firm is necessary while a partnership firm must be registered before it can maintain suits against outsiders.
- Each partner has a definite share in the business and this can be changed only by agreement but the share of a co-parcener is not fixed which can be enlarged by death or reduced by a birth in the family.

11. Company and Partnership

- The members constituting a partnership do not form a whole as distinct from the individuals composing it. The firm has no legal entity and has no rights and obligations separate from the partners.
- In a firm every partner is an agent of the rest of the partners but a member of a company is neither the agent of the company nor of other members.
- In a partnership, there are rights and obligations as against individual partners but in the case of a company the rights and obligations are as against the fictitious entity of the whole of the company and not the members composing it.
- The creditors of the partnership can call upon individual partners to pay the firm's debt but the members of a company are not personally liable for the company's debts.
- Partnership firm may dissolve by the death or insolvency of a partner but a company is not affected by the death or insolvency of a member.
- Partner cannot transfer his interest so as to substitute the transferee in his place as the partner without the consent of other partners. A member can transfer his share to anyone as per his discretion.

12. Change in a Firm

Indian Partnership Act, 1932, reflect following changes in a Partnership Firm

- Changes in the constitution of a firm.
- Changes in the nature of a business or undertakings.
- Changes in the duration of a firm.

Change in Constitution of a firm

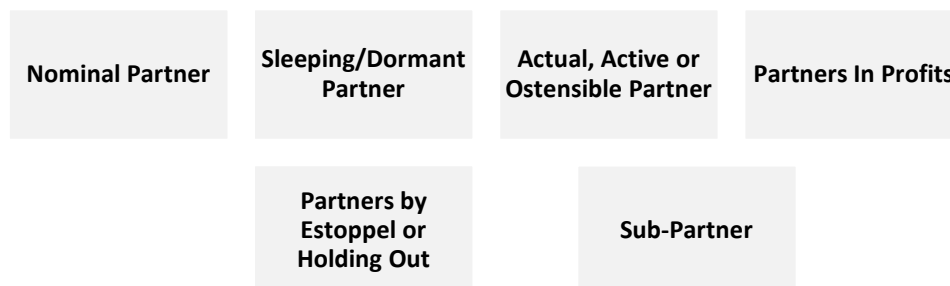
- A new partner is introduced as a partner in a firm; (Section 31)
- A partner retires from a firm; (Section 32).
- A partner is expelled from a firm; (Section 33).
- A partner is adjudicated as an insolvent; (Section 34) and
- A partner dies. (Section 35)

13. Partnership Property

In the absence of any such agreement, express or implied, the property of the firm is deemed to include:

- all property, rights and interests which have been brought into the common stock for the purposes of the partnership by individual partners whether at the commencement of the business or subsequently added thereto.
- those acquired in the course of the business with money belonging to the firm.
- the goodwill of the business.

14. Kinds of Partners



- **Nominal Partner:** People who do not invest or participate in the management of the firm but give their name to the business/ firm only. They are nominal partners but are liable to third parties for all the acts of the firm. They are known to the outsiders as partners in the firm whereas in reality they are not.
- **Sleeping/Dormant Partner:** These partners invest money in the firm's business and take their share of profits but do not participate in the functioning and management of the business. The liability of Sleeping Partner is unlimited. A sleeping partner can retire from the firm without giving any public notice to this effect. Such partner has no duties to perform but is entitled to have access to books and accounts of the firm and he can have a copy of them.
- **Actual, Active or Ostensible Partner:** These are the types of partners who invest money into the business of the firm, actively participate in the functioning and management of the business and share its profits or losses. Such partner as actively participates in the firm's business, binds himself and other partners by all his acts done in the usual course of partnership business. Such partner must give a public notice of his retirement from the firm in order to absolve (free) himself from liability for the acts of the other partners done after his retirement.
- **Partners in Profits:** A partner who is entitled to share in the profits of a partnership firm without being liable to share the losses is called a partner in profits only. A person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. He continues to be liable to the third parties for all acts of the firm.
- **Partners by Estoppels or Holding-out:** If a person who is declared to be a partner (if actually he is not) does not deny the fact that he is a partner, he being held out as a partner is responsible for all liability of the business. If the behaviour of a person arouses misunderstanding that he is a partner in a firm (if actually he is not) such a person is estopped from later on denying the liabilities for the acts of the firm. Such person is called partner by estoppels and is liable to all third parties.
- **Sub-Partner:** Where a partner agrees to share his profits in the firm with a third person,

then the third person is called a sub-partner. Such a sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. Also, he cannot bind the firm/ other partners by his acts.

15. Minor Admitted to the Benefits of Partnership

As per provisions of Section 11 of the Indian Contract Act, 1872, a minor's agreement is altogether void and unenforceable.

An agreement is an essential ingredient in a partnership. It follows that a minor cannot enter into an agreement of partnership. On the same principle, a minor cannot be clothed with all the rights and obligations of a full-fledged partner through a guardian.

Note: There must be at least two major partners before a minor is admitted into the benefits of partnership.

16. Rights and Liabilities of Minor

Rights of Minor	<ul style="list-style-type: none">▪ He is entitled to his agreed share and can inspect Books of Account of the firm. [Section 30(2)].▪ He can bring a suit for account and his share when he intends to sever his connections with the firm but not otherwise. [Section 30(4)]▪ A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted whichever date is later. He has to elect whether he wants to become a partner or his connection with the firm. He may give public notice of his election to continue or repudiate but if he fails to give any public notice within the period as mentioned above. He will be deemed to have elected to become a partner in the firm. [Section 30(5)]
Liabilities of Minor	<ul style="list-style-type: none">▪ A minor partner's liability is confined only to the extent of his share in the firm. He is neither personally liable nor is his private estate liable for the acts of the firm. A minor's share is liable for the acts of the firm. However, a minor is not personally liable in any such act.▪ Where a minor on attaining majority elects to become a partner, he becomes personally liable as other partners to the third parties for all the acts of the firm done since he was admitted to the benefits of partnership.

17. Election by Minor

- A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted whichever date is later.
- He has to elect whether he wants to become a partner or sever his connection with the firm.
- He may give public notice of his election to continue or repudiate but if he fails to give any public notice within the period as mentioned above. He will be deemed to have elected to become a partner in the firm.
- If he becomes/elects to become a partner, his position will be as under:
→ His rights and liabilities will be related to those of a full-fledged partner.

- He will be personally liable for all the acts of the firm done since he was admitted to the benefits of the partnership.
- His share of profits and property remains the same before unless altered by agreement.
- If he elects not to become a partner, then:
 - His rights and liabilities shall continue to be those of a minor up to the date of his giving public notice.
 - His share shall not be liable for any acts of the firm done after the date of the public notice.
 - He is entitled to sue the partners for his share of the property and profits in the firm.

18. Relation of Partners to one another

Relation of partnership arise through an agreement between the parties and such an agreement normally provides for mutual rights and obligations, or duties of the partners. The rights and duties of partners are governed by the Act. However, partnership arises by implication or wherever the articles of partnership are silent.

19. Rights and Duties of Partners

Rights of Partners:

- Every partner has a right to take part in the conduct and management of the business. [Section 12(a)].
- Every partner whether active or dormant, has a right of free access to all records, books and accounts of the business and also to examine and copy them. [Section 12(d)].
- Every partner is entitled to share in the profits equally, unless different proportions are stipulated. [Section 13(b)].
- A partner who has contributed more than the share of the capital for the purpose of the business is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But a partner cannot claim interest on capital, unless there is an agreement to pay it. [Section 13(d)]
- A partner is entitled to be indemnified by the firm for all expenses incurred by him in the course of the business, for all payments made by him in respect of partnership debts or liabilities and disbursements made in an emergency for protecting the firm from loss. [Section 13(e)]
- Every partner is a joint owner of the partnership property and have it applied exclusively for the purposes of the partnership. (Section 15)
- A partner has power to act in an emergency for protecting the firm from loss.
- Every partner is entitled to prevent the introduction of a new partner into the firm without his consent. (Section 31)
- Every partner has a right to retire by giving notice where the partnership is at will. [Section 32(1)(c)]

- Every partner has a right to continue in the partnership and not to be expelled from it. [Section 33(1)]
- An incoming partner will not be liable for any debts or liabilities of the firm before he becomes a partner.
- Every outgoing partner has a right to carry on a competitive business under certain conditions. (Section 36)

Statutory Duties of Partners:

- Every partner is bound to carry on the business of the firm to the greatest common advantage. (Section 9)
- Every partner must be just and faithful to other partners. (Section 9)
- A partner is bound to keep and render true, proper and correct accounts of the partnership. (Section 9)
- Utmost good faith between the partners is the rule and one partner must not take advantage of the other. As an agent of other partners, every partner is bound to communicate full information to them. (Section 9)
- Every partner must account for any benefits derived from the partnership business without the consent of the other partners, i.e., a partner must not make “secret profits”. [Section 16(a)]
- A partner must not compete with the firm, without the consent of the other partners. Any profits made by such unauthorised competition can be claimed by the firm. [Section 16(b)]
- Every partner is bound to attend diligently to the business of the firm and in the absence of any agreement to the contrary, he is not entitled to receive any remuneration. [Section 12(b) and 13(a)]
- In the absence of an agreement to the contrary, every partner is bound to share losses equally with the others. [Section 13(b)]
- Every partner must hold and use the partnership property exclusively for the firm. (Section 15)
- Every partner is bound to indemnify the firm for any loss caused by fraud in the conduct of the business. (Section 10)
- A partner who is guilty of wilful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners. [Section 13(f)]
- No partner can assign or transfer his partnership interest to any other person so as to make him a partner in the business. (Section 29)
- Every partner is bound to act within the scope of his actual authority. If he exceeds his authority he shall compensate the other partners for loss unless they ratify his act

20. Partners as Agents

- Every partner is an agent of the firm and of other partners for the purpose of the business of the firm (Section 18).
- In the case of a partnership, each partner is a principal and each one is an agent for the other partners. In nutshell, a partner is both a principal and an agent.
- The acts of every partner who does any act for carrying on in the usual way the

business of the kind carried on by the firm, bind the firm and his partners unless:

- The partner so acting has no authority to act for the firm in that matter.
- The person with whom he is dealing knows that he has no authority.
- Does not know or believe him to be a partner.

21. Authority of a Partner

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.

- **Express Authority:** Authority is said to be express when it is given by words, spoken or written. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.
- **Implied Authority:** Implied authority of a partner is also known as ostensible or apparent authority. The implied authority is subject to the following conditions:
 - Condition 1: The act done must relate to the “normal business” of the firm.**
 - Condition 2: The act must be done in the usual way.**
 - Condition 3: The act must be done in the name of the firm.**

22. Implied Authority of a Partner

- **Every partner has an implied authority to bind the firm by following Acts:**
 - By selling firm's goods;
 - By purchasing goods for the firm;
 - By accepting any payment of debts due to the firm;
 - By engaging and discharging employees.
- **In a Trading Firm i.e. one which carries on business of buying and selling goods, partner has following additional powers:**
 - To borrow money on the firm's credit and to pledge the firm's goods for that purpose.
 - To accept, make and issue negotiable instruments in the firm's name.
 - To employ a solicitor or attorney on behalf of the firm.

23. Acts beyond Implied Authority [Section 19(2) of Indian Partnership Act, 1932]

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

- Submit a dispute relating to the business of the firm to arbitration.
- Open a banking account on behalf of the firm in his own name.
- Compromise or relinquish any claim or portion of a claim by the firm.
- Withdraw a suit or proceeding filed on behalf of the firm.
- Admit any liability in a suit or proceedings against the firm.
- Acquire immovable property on behalf of the firm.
- Transfer immovable property belonging to the firm.
- Enter into a partnership on behalf of the firm.

24. Dissolution- Dissolution of Partnership, Dissolution of the Firm and Dissolution of the Firm through Court

Dissolution	<ul style="list-style-type: none"> ▪ “The dissolution of partnership between all the partners of a firm” is called the “Dissolution of the Firm”. ▪ Dissolution does not follow because the partnership has ceased to do business for the partnership may continue for the purpose of realising the assets.
Dissolution of Partnership	<p>Dissolution of partnership takes place when there is no dissolution of firm in following circumstances:</p> <ul style="list-style-type: none"> ▪ By the expiry of the fixed term for which the partnership was formed.[Section 42(a)] ▪ By the completion of the adventure. [Section 42(b)] ▪ By the death of a partner. [Section 42(c)] ▪ By the insolvency of a partner. [Section 42(d)] ▪ By the retirement of a partner. [Section 42(e)] <p><i>Note: In all the above cases, the remaining partners may continue the firm in pursuance of an agreement to that effect. If they do not continue then the dissolution of the firm takes place automatically.</i></p>
Dissolution of the Firm	<p>In the following cases there is necessarily a breaking up or extinction of the relationship between all the partners of the firm and closing up of the business:</p> <ul style="list-style-type: none"> ▪ By mutual agreement (Section 40): A firm may be dissolved where all the partners agree that it shall be dissolved. ▪ By insolvency of all the partners except one [Section 41(a)]: If all the partners except one become insolvent, the firm must come to an end as a partnership firm with one partner cannot continue. ▪ By business becoming illegal [Section 41(b)]: If the business of the firm becomes illegal because of some subsequent events, such as change of law then in such case it is automatically dissolved by the operation of law. ▪ By notice of dissolution (Section 43): Where the partnership is at will, the firm may be dissolved at any time by any partner giving notice in writing of his intention to dissolve the firm to all the other partners. <p><i>Note: The dissolution will take place from date mentioned in the notice or if no such date is mentioned from the date of the communication of the notice.</i></p>

25. Effect of Dissolution

<i>Continuing authority of partners</i>	<ul style="list-style-type: none"> ▪ Each partner has an equitable lien over the firm's assets entitling him to have them applied in payment of the firm's debts and in payment of whatever is due to partner. ▪ The authority of partners to bind the firm continues so long as is necessary for winding-up the business. <p>However, the firm is in no case bound by the actions of a partner who have been adjudged an insolvent except on the principle of holding out.</p>	
<i>Continuing liability of partners</i>	<p>After dissolution, the rights and obligations of partners continue in everything necessary for the winding-up of the business.</p> <p>The partners may complete incomplete transactions. However, this authority is only for the winding up of the affairs of the firm and not for new transactions.</p>	
<i>Right to Return of Premium (Section 51)</i>	<p>On dissolution, partner is entitled to demand the return of proportion of the premium if the partnership was for a fixed term and was dissolved before the expiry of that term unless dissolution was caused by</p> <ul style="list-style-type: none"> ▪ agreement, or ▪ misconduct of the party seeking return of the premium, or ▪ death of a partner. 	
<i>Settlement of Accounts on Dissolution</i>	<p>Section 48 of the Act provides that in settling accounts between the partners after a dissolution of partnership, the following rules shall subject to any agreement be observed:</p> <ul style="list-style-type: none"> ▪ Losses including deficiencies of capital shall be paid first out of undistributed profits, next out of capital. Lastly, if necessary by the partners individually in the proportion in which they were entitled to share profits. ▪ The assets of the firm including the sums contributed by the partners to make up losses or deficiencies of capital shall be applied in the 	

	<p>following manner and order:</p> <ul style="list-style-type: none"> → in paying outside creditors; → in repaying advances made by partners (distinct from investment of capital); → in repaying capital to partners; → ultimate residue (if any) shall be divided among the partners in the proportions in which profits are divisible.
<i>Loss due to insolvency of partners</i>	<p>In case a partner is insolvent and is not able to contribute towards the deficiency, the principle laid down in the case of Garner vs. Murray will be applicable.</p> <p><u>Important Points:</u></p> <ul style="list-style-type: none"> ▪ The solvent partners will contribute only their share of deficiency in cash. ▪ The available assets should be distributed among the solvent partners in proportion to their capital. ▪ The deficiency of capital of the insolvent partners will be distributed among the solvent partners in the ratio of their respective capitals.

26. Goodwill and Sale of Goodwill

Goodwill	<ul style="list-style-type: none"> ▪ Goodwill is a partnership asset and means the benefit arising from a firm's business connections or reputation. ▪ Goodwill is the advantage which is acquired by a business beyond the mere value of the capital, stock fund and properly employed therein in consequence of the general public patronage and encouragement which it receives from constant or habitual customers.
Sale of Goodwill	<ul style="list-style-type: none"> ▪ Where goodwill is sold either to a partner or to an outsider, the value is divisible among the partners in the same manner as they share profits and losses unless otherwise agreed. ▪ Buyer's rights On Sale of Goodwill: On the sale of goodwill the buyer may, unless the terms in the contract of sale provide otherwise: <ul style="list-style-type: none"> i. represent himself in continuing the business, ii. maintain his exclusive rights to the use of the firm name, and iii. solicit former customers of the business and restrain the seller of the goodwill from doing so. ▪ Seller's rights On Sale of Goodwill: The vendors may enter into competition with purchaser unless he is prevented by a valid restraint clause in contract of sale.

27. Registration of the Firm

A statement in prescribed form and accompanied by prescribed fee for registration includes:

- Name of the firm.
- Place or principal place of business of the firm.
- Names of any other places where the firm carries on business;
- Date when each partner joined the firm;
- Names in full and permanent addresses of the partners;
- Duration of the firm.

28. Effects of Non-registration of the Firm

- Limit on the right of the partners of a firm to sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act, if the firm is not registered and the person suing is or has not been shown in the Register of Firms as a partner in the firm.
- Limit on the institution of a suit by or on behalf of a firm against a third-party if the firm is not registered and the persons suing are or have not been shown in the Register of Firms as partners in the firm.
- There is no bar on the right of third-parties to sue the firm or any partner except the following suits:
 - A suit for the dissolution of a firm.
 - A suit for rendering of accounts of a dissolved firm.
 - A suit for realisation of the property of a dissolved firm.
 - A suit or claim of set-off, the value of which does not exceed one hundred rupees.
 - A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.

- A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.
- A suit for the realisation of the property of an insolvent partner.
