
UNIT 3 THE PARTNERSHIP ACT, 1932

Objectives

On completion of studying this Unit, you will be able to:

- Define partnership and explain its essential features
- Describe different types of partners and partnerships
- Differentiate between partnership and other forms of organization.
- Discuss how registration of a partnership firm can be done
- Explain the circumstances when a partnership is reconstituted and a firm is dissolved
- Appreciate the meaning of the term 'Limited Liability Partnership'(LLP), its need, scope advantages and incorporation of LLP

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3.1 INTRODUCTION

The development of business and growth in business transactions lead to the replacement of the proprietary form of organizations with partnership enterprises. Partnership is a form of business organization, where two or more persons come together for jointly carrying on some business. In partnership two or more persons pool their resources; both money and material, to their mutual advantage and thus share the business risk.

Towards the end of 19th century it was considered absolutely crucial to regulate the partnership form of business, so as to control the evils (many evils crept in over passage of time) from spreading and contaminating the business organization and mercantile transactions.

Initially, The Indian Contract Act, 1872, governed all aspects of Commerce and trade and Chapter IX, sections 239 to 266 of the Act regulated the partnership business. But these provisions were not exhaustive. Many aspects remained unnoticed and unregulated. This led to a need for more specific governance and the government took steps to legislate further. Chapter IX, sections 239 to 266 are replaced by Indian Partnership Act, 1932. It is based on the English Partnership Act, 1890.

Partnership is a mere voluntary collective and has no force of law to its constitution. Thus, the concept of partnership is that a firm is not an entity or a person in law but is merely an association of persons and the firm name is only a collective name for individuals who have agreed to carry on business in partnership. A Partnership arises from a contract, and therefore, such a contract is governed not only by the provisions of the Partnership Act in that regard, but also by the general law of contract in such matters, where the Partnership Act does not specifically make any provision. Thus, the rules relating to offer and acceptance, consideration, free consent, legality of object, etc, as contained in the Indian Contract Act, are applicable to a contract of Partnership also.

3.2 NATURE OF PARTNERSHIP

3.2.1 Definition of Partnership, ‘Partners’, ‘Firm’ and ‘Firm’s Name’

Section 4, The Indian Partnership Act, 1932, lays down the definition of “Partnership”, “Partner”, “Firm” and “Firm-Name”.

“*Partnership*” is the relationship between persons who have agreed to share the profits of the business carried on by all or any of them acting for all”.

There are three aspects to partnership: partners, firm, and the firm name.

Persons who have entered into partnership with one another are called individually ‘*partners*’ and collectively ‘*a firm*’, and the name under which the business is carried on is called the ‘*firm’s name*’.

Thus “*a firm*” in law is only a collective name of the partners of a partnership. It doesn't have a separate legal existence as is in a corporation.

While acquiring the “*firm name*”, the partners should keep in mind that they do not violate the rules relating to trade name or goodwill. The adopted name must not mislead the public to confuse them with a firm of repute already in existence with a similar name. They must not use a name implying the sanction of patronage of the Government. A partnership firm cannot use the word “Limited” as a part of its name.

3.2.2 Essentials of a Partnership

The examination of the definition of partnership given in section 4 of the Act indicates that the following elements must co-exist before a partnership can come into existence:

- 1) There must be ***minimum two persons***.
- 2) The relationship must arise out of an ***agreement*** between two or more persons to carry on a ***business***
- 3) The agreement must be to ***share the profits*** of a business
- 4) The business must be carried on ***by all or any of them acting for all***.
- 5) Each ***partner is liable*** for all the acts of a firm done by a partner.

We shall now discuss the aforesaid elements, briefly:

- 1) ***Association of two or more Persons***: In order to form partnership, there must be a contract between two or more persons coming together for a common goal. Persons must be competent to enter into a contract. They may all be natural or artificial or some natural and other artificial -

There are at least two persons required otherwise it cannot be a partnership. If this number gets reduced to one for reason like death or insolvency, the partnership ceases to exist. The Act is silent on the maximum number of partners but section 464 of the Companies Act, 2013 has now put a limit of 50 partners in any association/partnership firm. The Companies Act, 2013, lays limit on number of partners in a partnership as under:

- a) The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) Rules, 2014.
- b) Section 464 (1) of the Companies Act 2013 states “provided that the number of persons which may be prescribed under this sub-section shall not exceed one hundred.

Thus, the ceiling under rules can be varied but under no circumstance can go beyond 100.

- 2) ***Agreement***: According to section 5, the relation of partnership arises from contract and not from status; thus, the members of a Hindu undivided family carrying on a family business, or a Burmese Buddhist husband and wife carrying on business, are not partners in such business. The agreement is the basis of relationship between the partners. The agreement can be in written

or oral form. But it is preferred that the partners have a written agreement so that in case of dispute there is a greater clarity as to their relation and position.

- 3) **Business:** The agreement should be to carry on some lawful business. The term “business” includes trade, occupation and profession (Section 2(b) of the Act). In the definition of partnership the word “business” means “carrying on business” that is continuity or repetition of acts. But that doesn’t mean it should be lengthy operations, even a single venture of an undertaking, if there is continued participation of two or more persons for acquisition of gains is considered.
- 4) **Sharing of Profit:** To constitute a partnership, the parties must have agreed to carry on a business (not a charitable activity) and to share profits in common. Unless otherwise agreed sharing of profits also involves sharing of losses as well. However, the sharing of profit is an essential element of partnership, the sharing of losses is not. The partners can agree to share the profits in any ratio and either in specific proportions or in specific sums, but if only one partner is entitled to whole of the profit then there will be no partnership.
- 5) **Mutual Agency:** The business of a partnership concern may be carried on by all the partners or any of them acting for all. This statement has two important implications. First, every partner is entitled to participate in the conduct of the affairs of its business. Second, that there exists a relationship of mutual agency between all the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He can bind other partners by his acts and also is bound by the acts of other partners with regard to business of the firm.
- 6) **Liability of Partners:** Each partner is liable jointly and severally to the third party for all the acts of the firm done while he is a partner. The liability of a partner for acts of the firm is unlimited i.e., the partners private assets can also be used for paying off the firm’s debts.

3.2.3 Types of Partner

There are basically two categories of partners:-

- i) Partners by virtue of Partnership Agreement; and
- ii) Partners by virtue of holding out [section 28]

The Act does not provide about the types of partners. This is decided on the partnership contract. In practice based on the extent of liability, the different classes of partners are:

- 1) **Actual, Active or Ostensible Partner:** Such a partner actively participates in the functioning and management of the business and shares its profits or losses. He acts as an agent of other partners for all acts done in the ordinary course of business. In the event of his retirement, he must give a public notice in order to absolve himself of liabilities for acts of other partners done after his retirement.
- 2) **Sleeping or dormant partners:** These partners invest money in the firm’s business and share profits but do not participate in the functioning and management of the business. However, they are liable to the third parties

for all acts of the firm. Such a partner can retire from the firm without giving any public notice to this effect. His liability for the acts of the firm ceases soon after retirement. 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.

- 3) **Nominal partner:** Such a partner neither invests nor participates in the management of the firm but only gives his name to the business or firm. However, such partners are liable to third parties for all the acts of the firm. Unlike a sleeping partner, they are known to the outsiders as partners in the firm, whereas they are not. They require to give public notice at the time of being separated from the firm.
- 4) **Partners in profit only:** 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. Thus, a person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. In spite of his specific position, he continues to be liable to the third parties for all acts of the firm, just like other partners.
- 5) **Sub-partner:** Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub-partner. A sub-partner is not the partner in firm. He is partner of a partner. A sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. He can neither participate in partnership business nor check the accounts of such partner and claim share. Also he cannot bind the firm or other partners by his acts. The only right he has to share the profits in property at the time of winding-up.
- 6) **Partner by 'estoppel' or by holding out:** If a person by his act or words, gives another person reason to believe that he is a partner in a firm (when actually he is not) and that other person takes action on those set of facts, such a person is estopped from later on denying the liabilities for the acts of the firm. Thus, it is a legally binding partnership that may occur where previously, no formal partnership agreement was in place. Such person is called partner by estoppel and is liable to all third parties. Similarly, when the firm declares a person to be a partner (when actually he is not), and that person knowingly permits himself to be represented, to be a partner in a firm or does not deny the fact that he is a partner, then such a person is known as **partner by holding out**. An active partner who fails to give public notice at the time of retirement is also liable as **partner by holding out**.

3.2.4 Position of Minor as a Partner

Minor Admitted to the Benefits of Partnership:

Since partnership is a contractual relationship. The parties to contract must be competent to contract under the law to which they are subject. A minor is incompetent to contract. Hence, he cannot become a partner but, with the consent of all the partners, he may be admitted to the benefits of partnership.

Rights of Minor:

He is entitled to share of the property and of the profits of the firm as agreed upon. He can have access to and inspect and copy any of the accounts of the firm but not any other book [section 30(2)]

A minor can sue the partners for an account or payment of his share of the property or profits of the firm, when severing his connection with the firm. The amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in section 48.

Liabilities of Minor:

A minor is liable 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. He cannot be declared insolvent if the firm's debts cannot be paid out of the firm's property.

Position on attaining majority:

A minor has a choice to become a partner, or sever his connection from the firm, within six months of his attaining the age of majority or when he comes to know of his being admitted to the benefit of partnership, whichever date is later.

He has to give a public notice if he intends to become or that he has elected not to become a partner in the firm within six months. If he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months. [Section 30(5)]

Where such person becomes a partner-

- a) his right and liabilities as a minor continue up to the date on which he becomes a partner,
- b) he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership, and
- c) his share in the property and profits of firm shall be the share to which he was entitled as a minor.

Where such person elects not to become a partner-

- a) his rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice,
- b) his share shall not be liable for any acts of the firm done after the date of the notice, and
- c) he shall be entitled to sue the partners for his share of the property and profits

3.2.5 Types of Partnerships

A partnership may be for - a particular adventure or for a fixed period or at will. From the duration point of view, a partnership may be classified into the following two:

- i) Partnership-At-Will (Section 7)
 - ii) Particular Partnership (Section 8)
- i) Partnership-At-Will:*** According to Section 7 of the Act, partnership is at will when:
- i) no fixed period has been agreed upon for the duration of partnership, and
 - ii) there is no provision made as to the determination of partnership in any other way.

The death or retirement of a partner does not affect the existence of such partnership as there is no fixed or definite date of termination. Such a partnership can be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm [Section 43(1)]. The firm is dissolved from the date mentioned in the notice as the date of dissolution or, if no such date is mentioned, as from the date of communication of the notice”.

ii) Particular Partnership: When a partnership is formed for a particular adventure or undertaking or for a particular period, such a partnership is called “Particular Partnership. Such partnership automatically comes to an end on completion of venture or on expiry of the period. If partners want to dissolve the partnership before fixed period it can be done by mutual consent and if the partnership is continued after the expiry of the term or completion of venture it is deemed to be partnership at will.

3.2.6 Partnership Distinguished from other Forms of Organisation

i) Co-ownership and Partnership:

If two or more persons own a property jointly and employ the same property in a business and share the profits, it is co-ownership and not partnership. The main point of distinction between the two is:

- 1) Partnership always arises out of a contract, express or implied. Whereas co-ownership may arise from an agreement or by the operation of law or from status or any other way. e.g., co-heirs of a property.
- 2) A partner is the agent of the other partners, but a co-owner is not the agent of the other co-owner(s).
- 3) Partnership involves sharing of profits and loss. Whereas co-ownership does not necessarily do so.
- 4) A partner cannot transfer his rights and interests to anyone without the consent of all other partners. However, a co-owner can do so without the consent of the others.
- 5) A partner can only ask for share of the profits out of the properties. Whereas a co-owner can ask for division of property,
- 6) A partner has a lien on the firm property whereas co-owner doesnot.

ii) Hindu Joint Family Firm and Partnership:

A Hindu joint family firm differs from a partnership in the following ways:

- 1) A partnership arises out of contract and a Hindu joint family (HUF) firm out of status, i.e., by birth in the family.
- 2) Partnership is governed by Indian Partnership Act and HUF by Hindu Law
- 3) A minor cannot be a partner, although he may be admitted to the benefits of partnership. Whereas, in HUF a minor is a member from the very day of his birth by virtue of his status, but he is not personally liable.

- 4) The death of a partner dissolves the partnership, but the death of a co-parcener does not.
- 5) In partnership each partner has implied authority to borrow and bind other partner but in HUF firm only the Karta or manager (who is the head of the family) is entitled to do so.
- 6) Every partner is personally liable for the debts of the firm; but in a HUF business only the Karta is personally liable.
- 7) A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts; his only remedy is to ask for partition of the assets of the family firm.
- 8) Partnership firm must be registered before it can maintain suits against outsiders. Whereas for HUF no registration is necessary.
- 9) Every partner has a definite share and it can be changed only by agreement, but the share of a coparcener enlarges or reduces depending on death or birth in family.
- 10) 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.

Activity 1

- 1) Can the following be called partnership?
 - a) Several persons jointly purchase goods for resale with a view to divide the profits arising from the transaction.
 - b) Widow or child of a deceased receiving profits
 - c) Persons who join in the purchase of goods for the purpose of dividing the goods themselves.
 - d) A. B and C agreed that each should furnish Rs. 3000 worth of goods to be shipped on a joint venture, the profits is to be divided between them according to the amount of their several shipments
 - e) Two tenants in common of a house and divide the rent equally
- 2) Tick the right answer:
 - a) Where a partnership firm is constituted for a fixed period and after expiry of that term the firm continues its business without any agreement
 - i) The partnership becomes the partnership at will
 - ii) The partnership becomes illegal
 - b) Which is not an essential element of partnership firms?
 - i) Perpetual succession ii) Mutual agency
 - c) The relationship of partnership arises from
 - i) Contract ii) status
 - d) which of the following is the conclusive test of partnership
 - i) sharing of profit ii) mutual agency relationship
 - e) Goodwill of the business is the property of the business in absence of contract to contrary. True/False.

3.3 FORMATION AND REGISTRATION OF PARTNERSHIP

3.3.1 Formation of Partnership

Partnership comes into existence by contract and this contract may be written or oral- or implied, which is inferred from the conduct of the parties in business circumstances. According to the definition of partnership under the Indian Partnership Act, 1932, there must be an agreement between the partners of a partnership firm.

To constitute a valid contract, the parties to the contract must be competent to contract, their consent must be free and objective should not be forbidden by law or immoral or opposed to public policy. However, two exceptions may be noted:

- i) A minor may be admitted to the benefits of an existing partnership firm with the consent of all other partners.
- ii) As relations of partners inter se are that of agency, no consideration is required to create the partnership.

3.3.2 Partnership Deed

As already stated the agreement of partnership may be oral. But it is advisable to have it in writing so as to avoid any future disputes. The written document that contains the mutual rights and obligations of partners is known as partnership deed. The deed must be stamped according to the provisions of the Indian Stamp Act and copy of the same must be given to each partner and at the time of registration, a copy of the deed should be filed with the Registrar of Firms. The partnership deed is not a public document and therefore binds only third parties so far as they have notice of it.

Contents of Partnership Deed

The exact terms of the partnership deed (or agreement) will depend upon the circumstances but generally a partnership deed contains the following covenants:

- i) The firm name, date of establishment, duration of partnership .
- ii) Full names and permanent addresses of all the partners and the date when each partner joined the firm.
- iii) Nature and scope of business; the place or principal place of business of the firm,.
- iv) Total capital and the contribution by each partner.
- v) Provision for further capital and loans by partners to the firm.
- vi) Partner's drawings,
- vii) Interest on capital, loans, drawings and current account.
- viii) Salaries, commission and remuneration to partners,
- ix) Profit sharing ratio of partners.
- x) Guideline for maintaining proper books of accounts, inspection and audit, Bank Accounts and their operation.

- xi) Rights and duties of the partners.
- xii) Whether and in what circumstances, notice of retirement or dissolution can be given by a partner.
- xiii) Provision that death or retirement of a partner will not bring about dissolution of partnership,
- xiv) Valuation of goodwill on retirement, death, dissolution, etc.
- xv) The method of valuation of assets (and liabilities) on retirement or death of any partner.
- xvi) Provision for expulsion of a partner.
- xvii) Provision regarding the allocation of business activities to be performed by individual partners
- xviii) The arbitration clause for the settlement of disputes. The terms contained in the partnership deed may be varied with the consent of all the parties, and such consent may be express or implied by a course of dealing. [Section 11(1)]

3.3.3 Registration of Partnership

Registration of Partnership is not mandatory in India. But registering with a document deed puts into black and white all the intentions and the purposes of the partnership as well as its functioning. However, it is to be noted that registration only creates an instance or evidence of the existence of partnership, and not a creation of a legal entity.

Registration means getting the firm registered with the Registrar of the firm in the area where the business is situated or proposed to be situated.

Application for Registration

The registration of a firm may be affected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

- a) the name of the firm;
- 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 by their agents specially authorised in this behalf. (Section 58)

Registrar on being duly satisfied, record an entry of the statement in “Register of Firm” and then issue a certificate of registration. The firm, which is registered, shall use the brackets and word (Registered) immediately after its name. If, any change is made in points (a) to (f) above same should be duly notified to the registrar so that the same is incorporated in the register of the firm.

3.3.4 Effects of Non-Registration

Non-registration (**section 69**) leads to following effects:

- i) The partners of a firm cannot sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act,
- ii) The firm cannot institute a suit against a third party. Thus the firm cannot sue but can be sued.
- iii) The third party can sue the firm as well as any partner

However, the Act allows the following suits:

- a) A suit for the dissolution of a firm.
- b) A suit for rendering of accounts of a dissolved firm.
- c) A suit for realisation of the property of a dissolved firm.
- d) A suit or claim of set-off, the value of which does not exceed one hundred rupees,
- e) A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.
- f) A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.
- g) A suit for the realisation of the property of an insolvent partner.
- h) A suit by a firm whose places of business are situated in areas which are exempted from the application of Chapter VII of the Indian Partnership Act, 1932

Exceptions: Non-registration of a firm does not, however affect the following rights:

- a) The right of third parties to sue the firm or any partner.
- b) The right of partners to sue for the dissolution of the firm or for the settlement of the accounts of a dissolved firm, or for realization of the property of a dissolved firm.
- c) The power of an Official Assignees, Receiver of Court to release the property of the insolvent partner and to bring an action.
- d) The right to sue or claim a set-off if the value of suit does not exceed Rs. 100 in value.
- e) The right to suit and proceeding instituted by legal representatives or heirs of the deceased partner of a firm for accounts of the firm or to realise the property of the firm.

Activity 2

- 1) Whether following is true or false?
 - a) The relationship of partnership is created by contract which can be expressed or implied.
 - b) As relations of partners inter se are that of agency, no consideration is required to create the partnership.

- c) Partnership deed can be prepared on plain paper as it is not mandatory to have one.
 - d) Registration only creates an instance or evidence of the existence of partnership, and not a creation of a legal entity.
 - e) If a partnership firm is not registered it cannot institute a suit against a third party.
- 2) Fill in the blanks:
- a) Registration of partnership is _____
 - b) A non registered firm can file suit for _____ of firm.
 - c) Non registration does not affect the right of _____ party to sue any partner or firm.
 - d) Non-registration of a firm does not, however affect the right to sue or claim a set-off if the value of suit does not exceed ' _____ in value.
 - e) The firm, which is registered, shall use the brackets and word _____.

3.4 RELATION OF PARTNERS TO ONE ANOTHER

The deed of registration drawn and agreed by the partners governs the requisite relationship among the partners. In the event where there is no specific mention of mandatory relationship, sec 9-17 are applicable. These cover the general duties of a partner, the duty to indemnify for loss caused by fraud, the conduct of business, mutual rights and liabilities, property of firm, profits, etc.

3.4.1 Rights of Partners

Unless otherwise agreed by the partners, the following rules apply:

A) Right of partners in normal course

- i) **Right to participate in the conduct of the Business [Section 12(a)]:** Every partner has a right to take part in the conduct and management of the business.
- ii) **Right to be consulted [Section 12(c)]:** Every partner has right to express his opinion, before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners. However, the ordinary matters connected with the business may be decided by majority of the partners.
- iii) **Right of access to books [Section 12(d)]:** Every partner, has a right to access and inspect and copy all records, books and accounts of the business.
- iv) **Right of legal heirs/ representatives/ their duly authorised agents [Section 12(e)]:** The heirs or legal representatives or the duly authorised agents of deceased partner shall have a right of access to and to inspect and copy any of the books of the firm.
- v) **Right to share Profits [Section 13(b)]:** Unless there is contract to the contrary the partners are entitled to share equally in the profits, and shall contribute equally to the losses sustained by the firm. There is no connection between the proportion in which the partners shall share the profits and the proportion in which they have contributed towards the capital of the firm.

- vi) **Interest on Advances [Section 13(d)]:** Any contribution beyond the amount of capital agreed by partner to subscribe, is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But it is to be noted that a partner cannot claim interest on capital, unless there is an agreement to pay it.
- vii) **Interest on Capital [Section 13 (c)]:** A partner can be entitled to interest on capital if there is (i) an express agreement to that effect, or practice of the particular partnership or (ii) any trade custom to that effect; or (iii) a statutory provision which entitles him to such interest. This interest is payable only out of profit.
- viii) **Right to be indemnified [Section 13(e)]:** A partner is entitled to be indemnified by the firm for all expenses incurred by him-
- a) in ordinary and proper conduct of the business, and
 - b) 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, if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstances.
- ix) **Right to use partnership property (Section 15):** Every partner is, as a rule, a joint owner of the partnership property, and has it applied exclusively for the purposes of the partnership.
- B) Right of Partners in special circumstances**
- i) **Right in emergency (Section 21):** A partner has power to act in an emergency for protecting the firm from loss.
- ii) **Right to prevent admission of new partner (Section 31):** A new partner can be admitted only with the consent of all the partners. Therefore, the dissenting partner has right to stop admission of a partner.
- iii) **Right to Retire:** a partner may retire-
- a) With the consent of all the partners,
 - b) In accordance with an expressed agreement by partners,
 - c) by giving notice where the partnership is at will. [Section 32(1)(c)].
- iv) **Right to continue as partner:** Every partner has a right to continue in the partnership and not to be expelled from firm by any majority of the partner. [Section 33(1)]
- v) **Right of an outgoing partner to carry on competing business (Section 36):** An outgoing partner may carry on a business competing with that of the firm and he may advertise such a business, but, subject to contract to the contrary, he may not-
- a) Use the firm's name,
 - b) Represent himself as carrying on the business of the firm, or
 - c) Solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

- vi) **Right To Share Subsequent Profits (Section 37):** Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm.

3.4.2 Duties of Partners

A partner may have two types of duties:-

- a) Those envisaged in the partnership contract, and
- b) Those prescribed in the Act

a) **Duties envisaged in the partnership contract:**

Partners may fix any duties. These may be expressed or implied by a course of dealing. But these duties should not violate the Act or the general principles of contract.

b) **Duties prescribed in the Act:**

The following statutory duties are implied:

- i) **Duty of Good Faith (Section 9):** Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative. Duty to be just and faithful is a mutual duty on which the foundation of partnership stands.
- ii) **Duty to Indemnify for Loss Caused by Fraud (Section 10):** Every partner is bound to indemnify firm for any loss caused to it by his fraud in the conduct of the business of the firm.
- iii) **Duty of Due Diligence [Section 12(b) and 13(a)]:** 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.
- iv) **Duty to Proper use of Property (Section 15):** Every partner must hold and use the partnership property exclusively for the purpose of firm's business.
- v) **Duty to account for profit and pay it to the firm [Section 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 or the firm name, he shall account for that profit and pay it to the firm;
 - If a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

- vi) **Duty not to Compete [Section 16(b)]:** 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.
- vii) A partner who is guilty of willful 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)]
- viii) No partner can assign or transfer his partnership interest to any other person, so as to make him a partner in the business. But a partner may assign the profits and share in the partnership assets. But the assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business; he would be entitled only to share the actual profits. On dissolution of the firm, he will be entitled to the share of the assets and also to accounts but only from the date of dissolution. (Section 29)
- ix) 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.

3.5 RELATION OF PARTNERS TO THIRD PARTIES

There are two sets of relationships. **First**, the relationship between the partners themselves which are implied relations due to the rights and duties arising out of contracting partnership. **Second**, relations of partners to third parties consist of the business carried on by one or all members of the firm in the name to the firm. They are responsible as a firm to their customers.

3.5.1 Partners as Agents

As already discussed every partner is both a principal and an agent. Thus, the general law of agency is incorporated into the law of partnership. The acts of every partner which is done to carry on, in the usual way, the business of the kind carried on by the firm, bind the firm and his partners unless:

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

3.5.2 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.

- i) **Express Authority:** The 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.
- ii) **Implied Authority:** The authority which is inferred from the conduct of the parties, nature of business, circumstances, customs and usage are said to be implied authority. Sections 19 and 22 contain provisions regarding the scope

of the implied authority of a partner. The implied authority is subject to the following conditions: (1) the act done must relate to the “normal business” of the firm; (2) the act must be done in the usual way or in the ordinary course of business, and; (3) the act must be done in the name of the firm.

The general scope of implied authority is that it is limited to all that is just necessary to do the business and doesn't extend beyond that. Following acts are under the implied authority:

- a) To sell firm's goods;
- b) To purchase goods for the firm;
- c) To accept any payment of debts due to the firm; and
- d) To engage and discharge employees.

In a Trading Firm (one which carries on business of buying and selling goods), a partner has the following additional powers:

- a) To borrow money on the firm's credit and to pledge the firm's goods for that purpose;
- b) To accept, make and issue negotiable instruments in the firm's name; and
- c) To employ a solicitor or attorney on behalf of the firm

It is, however, open to the partners by means of an express contract to extend or limit the implied authority, but third parties will be bound by such limitations only when they have notice of such curtailment.

All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts (Section 25). This is known as the liability of partners for the acts of the firm. But in order that an act done may be an act of the firm and, therefore, binding on the firm, it is necessary that the partner doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity. The act must have been done in the ordinary course of the business of the firm. [Sections 19(1) and 22]

Activity 3

Choose the right answer.

- a) Which of the following acts are included in the implied authority of a partner?
 - i) To borrow money for the purpose of firm.
 - ii) To enter into partnership on behalf of firm
- b) The implied authority of a partner of the firm does empower him to:
 - i) Enter into partnership on behalf of the firm.
 - ii) act expressing or implying an intention to bind the firm
- c) If a partner commits fraud in the conduct of the business of the firm:
 - i) He shall indemnify the firm for any loss caused to it by his fraud
 - ii) He is liable to the third parties

- d) Which of the following is the right of partner i.e., which he cannot claim as a matter of right?
 - i) Right to take part in business
 - ii) Right to receive remuneration.
- e) Partners are bound to carry on the business of the firm-
 - i) To the greatest common advantage
 - ii) For the welfare of the society

3.6 RECONSTITUTION OF FIRM

A firm is said to be reconstituted, when there is change in the composition of the partnership. The reconstitution of the firm takes place on account of admission, death, retirement, expulsion, if partnership carries on business other than the business for which it was originally formed or when the partnership business is carried on after the expiry of the term fixed for the purpose. The reconstitution involves changes in the rights and liabilities of partners. How does the law cope with change concerning partnership is made amply clear in the following sections of the law.

3.6.1 Admission of a Partner

As discussed earlier, subject to a contract between partners and to the provisions regarding minors in a firm, no new partners can be introduced into a firm without the consent of all the existing partners.

As a general rule, an incoming partner is not liable for the debts incurred before he joined the firm as a partner [Section 31(2)]. The incoming partner may, however, assume liability for past debts by novation, i.e., by a tripartite agreement between (i) the creditor of the firm, (ii) the partners existing at the time the debt was incurred, and (iii) the incoming partner.

3.6.2 Retirement of a Partner

A partner can retire from the firm i) with the consent of all the other partners; or ii) in accordance with the expressed agreement among the partners; or iii) by giving a written notice to all the partners of his intention to retire, if partnership is at will.

An outgoing partner remains liable for the partnership debts contracted while he was a partner. He may, however, be discharged by novation, i.e., by an agreement between himself, the new firm and the creditors. He may also continue to be liable after retirement if he allows himself to be held out as a partner, e.g. by allowing his name to remain the firm name. To protect himself from his liability, he should give express notice of his retirement to the persons who were dealing with the firm before his retirement or give public notice in the manner as laid down in Section 72 of the Act, that is to say, by publishing it in the Official Gazette and in at least one vernacular newspaper where the firm carries on the business. [Section 32(3)]

3.6.3 Expulsion of a partner

A partner can be expelled only if i) the power of expulsion exists in a contract between the partners; ii) the power has been exercised by a majority of the partners; and iii) it has been exercised in good faith.

If all these conditions are not present, the expulsion is not deemed to be in bona fide interest of the business of the firm.

The rights and liabilities of the expelled partner are same as that of a retired partner.

3.6.4 Death or Insolvency

The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted after the date of the death or insolvency. It will, however, be liable for debts incurred before death or insolvency. (Sections 34 and 35).

Activity 4

Fill in the blanks:

- A new partner can be admitted in the firm with the consent of _____.
- Admission, Retirement, Expulsion or death of a partner leads to _____.
- A partner can retire by _____ if partnership is at will.
- The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted _____ the date of the death or insolvency.

3.7 DISSOLUTION

According to Section 39, “The dissolution of partnership between all the partners of a firm” is called the “Dissolution of the Firm”.

The law of Partnership makes a distinction between the “*dissolution of partnership*” and “*dissolution of firm*”. Where the relation between all the partners come to an end, it is a dissolution of the firm (Section 39). Where there is an extinction of relationship between some of the partners only, it is a dissolution of partnership. So the dissolution of a partnership may or may not include the dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well.

Dissolution of Partnership

The dissolution of partnership takes place (even when there is no dissolution of the firm) in the following circumstances:

- On the expiry of the fixed term for which the partnership was formed. [Section 42(a)]
- On the completion of the adventure. [Section 42(b)]
- On the death of a partner. [Section 42(c)]
- On the insolvency of a partner. [Section 42(d)]

- e) On the retirement of a partner. [Section 42(e)]

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.

Dissolution of the Firm

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:

- a) **By mutual agreement:** A firm may be dissolved where all the partners agree that it shall be dissolved. (Section 40)
- b) **By the insolvency of all the partners but one:** If all the partners or except one all the partners become insolvent, the firm must come to an end, as a partnership firm with one partner cannot continue. [Section 41(a)]
- c) **By business becoming illegal:** If the business of the firm becomes illegal because of some subsequent events, such as change of law, it is automatically or compulsorily dissolved by the operation of law. [Section 41(b)]
- d) **By notice of dissolution:** 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. The dissolution will take place from the date mentioned in the notice or, if no such date is mentioned, as from the date of the communication of the notice. (Section 43)

Modes of Dissolution of a firm (section 40 to 44)

The dissolution of partnership firm may be in any of the following ways:

- 1) Dissolution without the order of the court or voluntary dissolution.
- 2) Dissolution by the court (section 44)

1) Dissolution without the Order of the Court or Voluntary Dissolution:

It consists of following four types:

- i) **Dissolution by Agreement (Section 40):** A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.
- ii) **Compulsory dissolution (Section 41):** A firm is compulsorily dissolved by the:
 - a) adjudication of all the partners or of all the partners but one as insolvent; or
 - b) happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

However, it should be noted that when more than one separate venture or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

- iii) **Dissolution on the happening of certain contingencies (Section 42):** Subject to contract between the partners, a firm can be dissolved on the happening of any of the following contingencies-

- a) Where firm is constituted for a fixed term, on the expiry of that term
 - b) Where the firm is constituted to carry out one or more adventures or undertakings, then by completion thereof
 - c) By the death of a partner, and
 - d) By the adjudication of a partner as an insolvent.
- iv) ***Dissolution by notice of partnership at will (Section 43):*** Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the 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 so mentioned, as from the date of the communication of the notice.

2) ***Dissolution of the Firm through Court***

As per Section 44, at the suit of a partner, the Court may order dissolve a firm on any of the following grounds, namely:

- a) ***If a partner becomes of unsound mind:*** As the insanity of a partner does not automatically dissolve the firm, in such a case the suit for the dissolution of the firm may be brought by other partners or by next friend of partner who has become of unsound mind. In either case the Court may order dissolution which will take effect from the date of the order.
- b) ***Permanent incapacity of a partner:*** Where a partner has become permanently incapable of performing his duties as a partner, e.g., he becomes blind, paralytic, etc., the Court may, at the instance of any of the other partners, order the dissolution of the firm.
- c) ***Misconduct of a partner affecting the business:*** Where a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, the Court may dissolve the firm at the instance of any of the other partners. Gambling by a partner or conviction of a partner for travelling without ticket would be sufficient ground for dissolution.
- d) ***Persistent disregard of partnership agreement by a partner:*** Where a partner, other than the partner suing, willfully or persistently commits breaches of the partnership agreement relating to the management of the affairs of the firm or the conduct of its business; or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him; the Court may order dissolution at the instance of the other partners.
- e) ***Transfer of interest or share by a partner:*** A partner cannot assign his interest so as to introduce a new partner into the firm. Where a partner has transferred the whole of his interest to a third person or where his interest has been attached under a decree or sold under a process of law, the other partners may sue for dissolution.

- f) **Business working at a loss:** if the Court is satisfied that the business of the firm cannot be carried on except at a loss, it may order for dissolution.
- g) **Any just and equitable:** As the grounds mentioned are not exhaustive, the Court may dissolve a firm on any other ground if it is satisfied that it would be just and equitable to dissolve the firm. The Court may order dissolution where the sub-stratum of the partnership firm has gone or where there is a complete deadlock and destruction of confidence between the partners [re. Yenidjee Tobacco Co. Ltd. (1916) 2 Ch. 426].

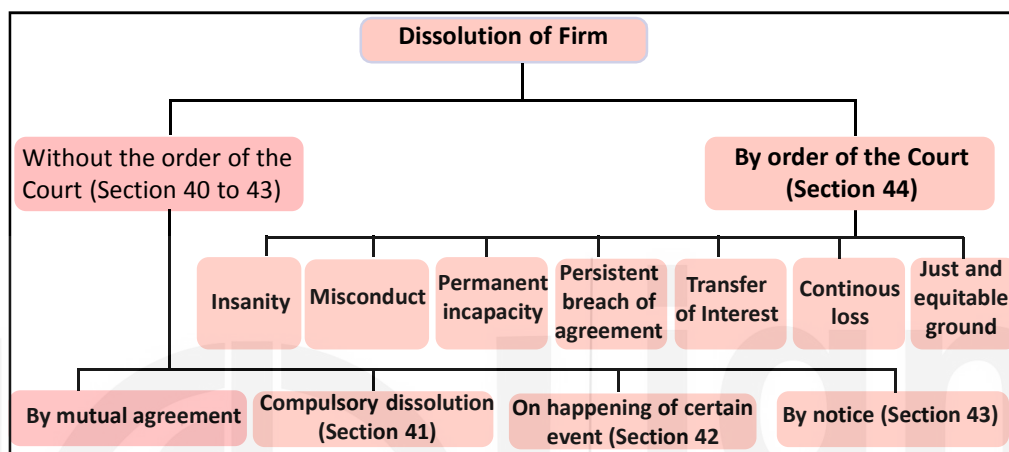


Figure 3.1: Different Forms of Dissolution of a Firm

Effect of Dissolution:

After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions. These rights and liabilities are discussed below:

Rights of Partners on Dissolution:

Right of partners to have business wound up after dissolution (section 46): On the dissolution of a firm every partner or his representative is entitled, as against all the other partners or their representative, to have the property of the firm applied in payment of the debts and liabilities of the firm, and to have the surplus distributed among the partners or their representatives according to their rights. This lien can be enforced by injunction forbidding unfair distribution. (Section 46)

Right to Return of Premium (Section 51): To buy entry into an existing firm, a new partner sometimes has to pay a premium to the existing partners in addition to any investment of capital. On dissolution, he is entitled to demand the return of a 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 (i) agreement, or (ii) misconduct of the party seeking return of the premium, or (iii) death of a partner. (Section 51)

Rights Where Partnership Contract is Rescinded for Fraud Or Misrepresentation (Section 52): Where a contract creating partnership is rescinded on the ground of fraud or misrepresentation of any of the parties thereto, the

party entitled to rescind is, without prejudice to any other right, entitle - (a) to a lien on, or right of retention of, the surplus of 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.

Right to Restrain from Use of Firm-Name or Firm-Property (Section 53): After a firm is dissolved, every partner or his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm-name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up : Provided that where any partner or his representative has brought the goodwill of the firm, nothing in this section shall affect his right to use the firm-name.

Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and notwithstanding anything contained in section 27, of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.

3.8 LIMITED LIABILITY PARTNERSHIP ACT, 2008

Limited Liability Partnership (LLP) has been introduced in India by way of Limited Liability Partnership Bill on 12th December, 2008; passed by both the houses of Parliament and assented by the President of India on 7th January, 2009 and called as the Limited Liability Partnership Act, 2008. It extends to whole of India. It fundamentally changes the nature of partnership from that of a free and voluntary entity to a legal one. However, the LLP, Act does not harm the existence Partnership Act; it remains as it is , and both are independent of each other.

The LLP Act, 2008 has 81 sections and 4 schedules.

The ***First Schedule*** deals with mutual rights and duties of partners, as well as limited liability partnership and its partners where there is absence of a formal agreement with respect to them.

The ***Second Schedule*** deals with conversion of a firm into LLP.

The ***Third Schedule*** deals with conversion of a private company into LLP.

The ***Fourth Schedule*** deals with conversion of unlisted public company into LLP.

The Ministry of Corporate Affairs and the Registrar of Companies (ROC) are entrusted with the task of administrating the LLP Act, 2008. The Central Government has the authority to frame the Rules with regard to the LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.

Definitions

Limited Liability Partnership means a partnership formed and registered under this Act. [Section 2(n)]

Accordingly–

- 1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- 2) A limited liability partnership shall have perpetual succession.
- 3) Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Features of LLP

Body corporate: LLP is a body corporate formed and incorporated under this Act.

Separate Legal Entity: The LLP is a legal entity separate from that of its partners. Therefore, LLP is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. In other words, creditors of LLP shall be the creditors of LLP alone.

Perpetual Succession: Any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP [Section 2(1)(d)].

Limited Liability: The liability of the partners is limited to their agreed contribution in the LLP. Such contribution may be of tangible or intangible nature or both.

Minimum and Maximum number of Partners: Every LLP shall have at least two partners and shall also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.

If in LLP, all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

Example: A LLP by the name SMY LLP has three partners namely 1. SI Limited, 2. MIS Limited, 3. YI Private Limited. This will not be considered for registration because the requirement for LLP is to have 2 individual members as partners apart from the body corporate. Accordingly, the said SMY LLP must consist of at least five partners; namely the three body corporates and 2 individual members, to constitute the LLP and the two individuals need to be treated as designated partners.

Third party liability: unlimited to all partners.

Artificial Legal Person: LLP is an artificial legal person because it is created by a legal process and is clothed with all rights of an individual. LLP is invisible, intangible, immortal (it can be dissolved by law alone) but not fictitious because it really exists.

Rights and Duties: Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act, 2008.

Mutual Agency: Every partner of a LLP, for the purpose of the business of LLP, is the agent of the LLP, but not of other partners (Section 26). In other words, no

partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct.

Example: The professionals like Engineering consultants, Legal Advisors and Accounting Professional are afraid of entering into business due to unlimited liability. Hence the LLP partnership Act provides an avenue for these professionals to Limited Liability Partnership firms which restricts their liability to the agreed amount. This has encouraged Professionals to form LLP.

Management of Business: The partners in the LLP are entitled to manage the business of LLP. But only the designated partners are responsible for legal compliances.

Business for Profit Only: The essential requirement for forming LLP is carrying on a lawful business with a view to earn profit. LLP cannot be formed for charitable or non-economic purpose.

Common Seal: Any LLP being an artificial person can act through its partners and designated partners. LLP may have a common seal, if it decides to have one [Section 14(c)]. Thus, it is not mandatory for a LLP to have a common seal. It shall remain under the custody of some responsible official and it shall be affixed in the presence of at least 2 designated partners of the LLP.

Foreign LLPs: Foreign LLP can become a partner in an Indian LLP. Section 2(1)(m) defines foreign limited liability partnership "as a limited liability partnership formed, incorporated, or registered outside India which established as place of business within India".

Who can be a Partner?

"**Partner**" in relation to LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement. Section-5 lays down that -

Any individual or body corporate may be a partner in a LLP. Provided that an **individual shall not be capable** of becoming a partner, if —

- a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
- b) he is an undischarged insolvent; or
- c) he has applied to be adjudicated as an insolvent and his application is pending.

Body Corporate shall exclude:

- a corporation sole, means a public office established by the Act of Parliament, a sole officeholder;
- a co-operative society; and
- any other body corporate not being a company as defined under Companies Act, 2013.
- NBFCs are prohibited to be partner of LLPs.

Following can be partners in LLP:

- A company incorporated outside India.
- A LLP can become a partner in another LLP

- A trust cannot become partner in LLP. However, trustee can become a partner of LLP in his “individual capacity” but not in a representative capacity of trust
- Similarly, an HUF cannot become a partner but Karta can in his “individual capacity” but not in a representative capacity of HUF

Liability of Partners:

Nature & extent of liability of a partner of an LLP: Every partner of an LLP would be, for the purpose of the business of the LLP, an agent of the LLP but not of the other partners. Liability of partners shall be limited except in case of unauthorized acts, fraud and negligence. But a partner shall not be personally liable for the wrongful acts or omission of any other partner. An obligation of the LLP whether arising in contract or otherwise, is solely the obligation of the LLP. The liabilities of LLP shall be met out of the property of the LLP.

Liability of a Partner upon reduction of minimum number of members in an LLP: If at any time the number of partners of LLP is reduced below two and the LLP carries on business for more than six months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligation of LLP incurred during that period.

Liability of ‘partner by holding out : The Act provides that any person (not being a partner in any LLP), who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented as a partner in a LLP (known as ‘partner by Holding out’) is liable to any person who has on the faith of any such representation given credit to the LLP, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.

It has further been provided that where any credit is received by the LLP as a result of such representation, the LLP shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.

The provisions have also been made in the Act to provide that where after a partner’s death the business is continued in the same LLP name, the continued use of that name or of the deceased partner’s name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the LLP done after his death.

Designated Partners (Section 7)

A designated partner means any partner designated as such u/s 7. Appointment of at least two ”Designated Partners” is mandatory for all LLPs. “Designated Partners” shall also be accountable for regulatory and legal compliances, besides their liability as ‘partners, per-se’.

- 1) Every LLP must have atleast two individuals as Designated Partners and at least one of them shall be a resident of India (Resident means a person who stayed in India in Previous year not less than 182 days).
- 2) In a LLP where all the partners are bodies corporate or where one or more partners are individuals and bodies corporate, at least two individuals who

are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

- 3) U/s 7(2) one become the designated partner if the incorporation document
 - Specifies such person/s; or
 - States that each of the partners from time to time of a LLP is to be a designated partner, then every partner shall be a designated partner;
- 4) Any partner may become the designated partner or cease to be a designated partner, in accordance with the LLP agreement;
- 5) An Individual shall not become a designated partner unless he has given his prior consent ;
- 6) Every LLP shall file with ROC the particulars of every Individual who has given his consent to act as designated partner, within 30 days of his appointment;
- 7) An individual eligible to be a designated Partner must satisfy the condition and requirement as may be prescribed.
- 8) A person shall not be capable of being appointed as a designated partner of LLP, if he
 - At any time within the preceding five years, has been adjudged insolvent;
 - Suspends at any time within the preceding five years, payment to his creditors and has not, at any time in preceding five year, made a composition with them;
 - Has been convicted for any offence involving moral turpitude and sentenced to imprisonment for not less than six months;
 - Has been convicted by Court for an offence involving section 30 of the LLP Act;
- 9) Every designated partner must obtain Designated Partner Identification Number (DPIN) from Central Government and provision of Section 153 to 159 of the Companies Act, 2013;
 - If a person holds both DIN and DPIN then his DPIN shall stand cancelled and DIN shall be sufficient for being appointed as Designated Partner
 - Every designated Partner shall in the event of any changes as stated in Form 10 or DIR-3, intimate the Central Government in Form DIR-6 under Companies (Appointment and Qualification of Directors) Rules, 2014; {Rule 10(4)(i)}
 - The concerned designated partner shall fill-in the relevant changes to the LLP on which he is a designated partner within 30 days of such changes; {Rule 10(4)(ii)}

Liability of a Designated Partner (Section 8)

Unless expressly provided otherwise in this Act, a designated Partner shall be-

- a) Responsible for performing all acts, matters and things including filing of any document, return, statement and the like report as mentioned under this Act and specified in the LLP agreement; and

- b) Liable to all penalties imposed on the LLP for contravention of those provisions.

Change in Designated Partners (Section-9)

- A LLP may appoint a designated partner within 30 days of a vacancy arising for any reason and provision of section 7 (4) and (5) shall apply in respect of such new designated partner;
- If no Designated Partner appointed within 30 days of vacancy or if number of designated partner at any time reduced below the two then all partner shall deemed to be a designated partner.
- Section 64 (b) of the LLP Act, provides that if number of partners reduced below the two and LLP continues, as same, for more than 6 months then the LLP may be wound up by the Tribunal.

3.9 DIFFERENCES WITH OTHER FORMS OF ORGANISATION

LLP and Partnership:

- LLP is regulated by The Limited Liability Partnership Act, 2008 where-as Partnership firm by The Indian Partnership Act, 1932.
- LLP is a body corporate where as Partnership is not.
- LLP is a separate legal entity where as partnership is not.
- LLP is created by a legal process called registration under the LLP Act, 2008, where as the partnership is created by an agreement between the partners
- Registration is mandatory for LLP where as it is voluntary for partnership.
- LLP can sue and be sued in its own name. Only the registered partnership firm can sue the third parties
- LLP has perpetual succession. The death, insanity, retirement or insolvency of the partner(s) does not affect its existence, where as it is not so in partnership
- Name of the LLP to contain the word limited liability partners (LLP) as suffix. No guidelines for partnership.
- Liability of each partner limited to the extent to agreed contribution except in case of willful fraud. Liability of each partner is unlimited in partnership.
- Each partner can bind the LLP by his own acts but not the other partners. However, in partnership each partner can bind the firm as well as other partners by his own acts.
- Every LLP should have at least two designated partners and at least one of them shall be resident in India. There is no provision for such partners under the Partnership Act, 1932.
- LLP may have its common seal as its official signatures. No such concept in partnership.
- In LLP only designated partners are responsible for all the compliances and penalties under the Act where as in partnership all partners are responsible for all the compliances and penalties under the Act.

- Partnership firm is not required to file any annual document with the Registrar of firms. However, LLP is required to file -Annual statement of accounts, Statement of solvency, Annual return with the registration of LLP every year.
- Foreign nationals can become a partner in a LLP. However, it is not so in partnership.
- Minor can be admitted to the benefits of the partnership with the prior consent of the existing partners, but it is not so in the case of LLP.

LLP and Company:

- LLP is regulated by the LLP Act, 2008, and the companies by the Companies Act, 2013.
- The persons who contribute to LLP are known as partners of the LLP. The persons who invest the money in the shares are known as members of the company.
- The internal governance structure of a LLP is governed by contract agreement between the partners. The internal governance structure of a company is regulated by statute (i.e., Companies Act, 2013).
- Name of the LLP to contain the word “Limited Liability partnership” or “LLP” as suffix. Name of the public company to contain the word “limited” and Pvt. Co. to contain the word “Private limited” as suffix.
- Minimum – 2 members. Maximum – No such limit on the members in the LLP Act. The members of the LLP can be individuals/or body corporate through the nominees. Private company: Minimum – 2 members Maximum 200 members Public company: Minimum – 7 members Maximum – No such limit on the members. Members can be organizations, trusts, another business form or individuals.
- Liability of a partners is limited to the extent of agreed contribution except in case of intention is fraud. Liability of a member is limited to the amount unpaid on the shares held by them.
- The business of the LLP is managed by the partners including the designated partners authorized in the agreement. The affairs of the company are managed by Board of Directors elected by the shareholders.
- Minimum 2 designated partners for LLP, Pvt. Co. – 2 Directors, Public co. – 3 Directors.

3.10 ADVANTAGES AND DISADVANTAGE OF LLP

Advantages of LLP:

- **Easy to form:** less legal and procedural requirements
- **Low Cost of formation:** The minimum fees of incorporation is as low as Rs 800 and maximum is Rs 5600.
- **Separate legal entity:** LLP & its partners are distinct from each other
- **Perpetual existence:** The LLP shall continue to exist till its wound up in accordance with the provisions of the relevant law

- **Limited Liability:** liability is limited to extent of his contribution. Personal assets of the partners are exposed in case of fraud
- **Flexibility in management:** The LLP Act does not regulate the LLP to large extent rather it gives freedom to partners to decide the way they want to run and manage the LLP, in form of LLP Agreement.
- No requirement of minimum capital contribution
- No restrictions as to maximum number of partners
- A partner cannot bind the other partner for his act.
- Easy to dissolve or wind-up
- No requirement to maintain statutory records except Books of Accounts

Disadvantages of LLP:

- The documents filed through the Ministry of Corporate Affairs portal are public documents and any person can assess them by paying a nominal fee
- LLP cannot raise funds from Public, it can either borrow debt from financial institutions or via a loan from partners.
- Any act of the partner without the knowledge of other partners may bind the LLP
- No separation of Management from owner.

3.11 INCORPORATION OF LLP

Pre-requisites for Incorporating a LLP

- Minimum two partners (Individual or body corporate).
- Minimum two designated partners who are individuals and at least one of them should be resident in India.
- Digital signature certificate
- LLP Name
- LLP Agreement
- Registered office

LLP incorporation Process

The Ministry of Corporate Affairs (MCA) vide its Notification dated 18th September, 2018 made major amendments in the rules for incorporation of LLP vide Limited Liability Partnership (Second Amendment) Rules, 2018, which came into force from 2nd October, 2018.

The highlights of the amended LLP incorporation process includes the introduction of specified LLP-RUN services (similar to RUN service for Company Incorporation) for Reservation of Name for the proposed LLP, Form FiLLiP i.e. Form for Incorporation of LLP. Form FiLLiP is similar to form SPiCe for Company Incorporation.

STEP – I: Procure Digital Signature Certificate

STEP – II: Apply for Name Approval

STEP – III Preparation of Documents for Incorporation of LLP:

STEP – IV: Fill the Information in Form: [FiLLiP]

STEP – V: Certificate of Incorporation

STEP – VI: Apply for PAN and TAN

STEP – VII: Preparation of LLP Agreement

Step 1: Procure Digital Signature Certificate (DSC)

The first step towards registering LLP is to procure the digital signatures with validity of 2 years for the designated partners. A digital signature is must because every form is filed online with the Ministry of Corporate Affairs and each requires to be signed digitally by the applicants and partners of the LLP. The DSC is associated with the PAN card of the application.

Digital signatures required can be obtained from certified government agencies, such as National Informatics Center, IDRBT Certifying Authority, E-MUDHRA, CDAC and NSDL. The cost of acquiring a DSC will be according to the certifying agency that the applicant has applied for.

Step 2: Apply for Name Approval

To register a proposed LLP, the applicant needs to get a Limited Liability Partnership-Reserve Unique Name (LLP-RUN) that can be processed at the Central Registration Centre. However, before citing or quoting the name, it is always advisable to check from the Ministry of Corporate Affairs (MCA) portal for a free name. The new process requires the applicants to file the web form named RUN-LLP (Reserve Unique Name – Limited Liability Partnership). RUN-LLP replaces the old form LLP Form 1. The new form has been simplified that requires information related to the desired name, its significance and other basic details.

The application can be made with maximum 2 names in preference order providing their significance. The names must comply with the provisions for name reservation. If none of the names is approved by the MCA, another chance is provided to apply two more names. The government fees for RUN, as per Register Office Fees Rules, shall be Rs 1,000. DSC and DIN are not required for filing of RUN form for reservation of name but account of MCA portal is mandatory. The name allotted under LLP-RUN will be reserved for a period of 90 days. If the LLP registration application is not filed in given period, the name will expire and it can be reserved through new application.

Step 3: Preparation of Documents for Incorporation of LLP

After approval of name, LLP applicant is required to prepare the following documents:

- Proof of office address (Conveyance/Lease Deed/Rent Agreement etc. along with rent receipts)
- NOC from owner of the property
- Copy of utility bills (not older than 2 months)
- Subscription sheet including consent
- In case, a designated partner does not have a DIN, it is mandatory to attach: Proof of identity and residential address of the subscribers

- All the DPs should have digital signature
- Detail of LLP(s) and/or Company(s) in which partner or designated partner is a director/partner
- Copy of approval in case the proposed name contains any word(s) or expression(s) which requires approval from Central Government.

Step 4: Fill the Information in Form: [FiLLiP]

Once all the above mentioned documents/ information are available. Applicant has to fill the information in the e-form “ FiLLiP” (Form for incorporation of Limited Liability Partnership). This is a major change in the new process. FiLLiP replaces the earlier, form 2.

Earlier if a Person wants to incorporate LLP then s/he had to apply separately for the DIN, Approval of the Name availability, registered office address, etc. But this form is a single window for Incorporation of LLP and it can be used for the following purposes:

- Application of DIN
- Application for Availability of Name
- No need to file separate form for address of registered office

Only 2 DPIN/DIN can be allotted through FiLLiP. In case, there are more than 2 DPs or DPs are to be changed; the respective partners is required to obtain it by filing DIR-3 after incorporation.

The e-form is to be attested by the partners through DSC and certified by the practicing Chartered Accountant or Company Secretary or Cost & Works Accountant.

The application will be processed for approval by Central Registration Centre (CRC). If the registrar finds it necessary to call for further documents or information, he may do so by directing for re-submission within 15 days. Another opportunity of re-submission maybe provided after re-examination of application, which again has 15 days period. It is provided that the total period for re-submission of documents shall not exceed 20 days in total.

Step 5: Certificate of Incorporation

Once the Registrar approves all the forms and documents, the Certificate of Incorporation (CoI) is issued in form 16 along with DPIN/DIN allotted to the Designated Partners. CoI will also consist of the Limited Liability Partnership Identification Number (LLPIN). Registrar of Companies (ROC) assigns a Limited Liability Partnership Identification Number (LLPIN) for every LLP which is registered. The date of CoI will be the date of LLP incorporation since when it has come into legal existence. LLP is now entitled to commence business in its name. The certificate of incorporation shall be the conclusive evidence that the limited liability partnership is incorporated by the name specified therein.

Step 6: Apply for PAN and TAN

Soon after getting the incorporation certificate, the application for PAN and TAN is required to be made separately for LLP through offline or online mode. The applications are made directly to the Income Tax Department and also processed

by it. The applications are made in forms 49A and 49B respectively with Certificate of Incorporation as supporting proof.

Step 7: Drafting and Filing LLP Agreement

The next step is to draft LLP Agreement and other documents for registration. An LLP agreement is essential, as it determines the mutual rights and duties amongst the partners, and between the LLP and the partners. The agreement must be filed with MCA within 30 days of date of incorporation. The delay leads to penalty of Rs. 100/- per day till the date of actual filing.

LLP Agreement contains, the name of LLP, name and address of partners and designated partners, business object, place of business and other details of LLP. Other clauses will be form of contribution and interest on contribution, profit sharing ratio, rights and duties of partners in case of admission, resignation, retirement, cessation and expulsion, proposed business, and rules for governing the LLP.

Once the LLP Agreement is reviewed and agreed upon by the partners, it will be executed by payment of stamp duty as applicable in the state where the registered office of the LLP is situated. Then with signature by partners and attestation by the witnesses, the agreement will be executed.

Activity 5

State whether the following statement are true or false.

- a) LLP is a separate legal entity _____
- b) LLP should be for profit or charitable business _____
- c) LLP is registered with Registrar of companies _____
- d) LLP can be converted into partnership _____
- e) An unlisted public company can be converted into LLP _____

3.12 SUMMARY

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. Persons who have entered into partnership with one another are called individually '*partners*' and collectively '*a firm*', and the name under which the business is carried on is called the '*firm's name*'. The true test, in determining whether a partnership exists, is to see whether the relation of mutual agency i.e., principal and agent exists between the parties and not. Registration of firm is not mandatory but desirable as an unregistered firm suffers from a number of disabilities. Based on their conduct or profit sharing, partners can be of different types like; Actual, Active or Ostensible Partner, Sleeping or dormant partner, Nominal partner, Partner by estoppel or by holding out and so on.

A minor cannot be a partner but he can be admitted to the benefit of partnership with the consent of all. He has right to share profits but his liability is limited to the extent of his share and not personally liable for any losses.

The rights and duties of partners are governed by the agreement among them but

in case of absence of the same the provisions of the Partnership Act, are applicable. Unless there is contract to the contrary every partner is the joint owner of the property of the firm. Every partner binds the firm for the acts done within the scope of implied authority. A change in the constitution of a firm takes place on admission, retirement, expulsion, death or insolvency and transfer of interest.

The dissolution of partnership firm may be without the order of the court or voluntary dissolution or by the court. After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions.

Limited Liability Partnership (LLP) is a body corporate with separate legal existence, perpetual succession and a common seal if it decides to have one. It is mandatory for a LLP to register with 'LLP' at the end of its name. The rights and duties of a partners and the partnership are governed by the agreement to the same. LLP should have at least two members and two individuals as its designated partners, one of whom should be resident in India. A firm, private company, unlisted public company can be converted into LLP.

3.13 SELF ASSESSMENT QUESTIONS

- 1) Define partnership.
- 2) Can a minor be admitted to partnership? If so, what are his rights and liabilities
- 3) What is partnership property?
- 4) Can a partner be expelled? If so, under what conditions?
- 5) Distinguish between dissolution of partnership and partnership firm.
- 6) Discuss the rights and liabilities of the partners on dissolution of the firm.
- 7) What is LLP? State the need of LLP How is it different from partnership?
- 8) Who is a designated partner?

3.14 FURTHER READINGS

- 1) Avtar Singh, 2018, *Introduction to Law of Partnership*, Eastern Book Company.
- 2) Bangia, R.K., 2019, *The Indian Partnership Act*, Allahabad law Agency.
- 3) Mitra, S.C., and Pradeep Kacker, 2019, *Law of Partnership in India*, Orient Publishing.
- 4) Jain, D.K., and Ishan Jain, 2021, *Bharat's Law and Procedure of Limited Liability Partnership*, Bharat Law House Pvt. ltd.