Indian Partnership Act ,1932

Historical

The Indian Partnership Act was enacted in 1932 and it came into force on 1st day of October, 1932 [Sec 1. The act came into force on the 1st day of October, 1932 except Section 69, which came into force on the 1st day of October, 1933]. The present Act superseded the earlier law relating to Partnership, which was contained in Chapter XI of the Indian Contract Act, 1872. The Act is not exhaustive. It purports to define and amend the law relating to Partnership [See Preamble to the Act].

Preamble—Scope and Purpose

The preamble is an admissible aid to construction. It throws light on the intent and design of the legislature and indicates the scope and purpose of the legislation itself [Poppatlal Shah vs. State Of Madras AIR 1953 SC 274]. But it cannot be used to control or qualify precise and unambiguous language of the enactment . It is only when there is a doubt as to the meaning of a provision, that recourse may be had to the preamble to ascertain the reasons for the enactment and hence, the intention of Parliament [Tribhuban Parkash Nayyar Vs. Union Of India (1969) 3 SCC 99].

Scope

The scope of a partnership is primarily a question of the intention of the partners. There is <u>no restriction</u> on the exercise of such powers as it chooses at any time to exercise, except such prohibitions on illegal, immoral or fraudulent conduct as apply equally to individuals.

1- A partnership may itself be a member of another firm if the partners of the constituent firm consent thereto.

2- If it appears that all the partners have either authorized or ratified the contract, no further question as to its validity ordinarily remains. The case where the question of the validity of partnership contract arises is where one partner has made the contract without specific authority from his co-partners. As to their implied scope partnerships may be divided into the classes of the non-trading and the trading. Some powers can be exercised by partners in partnership of either type. Thus a partner may retain an attorney protect the interests of the firm.

Definition of Partnership

Section 4 of the Indian Partnership Act ,1932 defines 'Partnership' as under :

'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 '

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The present definition replaces Section 239, Indian Contract Act which defined 'Partnership' as under: 'Partnership is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business , and to share the profits thereof between them. The present definition is wider than the one contained in the Indian Contract Act in so far as it includes the important element of ' mutual agency ', which was absent in the old definition.

Essentials of Partnership

According to Section 4, the following essentials are necessary to constitute a 'Partnership'.

1. There should be an agreement between the persons who wants to be partners.

2. The purpose of creating partnership should be carrying on of business.

3. The motive for the creation partnership should be earning and sharing profits.

4. The business of the firm should be carried on by all of them or any of them acting for all, i.e., in mutual agency

When all the above elements are present in certain relationship that is known as 'partnership'. Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm' and the name under which their business is carried on is called the ' firm name'.

Elements of 'Partnership'

The definition of 'partnership ' contains three elements: [Dulichand Laxminarayan Vs. CIT AIR 1956 SC 354 ,Para 11 ; see also Pratibha Rani Vs. Surajkumar AIR 1985 SC 628, (1985) 2 SCC 370 and Sanjay Kanubhai Patel Vs. Chief Controlling Revenue Authority AIR 2005 Bom 57, para8]

1. There must be an agreement entered into by all the persons concerned [Rampratap v Durgaprasad AIR 1925 Pc 293; Hemchandra Dev vs. Dhirendra Chandra Das AIR 1960 Cal 691].

2. The agreement must be to share the profits of business; and

3. The business must be carried on by all or any of the persons concerned, acting for all.

Its main features are:-

A partnership is easy to form as no cumbersome legal formalities are involved. Its registration is also not essential. However, if the firm is not registered, it will be deprived of certain legal benefits.

- The Registrar of Firms is responsible for registering partnership firms.
- The minimum number of partners must be two, while the maximum number can be 10 in case of banking business and 20 in all other types of business. (Section 11 of the Companies Act , 1956)

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- The firm has no separate legal existence of its own i.e., the firm and the partners are one and the same in the eyes of law.
- In the absence of any agreement to the contrary, all partners have a right to participate in the activities of the business.
- Ownership of property usually carries with it the right of management. Every partner, therefore, has a right to share in the management of the business firm.
- Liability of the partners is unlimited. Legally, the partners are said to be jointly and severally liable for the liabilities of the firm. This means that if the assets and property of the firm is insufficient to meet the debts of the firm, the creditors can recover their loans from the personal property of the individual partners.
- Restrictions are there on the transfer of interest i.e. none of the partners can transfer his interest in the firm to any person (except to the existing partners) without the unanimous consent of all other partners.
- The firm has a limited span of life i.e. legally, the firm must be dissolved on the retirement, lunacy, bankruptcy, or death of any partner.

How to form a partnership firm?

A partnership is formed by an agreement, which may be either written or oral. When the written agreement is duly stamped and registered, it is known as "Partnership Deed". Ordinarily, the rights, duties and liabilities of partners are laid down in the deed. But in the case where the deed does not specify the rights and obligations, the provisions of the THE INDIAN PARTNERSHIP ACT, 1932 will apply. The deed generally contains the following particulars:

- Name of the firm.
- Nature of the business to be carried out.
- Names of the partners.
- The town and the place where business will be carried on.
- The amount of capital to be contributed by each partner.
- Loans and advances by partners and the interest payable on them.
- The amount of drawings by each partner and the rate of interest allowed thereon.
- Duties and powers of each partner.
- Any other terms and conditions to run the business.

Advantages

Partnerships have many of the same advantages of the sole proprietorship, along with others:

- ✓ Except for the time and the legal cost of crafting a partnership agreement, it is easy to establish.
- ✓ Because there is more than one owner, the entity has more than one pool of capital to tap in financing the business and its operations.

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- ✓ Profits from the business flow directly to the partners personal tax returns; they are not subject to a second level of taxation.
- ✓ The entity can draw on the judgment and management of more than one person. In the best cases, the partners will have complementary skills.
- ✓ . The Partners can withdraw profits from the business in the Name of Interest on Capital and Salary but subject to certain limits.
- ✓ The Registration of the Partnership is optional

Dis-advantages

As mentioned earlier, partners are jointly and severally liable for the actions of the other partners. Thus, one partner can put other partners at risk without their knowledge or consent. Other disadvantages include the following:

- ✓ Profits must be shared among the partners.
- ✓ With two or more partners being privy to decisions, decision making may de slower and more difficult than in a sole proprietorship. Disputes can tie the partnership in knots.
- ✓ As with a sole proprietorship, the cost of some employee benefits may not be deductible from income taxation.
- ✓ Depending on the partnership agreement, the partnership may have a limited life. Unless otherwise specified, it will end upon the withdrawal or death of any partner.
- ✓ The Partnership firm is not a separate legal entity. Meaning Assets cannot be purchased in the name of the Partnership firm.
- ✓ There are certain limits for withdrawals such as Interest on Capital & Salary to partners. Tax has to be paid if the amount paid exceeds these limits.
- ✓ Unlimited liability

Partnership Agreement – Oral, Written or By Conduct

The Supreme Court has, construing the provisions of section 4, observed that a partnership agreement is the source of a partnership, and it also gives expression to the other ingredients defining the partnership, specifying the business agreed to be carried on, the persons who will actually carry on the business, the shares in which the profits will be divided, and several other considerations which constitute such an organic relationship. A partnership agreement therefore, identifies the firm and each partnership agreement may constitute a distinct and separate partnership. That is not to say that a firm is corporate entity or enjoys a juristic personality in that sense. However, each partnership is a distinct relationship. The partners may be different and yet the nature of the business may be the same, the business may be different and yet the partners may be the same. The intention may be to constitute two separate partnerships and therefore, two distinct firms, or to extend merely a partnership, originally constituted to carry on one business, to the carrying on of another business. The intention of the partners will have to be decided with reference to the terms of the agreement and all the surrounding circumstances, including evidence as to the interlacing or interlocking of management, finance and, other incidents of the respective business. [Deputy Commr Of Sales Tax (Law) Board Of Revenue (Taxes) vs. K Kelukutty AIR 1985 SC 1143 , from (1978) 2 ILR Ker 82]

Agreement of partnership need not to be express, but can be inferred from the course of conduct of the parties to the agreement. The firm rule is that once the parties entering into the partnership are clearly described in the instrument, there is no scope for further inquiry to find out by some process or casuistry, if any of the parties has got obligation to others for the purpose of inducting those others to whom any of

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the parties may be accountable in law, into the arena of partnership and for treating them as partners under the law.[Deputy Commr Of Sales Tax (Law) Board Of Revenue (Taxes) vs. K Kelukutty AIR 1985 SC 1143, from (1978) 2 ILR Ker 82.] If, the parties to an agreement have not agreed on the date of commencement of the partnership, it cannot be said that they have become partners.

The Supreme Cour, [in Tarsem Singh v Sukhminder Singh (1998) 3 SCC 471 ,Para 13], has held that it is not necessary under the law that every contract must be in writing. There can be an equally binding contract between the parties on the basis of oral agreement, unless there is a law which requires the agreement to be in writing.

The relations inter se, among the promoters of a company, are not the same as the relations between partners. Persons entering into contract are not, on the authority of Keth Spicer Ltd v Mansell, necessarily to be viewed as partners. However, if they perform a large number of acts as part of the promotion , the court might come to a different conclusion.

Construction of Partnership Agreements

It is settled canon of construction that a contract of partnership must be read as a whole and the intention of the parties must be gathered from the language used in the contract by adopting harmonious construction of all the clauses contained therein. The cardinal principle is to ascertain the intention of the parties to the contract through the words they have used, which are key to open the mind of the makers. It is seldom that any technical or pedantic rule of construction can be brought to bear on their construction. The guiding rule really is to ascertain the natural ad ordinary sensible meaning to the language through which the parties have expressed themselves, unless the meaning leads to absurdity. A partnership deed must be constructed reasonably.

Importance of Partnership Agreement

A Partnership Agreement is a voluntary contract between two or more persons to enter into a business relationship between or among one another with the intention of carrying out the said business and sharing its profits/losses among themselves as agreed to in the document.

The parties to the agreement are referred to as Partners. The Partners agree to put all their capital, labour and skills towards achieving maximum gains from the venture. A Partnership Agreement will also spell out the manner in which it may be dissolved and must be signed and followed by each of the Partners.

A Partnership Agreement is defined as being an arrangement that is agreed to by all parties to the transaction and is an effectual method of helping each of the partners to:

- Agree to share a vision to collaborate together
- Set up mutually acceptable goals
- Specify the basis on which to begin working together
- Make sure that each of the partners are clear about about what needs to be achieved
- Assess the effectiveness of the agreement
- Bring out issues related to accountability and responsibility
- Lay a strong foundation that can sail through difficulties and testing times ahead

Procedure for Registration of Partnership Firms

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Under Section 58 of the Act, a firm may be registered at any time (not merely at the time of its formation but subsequently also) by filing an application with the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated.

1. Application shall contain:-
   - ✓ name of the firm
   - ✓ place or principal place of business
   - ✓ names of any other places where the firm carries on business.
   - ✓ date on which each partner joined the firm
   - ✓ name in full and permanent address of partners.
   - ✓ duration of the firm
2. Application shall be signed and verified by all the partners or their duly authorized agents.
3. Application shall be accompanied by prescribed fee as well as the following documents:
   - Prescribed Registration Form for Incorporation of a Firm. (Form No. 1)
   - certified true copy of the Partnership deed entered into.
   - ownership proof of the principal place of business
4. Name of the firm should not contain any words which may express or imply the approval or patronage of the government except where the government has given its written consent for the use of such words as part of the firm name.
5. Under Section 59 of the Act, when the Registrar of Firms is satisfied that the provisions of section 58 have been duly complied with, he shall record an entry of the statement in the Register of Firms and issue a Certificate of Registration.

Penalty for furnishing false particulars (Section 70)

Any person who signs any statement, amending statement, notice or intimation under this Chapter containing any particular which he knows to be false or does not believe to be true or containing particulars which he knows to be incomplete or does not believe to be complete, shall be punishable with imprisonment which may extend to three months, or with a fine or with both.

Any alterations, subsequent to Registration shall be notified to the registrar

- Change in firm name and principal place of business (Section 60) shall require sending of a new application form along with the prescribed fee, duly signed and verified by all the partners.
- Change relating to opening and closing of branches. (Section 61)
- When a registered firm discontinues business at any place or begins to carry on business at any place, such place not being its principal place of business, any partner or agent of the firm may send intimation thereof to the Registrar.
- Change in the name and permanent address of any partner (Section 62)
- When any partner in a registered firm alters his name or permanent address, an intimation of the alteration may be sent by any partner or agent of the firm to the Registrar
- Change in the constitution of the firm and its dissolution [Section 63(1)]
- When change occurs in the constitution of the firm, any of the new, continuing or the outgoing partner, while when a registered firm is dissolved , any person who was a partner immediately before the dissolution or the agent of any such partner or person specially authorized on his behalf, may give notice of such a change to the Registrar, specifying the date thereof.
- Under Section 63(2), when a minor who has been admitted to the benefits of partnership in a firm attains majority and elects to become or not to become a partner, he or his agent specially authorized in this behalf, may give notice to the Registrar that he has or has not become a partner.

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- Accordingly, the various forms prescribed under the Indian Partnership Act, 1932, for the alterations in the registered partnership firm are:-
    a) Form No. II: For change of principle place of business & change in the name of the firm.
    b) Form No. III: For change of the other then principle place of business.
    c) Form No. IV: For change of name of the partners & permanent address of the partners.
    d) Form No. V: For change of constitution of forms & addition or retirement of partner.
    e) Form No.VI: For dissolution of the firm
    f) Form No. VII: For minor partner attains the age of majority.

Effects on Non-Registration

Partnership Act, 1932 does not provide for compulsory registration of firms. It is optional for partners to set the firm registered and there are no penalties for non-registration. However, Section 69 of the Act which deals with the effects of non-registration denies certain rights to an unregistered firm. Under the Act:-

- ✓ A partner of an unregistered firm cannot file a suit in any court against the firm or other partners for the enforcement of any right arising from a contract or right conferred by the Partnership Act unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm.
- ✓ No suits to enforce a right arising from a contract shall be instituted in any Court by or on behalf of a firm against any third party unless the firm is registered and the persons suing are or have been shown in the Register of Firms as partners in the firm.
- ✓ An unregistered firm or any of its partners cannot claim a set off (i.e. mutual adjustment of debts owned by the disputant parties to one another) or other proceedings in a dispute with a third party.

Hence, every firm finds it advisable to get itself registered sooner or later. However, non-registration of a Partnership firm shall not affect:

- ✓ The rights of third parties to sue the firm and/or its partners.
- ✓ The firms or partners in the firms which have no place of business in the territories to which this Act extends, or whose places of business in the said territories are situated in areas to which the act does not apply.
- ✓ any suit or claim or set-off not exceeding one hundred rupees in value which, in the Presidency-towns, is not of a kind specified in Section 19 of the Presidency Small Cause Courts Act, 1882 (15 of 1882), or outside the Presidency- towns, is not of a kind specified in the Second Schedule to the Provincial small Cause Courts Act, 1887 (9 of 1887), to any proceeding in execution or other proceeding incidental to or arising from any such suit or claim.
- ✓ the enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm, or any right or power to realise the property of a dissolved firm.
- ✓ the powers of an official assignee, receiver or Court under the Presidency-towns Insolvency Act, 1909 (3 of 1909), or the Provincial Insolvency Act, 1920 (5 of 1920), to realise the property of an insolvent partner.

Rectification of mistakes (Section 64 of the Act)

- The Registrar shall have power at all times to rectify any mistake in order to bring the entry in the Register of Firms relating to any firm into conformity with the documents relating to that firm filed under this Act.

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- On application made by all the parties who have signed any document relating to a firm filed under this Act, the Registrar may rectify any mistake in such document or in the record or note thereof made in the Register of Firms.

Inspection of Register and filed documents (Section 66 of the Act)

- The Register of Firms shall be open to inspection by any person on payment of such fee as may be prescribed.
- All statements, notices and intimations filed under this Act shall be open to inspection, subject to such conditions and on payment of such fee as may be prescribed.

Grant of copies (Section 67 of the Act)

The Registrar shall on application furnish to any person, a payment of such fee as may be prescribed, a copy, certified under his hand, of any entry or portion thereof in the Register of Firms.

Tax provisions under Income Tax Act, 1961

Partnership firm is subjected to taxation under the Income Tax Act, 1961. The Income Tax Act is subjected to annual amendments by the Finance Act, which mentions the 'rates' of income tax and other taxes for the corresponding year.

Under the Income Tax Act, the Partnership firm is taxed as a separate entity, distinct from the partners. In the Act, there is no distinction between assessment of a registered and unregistered firms. However, the partnership must be evidenced by a partnership deed. The partnership deed is a blue print of the rights and liabilities of partners as to their capital, profit sharing ratio, drawings, interest on capital, commission, salary, etc, terms and conditions as to working, functioning and dissolution of the partnership business.

Under the Act, a partnership firm may be assessed either as a partnership firm or as an association of persons (AOP). If the firm satisfies the following conditions, it will be assessed as a partnership firm, otherwise it will be assessed as an AOP:-

- ❖ The firm is evidenced by an instrument i.e. there is a written partnership deed.
- ❖ The individual shares of the partners are very clearly specified in the deed.
- ❖ A certified copy of partnership deed must accompany the return of income of the firm of the previous year in which the partnership was formed.
- ❖ If during a previous year, a change takes place in the constitution of the firm or in the profit sharing ratio of the partners, a certified copy of the revised partnership deed shall be submitted along with the return of income of the previous years in question.
- ❖ There should not be any failure on the part of the firm while attending to notices given by the Income Tax Officer for completion of the assessment of the firm.

It is more beneficial to be assessed as a partnership firm than as an AOP, since a partnership firm can claim the following additional deductions which the AOP cannot claim :-

- ❖ Interest paid to partners, provided such interest is authorised by the partnership deed.
- ❖ Any salary, bonus, commission, or remuneration (by whatever name called) to a partner will be allowed as a deduction if it is paid to a working partner who is an individual. The remuneration paid to such a partner must be authorised by the partnership deed and the amount of remuneration must not exceed the given limits.

Tax Rates for a Partnership Firm

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Income of the Partnership firm is chargeable @ 30% flat.

Surcharge in the current financial year is nil. But, next financial year onwards is applicable @ 5% for firms having total income exceeding Rs.1 Crore and 10% if total income exceeds 10 crores.

Educational Cess @ 2% and secondary and higher education cess @ 1% is also applicable for all firms.

Accounting Treatment

The amount of capital that the Partners will invest in the business will be held in a separate capital account and neither of the Partners will be able to withdraw any money from it. And, finally each individual capital account will be maintained in accordance with the profit sharing capabilities of the Partners as set forth in the agreement.

The income statement of the partnership shall be made individually in the names of each Partner and the profits/losses will be shared in accordance with the terms agreed to by each individual. Partnership profits or losses will be charged to the individual income accounts of the Partners. Partners are not entitled to draw any salary, but may draw upon their income accounts for any monies needed as defined in the partnership agreement.

Dissolution of the Partnership Firms

The partnership may be voluntarily dissolved at any time with the mutual consent of the partners. In such an eventuality, the withdrawing partner should move reasonably swiftly to facilitate the liquidation. In case a partner was to die, the remaining partners will have the option to either liquidate the partnership or to buy out the share of the deceased partner.

Dissolution of a firm implies dissolution of the partnership between all partners of a firm. It may be by agreement, compulsory, due to contingency, by will and by the court. The settlement of accounts at this point of time is mentioned in Section 48 and basically provides for payment of debts and payments to partners. Now, the special provision for Goodwill is Section 55 which deals with the mode of dealing with goodwill at the time of dissolution. A close connection of this section exists with Section 53 and Section 54 both of which speak of restraint of trade.

Goodwill in connection with Dissolution of a Firm

Goodwill is essentially an intangible asset of a firm accruing to it by the good conduct and business performance. Therefore it can effectively be defined as the benefits arising from connection and reputation of the business and is primarily an asset. It is intangible and rather difficult to identify per se. It is also difficult to specify when the goodwill takes existence and no business which commences possesses goodwill from the start. It is generated as the business is carried on and may be augmented with the passage of time.

It has been held in the case of CIT v. B.C. Srinivasa Setty that the goodwill is affected by everything relating to the business , the personality of the owners, the nature and character of the business , its name and reputation , its location , its impact on the contemporary market and on the prevailing socio-economic ecology.

Now, at the time of dissolution, the goodwill may be sold separately or along with the other assets. If there is dissolution of a partnership with a condition that the assets fall to a particular partner and no mention of goodwill is made, it is assumed that the goodwill also falls to the partner getting the other assets. It is therefore quite clear that goodwill is an integral part of the assets. At this time goodwill might infact be the most important and valuable asset. Also if there is no express or implied agreement to

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the effect then the goodwill may be sold as an asset on insistence of a partner. It must be noted that earlier neither the Contract Act nor the Partnership Act had any specific provision on goodwill and it has been only a recent development to include the section on goodwill as part of partnership act. The question whether the firm has goodwill or not is a question of fact.

The name of a firm which is included in the goodwill may be excluded from the sale where use of that name is likely, to expose continuing partners, who carry on business, to liability. Goodwill of the business sold -- seller of goodwill may set up rival business but if he tries to attract customs of old firms he can be restrained by an injunction from doing so, where a person is taken on the condition that the goodwill shall bring to other partner on termination of the partnership above principles applies. Also if there exists a deed of modification to separate business , it cannot be considered a deed of dissolution and thus will not attract Section 55 of the Indian Partnership Act.

The most relevant judgement on this section has been the case of Khushal Khemgar Shah & others v. m/s Khorshed Banu Dadibar.

The facts of the case read as follows, Dadiba Boatwalla was one of the eight partners of M/s Meghji Thoban & co. Boatwalla died and by virtue of clause 8 of the deed of partnership, the business of the firm was continued by surviving partners. Now, his widow and son obtained the letter of administration and commenced an action in the High Court.

This was resisted by the surviving partners and the High Court held that the plaintiff (widow and son) were not entitled to an account of profits and losses after the death of Boatwalla. However the court held that the plaintiff was entitled to 6% interest per annum on Boatwalla's share including the goodwill.

In return the defendants appealed again, contending that the plaintiffs as a legal representatives were not entitled to a share in the goodwill. The reason being that the goodwill may be taken into account only when there is dissolution of the firm and in any event because Boatwalla had already agreed the interest on goodwill would cease on his death and the business would be continued by the surviving partners. The Supreme Court through Justice Shah, opined that"

'Section 55 does not allow the interpretation, that, goodwill may be taken into account only when there is a general dissolution of the firm, and not when the representatives of the partner claim their share in the firm , which by express stipulate is to continue notwithstanding death of a partner. The provision deals with the concept and consequences of dissolution of the firm. The Act does not operate to extinguish the right in the assets of the firm of a partner who dies, when the partnership agreement provides that on his death, the partnership continues.'

The court also laid down the guidelines of interpretation of the deed of partnership.

'The court must insist upon some indication that the right to a share in the assets is by virtue of an agreement; that the surviving partners are entitled to carry on business on the death of the partner to be extinguished. In the absence of a provision expressly made or clearly implied , the normal rule that the share of a partner in the assets devolves upon his legal representatives will apply to the goodwill as to other assets.'

In Dulaldas Mullick & others v. Ganesh Das Damani and others , the plaintiff was carrying on business as a paint and varnish dealer in a shop room, paying rent under the name of D Mullick & Co. He was indebted to one Gopal Lal Daga , who instituted a suit and got a decree in his favour. Execution proceedings started and the stock in trade, goodwill and furniture was sold to one Damani who took possession of the room . The basic point was whether goodwill includes right of a plaintiff as a tenant.' there can be no hard and fast rule ; no simple formula and no inflexible and rigid definitions of the term

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goodwill, but in each case it is necessary to see the entire nexus of facts connected with the business whose goodwill is to be determined. The bench cited Commr. Of Inland Revenue v. Muller & Co. Margarine Ltd. with respect to the meaning of the word goodwill. Lord Lindley said ' I understand the word to include whatever adds value to a business by reason of situation , name and reputation, connection .goodwill is inseparable from the business to which it adds value and in my opinion exists where the business is carried on'.

Finally the bench reached the conclusion that tenancy rights were included in goodwill. Therefore the position which emerges is goodwill is essentially a form of an asset and is treated in the same way as an ordinary asset.

Rights and Duties of Partners: at the time of sale of goodwill

At the time of dissolution all partners have the right to sell the goodwill of the firm for the common benefit of the partners. This does not restrict the right merely to general dissolution. The legal representatives of the deceased partner are also entitled to a share in the goodwill of the partnership which is continued after the death of the partner.

Goodwill is essentially a estimation by the customers and protecting goodwill means protecting the custom of the firm. The seller may continue to trade in the same field, can offer competition in every lawful manner, advertise to the general public and follow other commercial tactics. He may offer better and cheaper services, if he can so afford, and divert the flow of customers to his new place, but not, by a personalized approach or solicitation. This is necessary to ensure freedom of trade to every individual.

However if the seller of the goodwill represents to the customer that he is the same person carrying on the old business, it would destroy the buyer's purchase of goodwill. Therefore certain restrictions are required to be imposed on the seller and buyer of goodwill. This section essentially speaks of such restrictions and the boundary within which both parties have to function. Though restrictions are to be imposed, it must also be noted that common law normally does not provide for restrictions on trade . Therefore a level of balance has to be maintained.

Sub section 2 of Section 55 provides that though the seller may continue the business as he pleases, he may however not ,

Use the firm name,

#Cannot represent to the people that he is carrying on the old business.

He cannot solicit the custom of persons who were dealing with the firm before its dissolution.

He cannot approach customers with the intention of diverting them to his business, but 'is at liberty to deal with them if they come to him of their own accord'.

Even the representatives of a deceased partner cannot do such solicitation.

Subsection 3 deals with agreement in restraint of trade and lays down that any partner may, upon sale of goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within a specified local limit, and not withstanding anything contained in Section 27 of the Indian Contract Act 1872., such agreement shall be valid if the restrictions imposed are reasonable.

Therefore the essential components of the section are as follows:

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The seller may make an agreement with the buyer of not carrying on business:

Similar to the firms

Within a specified period

Within the specified local limits, if the restrictions imposed are reasonable.

The parties provide for restrictions in the agreement. In order to maintain the value of the goodwill it is usual for the buyer to require the seller to enter into an agreement restricting his right of competition. Sub-section 3 legitimizes this. The object of the agreement is to enable the buyer of goodwill to have time to establish himself and attach to himself the custom he has bought and make it his very own. Accordingly the restriction cannot be absolute and thus the section provides that the

It should specify the period of local limits of the restraint.

#The restriction must be reasonable.

Some important judicial pronouncements:

1. **M/s. D.R.Associates Vs General Manager, East Coast Railways & Ors.) 2005(1) Civil Court Cases 328 (Orissa) -** Property belonging to a partner does not become partnership property by being used for the purpose of partnership. There must be some evidence of an intention to treat the property as a part of the capital of the business. Where a partner brings certain property into the common stock as part of his capital, it becomes partnership property. Act has also specifically included the goodwill among the partners of the firm subject to any contract between the partners, in all accounts for determining the shares.
2. **Smt.Sarojini, LRs. of Deceased 1st defendant Vs Kumari Bhagyavathi & Ors.) 2005(3) Civil Court Cases 327 (Madras) -** One of the partners died and the firm stood dissolved. New partnership firm constituted in which new partners introduced. Held, surviving partner is liable to render accounts till the date on which the firm stood dissolved.
3. **State Bank of India Vs M/s.Simko Engineering Works) 2005(1) Civil Court Cases 319 (P&H) -** A partnership firm has no independent entity of its own and all the liabilities against the firm or all acts done by any one of its partners for and on behalf of the firm shall bind all the other partners as well. However, Section 20 is an exception to the implied authority. Partners by contract between themselves extend or restrict the implied authority of any partner. However, notwithstanding any such restriction, any act done by a partner on behalf of the firm, which falls within his implied authority, binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believe that partner to be a partner. Onus to prove that such authority of partner is restricted is upon the person who claims such a restriction.
4. **Ashutosh Vs State of Rajasthan & Ors.) 2005(2) Apex Court Judgments 657 (S.C.) : 2005(3) Civil Court Cases 606 (S.C.) -** Notice to agent tantamounts to the principles and vice versa. Notice to a principal is notice to all his agents and notice to an agent of matters connected with the agency is notice to his principal.
5. **Ashutosh Vs State of Rajasthan) 2005(2) Apex Court Judgments 657 (S.C.) : 2005(3) Civil Court Cases 606 (S.C.) -** A creditor of the firm can recover the debt from any one or more of the partners. Each partner is liable as if the debt of the firm has been incurred on his personal liability.
6. **Harihar Davey Vs Kamlesh Steel Enterprises & Ors.) 2005(3) Civil Court Cases 774 (Madras) -** Public notice as required u/s 72 of the Act not given. Held, a retiring partner is liable

for any subsequent act on behalf of the firm which would bind the firm until the public notice as prescribed by Section 72 is given.

7. **P.N.Shanmugam & Anr. Vs P.D.Vadivelu & Anr.) 2006(4) Civil Court Cases 660 (A.P.)** - Dissolution and reconstitution - Two different legal concepts. Dissolution puts an end to the partnership, but reconstitution keeps it subsisting, though in another form. Dissolution followed by some of the erstwhile partners taking over the assets and liabilities of the dissolved partnership and forming themselves into a partnership is not reconstitution of the original partnership. Partnership formed after dissolution is a new partnership and not a reconstitution of the old partnership. A reconstitution of a firm denotes a structural alteration of the membership of the firm, by addition or reduction of members and an incidental redistribution of the shares of the partners.
8. **(P.N.Shanmugam & Anr. Vs P.D.Vadivelu & Anr.) 2006(4) Civil Court Cases 660 (A.P.)** - Court can dissolve the firm if meeting of partnership was never held after execution of the partnership deed in spite of repeated requests by plaintiff, managing partner did not show him the accounts and confidence between the partners i.e. plaintiff on the one hand and defendant on the other found lost.
9. **(P.N.Shanmugam & Anr. Vs P.D.Vadivelu & Anr.) 2006(4) Civil Court Cases 660 (A.P.)** - Managing partner if stated in evidence that firm has been dissolved and fresh partnership is constituted, it amounts to dissolution by notice on the date of deposition. Court can grant relief of dissolution of firm even if plaintiff has not asked for it and order rendition of accounts prayed for.
10. **P.N.Shanmugam & Anr. Vs P.D.Vadivelu & Anr.) 2006(4) Civil Court Cases 660 (A.P.)** - Changes in the constitution of the Firm do not change registration once made. Fresh registration need not be applied and obtained. However, changes made have to be notified to the Registrar u/s 63(1) of the Act. Default made by firm in not so notifying is not of relevance in considering the question of the maintainability of the suit u/s 69(2) of the Act.
11. **Chandrayya Mutwayya Irabatti Vs Sidram Ganpat Ingale) 2006(1) Civil Court Cases 600 (Bombay)** – one partner forcible breaking lock of shop of partnership firm and taking away certain articles lying therein. Onother partner suit for damages. Such suit is not a suit for enforcing right arising out of contract or for enforcing a right conferred by Partnership Act. Such suit is essentially a suit for damages for misconduct and is not barred by Section 69 of the Act.
12. **(M/s Samyuktha Cotton Trading Co. Vs Bheemineni Venkata Subbaiah & Ors.) 2005(1) Civil Court Cases 501 (A.P.)** - Unregistered partnership firm, filed an application for registration of firm during pendency of suit. Court held that, Bar under Section 69 does not apply.
13. **M/s. IBP Company & Anr. Vs M/s. Uday Singh Jeet Ram & Ors.) 2004(3) Civil Court Cases 699 (P&H)** – Application for registration of firm has been filed after filing the suit. Court held that, cures the initial defect provided the bar of limitation does not come in. Even fresh suit on the same cause of action is permitted.

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DEED OF PARTNERSHIP

THIS DEED of Partnership is made at.................... on this .... day of .... by and between: Shri .... aged about .... years, son of Shri .... resident of .... (Hereinafter to be called the First Party); Shri .... aged about .... years, son of Shri .... resident of ....(Hereinafter to be called the Second Party); Shri .... aged about .... years, son of Shri .... resident of (Hereinafter to be called the Third Party); Shri .... aged about .... years, son of Shri .... resident of (Hereinafter to be called the Fourth Party);

WHEREAS the parties to this deed have been carrying on the business of .... under the name and style of M/s. .... with its principal place of business at .... on the terms and conditions incorporated in the Partnership Deed executed on ....

AND WHEREAS the parties to this deed have been carrying on the above said business in partnership on the terms and conditions orally and mutually agreed amongst themselves as aforesaid;

AND NOW WHEREAS the parties to this deed desire that the terms and conditions on which they have been carrying on the above said business in partnership since .... and propose to continue in future be reduced to writing to avoid future difficulties or misunderstanding.

NOW, THEREFORE THIS DEED WITNESSETH as under, incorporating the aforesaid amendment/ alteration in the terms and conditions of the partnership:

1. That the partnership business has been and shall continue to be carried on under the name and style of M/s. ....
2. That the partnership business has been and shall continue to be that of .... with its principal place of business at .... The parties by mutual consent may carry on business at such other place or places, in such other name or names and of such other nature or natures, as they may deem fit and proper from time to time.
3. That the amount lying to the credit of the partners as on 1-4-1992 shall be deemed as their capital investment. Further capital, loans or deposits looking to the needs/requirements of the partnership firm shall be arranged, invested or contributed by the partners.

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4. That interest at the rate of 18% per annum or as may be prescribed under section 40(b)(iv) of the Income-tax Act, 1961 or any other applicable provisions as may be in force in the income-tax assessment of the partnership firm for the relevant accounting period or at a lower rate as may be agreed to by and between the parties from time to time shall be paid to the partners or credited to the partners on the amount standing to the credit of the account of the partners.

Such interest shall be considered as an expenditure of the firm and shall be debited to the Profit & Loss Account of the firm before arriving at the divisible profit or loss. The interest to persons other than partners shall be paid or credited to their accounts at the rate or rates as may be agreed to by and between the partners and such persons from time to time.

5. That Shri ……………………………. Shri ………………… and Shri ………………………. the parties of the ……………………. parts have agreed to keep themselves actively engaged in conducting the affairs of the business of the partnership firm. The said partners shall be working partners. It is hereby agreed to that in consideration of the said parties keeping themselves actively engaged in the business of the partnership firm and working as working partners, shall be entitled to remuneration.

The remuneration payable to the said working partners shall be computed in the manner laid down or deduction under section 40(b)(v), read with Explanation 3 of the Income-tax Act, 1961 or any other applicable provision as may be in force in the income-tax assessment of the partnership firm for the relevant accounting year. Such amount of remuneration shall be distributed between the said working partners in the following proportion:

A. Shri …………………………… ……. per cent of such amount

B. Shri …………………………… ……. per cent of such amount

C. Shri …………………………… ……. per cent of such amount

The partners shall be entitled to increase or reduce the above remuneration and may agree to pay remuneration to other working partner or partners as the case may be. The partners may also agree to revise the mode of calculating the above said remuneration as may be agreed to by and between the partners from time to time.

6. That the parties hereto shall be true and faithful to each other and shall not do or cause to be done anything which may be detrimental to the interest of the firm.

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7. That the parties shall keep or cause to be kept proper books of account and documents and shall make entries therein of all receipts, payments and other matters as is usually done and entered in the books of account kept by persons engaged in business similar to that of the firm. Each partner shall have a right to have access to and to inspect and take copy of the same.

8. That the partnership has been and shall be a partnership at will.

9. That the net profit of the partnership firm after deduction of all expenses including rent, salaries, other establishment expenses, interest and remuneration payable to the partners in accordance with this deed of partnership or any supplementary deed as may be executed by the partners from time, to time, shall be divided and distributed amongst the partners in the following proportion:

Sr. No.	Name of Party	Share in profits
1.		
2.		
3.		
4.		

The losses, if any, including loss of capital suffered in any year shall also be apportioned in the above said proportion.

10. That the bank account or accounts have been and shall be maintained in the name of the firm and shall be operated singly or jointly by the partners.

11. That the books of account shall be closed on 31st day of March each year. The net profit or loss after deducting all expenses, interest, remuneration, outgoings shall be divided between the parties in proportion to the sharing ratio referred to hereinabove.

12. That notwithstanding anything contained in the Indian Partnership Act it is hereby mutually agreed to by and between the parties that in case of death of any one or more partners, the firm shall not be dissolved but shall continue to be carried on by and between the surviving partners and legal heirs and/or representatives of the deceased partner, as a continuing concern, on the same terms and conditions as incorporated in this Deed or on such terms and conditions as may be agreed to by and between them from time to time. It is hereby further clarified that it shall be deemed as change in constitution and not succession.

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13. That with respect to any matter connected with the affairs of the firm, which is not specifically provided for herein, the partners may make such agreements therefor and may set in such manner with regard thereto as may be agreed upon by and between themselves.

14. That if the partners deem proper and in their interest, they may admit any other person or persons as partners on the terms and conditions as may be mutually agreed amongst themselves.

15. That the partners to this deed are partners in their individual capacity/representing HUF styled as M/s. .... The parties do not represent any other person.

16. All bonds, bills, notes, bills of exchange, hundies or promissory notes or other securities given on behalf of the partnership (except cheques) shall be signed, endorsed, accepted or executed jointly by all the partners and any bond, bill, note, bill of exchange, etc. to which any partner may be a party contrary to this provision shall be deemed to have been on the personal account of such partner and he shall pay and discharge the same out of his own moneys and indemnify other partners and the firm against payment thereof and against all actions, proceedings, costs, charges, expenses, claims and demands in respect thereof.

17. That the parties of .... part are not working partners but are only financing, dormant and sleeping partners. The parties of .... part need not be in charge of, responsible to the firm for the conduct of the business of the firm and need not take interest in day-to-day working and business of the partnership firm.

That the parties of the .... part shall not be liable to any criminal action for the business or working of the partnership firm or for the acts of the other partners or its employees or its representatives for and on behalf of or on account of the partnership firm or for the purposes of the partnership firm. The said partners shall not be liable for any liability, civil or criminal, against the partnership firm or other partners.

That the said partners shall not become and shall not be liable for any criminal action for any default or offence committed by other partners or employees or authorised representatives of the firm under the Income-tax Act, Customs Act, Foreign Exchange Regulation Act, Sales tax Laws or other Central or State Acts, laws, Rules or Regulations.

18. That the partners shall be entitled to modify the above terms relating to remuneration, interest, etc. payable to partners by executing a supplementary deed and such deed when executed shall

have effect unless otherwise provided from the first day of accounting period in which such supplementary deed is executed and the same shall form part of this deed of partnership.

19. That all disputes and questions in .... connection with the partnership or this deed arising between the partners or between any one of them or their legal representatives and whether during or after the partnership, shall be referred to the arbitrator in accordance with the provisions of the Arbitration and Conciliation Act, 1996 then in force.

IN WITNESS WHEREOF the parties to this deed have set their hands on the day and year first above written and in the presence of:

First Party

Second Party

Third Party

Fourth Party

WITNESSES;

1.

2.

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