



Long Answer Type Questions

Q1. Explain the process of dissolution of a partnership firm?

Solution:

The process of discontinuation of a partnership business is known as dissolution of partnership. According to Section 39 of the Partnership Act, dissolution of partnership between all partners of a firm is called dissolution of a partnership firm. Dissolution involves winding up of business, disposal of assets, paying off liabilities and distribution of any surplus or loss by partners of the firm. According to the Partnership Act 1932, a partnership firm may be dissolved on any of the following grounds:

- i. Dissolution by Agreement (Sec. 40)
- ii. Compulsory Dissolution (Sec. 41)
- iii. Dissolution due to Certain Contingencies (Sec. 42)
- iv. Dissolution by Notice of Partnership at Will (Sec. 43)
- v. Dissolution by Court (Sec. 44)

Although the process of dissolution remains the same, the ways and modes in all five are different.

1. Dissolution by Agreement:

A firm may be dissolved with

- a. Consent of all partners
- b. Contract between partners

2. Compulsory Dissolution:

A firm may be dissolved by

- a. Adjudication of all partners or of all partners but one as involved
- b. Happening of an event or change in government policies which make the business unlawful

3. Dissolution due to Certain Contingencies:

Subject to the contract between partners, a firm is dissolved

- a. If formed for a specific period, then on the expiry of the period
- b. If formed for a specific purpose, then on completion of the purpose
- c. On the death of partner/partners
- d. On insolvency of a partner/partners

4. Dissolution by Notice:

If a partnership is at will, then the partnership firm is dissolved if any partner gives a written notice to all the other partners expressing **his/her** intention to dissolve the firm.

5. Dissolution by Court:

The court may order dissolution of a partnership firm when

- a. A partner becomes insane or a lunatic.
- b. A partner becomes permanently incapable of performing duties.
- c. A partner is guilty of misconduct and affects business activities.
- d. A partner repeatedly breaks the terms of agreement.
- e. A partner transfers his interest to a third party without the consent of other partners.
- f. A business persistently incurs losses.

Besides these circumstances, a partnership firm may be dissolved if the court at any stage finds dissolution of the firm to be justified and inevitable.

Dissolution of a firm is carried out in three steps:

- i. Preparation of a balance sheet of the firm to be dissolved
- ii. Realisation of assets and liabilities
- iii. Distribution of cash to creditors and partners

Also, for the settlement of accounts, Section 48 of the Partnership Act 1932 would be applicable.

1. Application of Assets: Amount received by the realisation (sale) of assets shall be used in the following order:

- a. Debts of the firm towards third parties, or first, external liabilities and expenses are to be paid.
- b. Then all loans and advances forwarded by partners should be paid.
- c. Then the capital of each partner should be paid off. Any surplus remaining after the payment of (a), (b) and (c) should be distributed among partners in their profit-sharing ratio.

2. Treatment of Loss: Loss and any deficiency of capital should be paid in the following order:

- a. First, these should be adjusted against the firm's profits.
- b. Then against the total capital of the firm.
- c. If there is still any loss and deficiency, then it should be borne by all partners individually in their profit-sharing ratio.

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