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# **DISTRIBUTION OF THE RESIDUE OF** **A PARTNERSHIP FIRM UPON** **DISSOLUTION**

AUTHORED BY - ZAINAB UL KUBRA

## **INTRODUCTION**

Partnership results from a contract and is governed by the Partnership Act, 1932.<sup>1</sup> There is no such provision in the Partnership Act to declare a partnership firm to be a separate legal entity or a juristic person, in contrast to the Companies Act, 2013,<sup>2</sup> (or, its earlier versions), which has a specific provision declaring a company to be a separate legal person independent of its shareholders/members.

The partnership is also governed by the general provision of the Indian Contract Act, 1872<sup>3</sup> on such matters where the Partnership Act is silent. It is expressly mentioned that the provision of the Indian Contract Act which is not repealed will apply to the Partnership until and unless such provision is contrary to any provision of the Partnership Act, 1932.<sup>4</sup> The rules of contract regarding the capacity to contract, offer, acceptance, etc will also apply to the partnership. But the rules regarding the status of minors will be governed by Section 30 of the Partnership Act, 1932<sup>5</sup> since the act talks about the position of the minor. The partnership must be created to carry the legal business. Co-ownership of property does not amount to a partnership. They must all handle the business, or any one of them may do it on their behalf. It makes two predictions:

Each partner has the right to run the company. There is a mutual agency between the partners. Each partner represents the other partners as both a principal and an agent. He can bind others with

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<sup>1</sup> Partnership Act, 1932.

<sup>2</sup> Companies Act, 2013.

<sup>3</sup> Indian Contract Act, 1872.

<sup>4</sup> *Supra note 1.*

<sup>5</sup> Partnership Act 1932, s. 30.

his deed and can also bind them with the acts of the other partners.

According to the agreement, partners would split gains and losses. Profit and loss distribution may be equal or in proportion to the amount of capital invested. If the partnership experiences losses, it aids in distributing the burden among the members.

### Meaning:

In *Dy. CST v. K Kelukutty*,<sup>6</sup> the Supreme Court of India defined "Partnership," and its essentials stating that (1) The partnership must be the product of an agreement and such an agreement is frequently in writing, in the form of a "Partnership deed," (2) That is set up to conduct business and the parties involved agree to split the firm's profits; (3) That all or any of them will conduct the business on their behalf. This is the "mutual agency" idea, according to which each partner acts as his co-partners agent. This idea is taken from the well-known *Cox v. Hickman*<sup>7</sup> case in England wherein, Lord Cranworth said, "*The liability of one partner for the actions of his co-partner is in truth the liability of the principal for the acts of his agent. Every partner is an agent of the partnership, and his position is governed by the same rules as that of an agent. A partner virtually embraces the character of both a principal and an agent.*"

According to **Section 4** of the Partnership Act, 1932<sup>8</sup>

*"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."*

Accordingly, 'Partnership' is defined as the relationship of individuals who have contended to share the benefit of a company carried out by all or any of them acting for all. Additionally, it is said that individuals who have formed a partnership with one another are referred to as 'Partners' individually and 'Firm' collectively, and the name under which their business is operated is referred to as the 'Firm name'. The partnership firm is not recognized by law as a separate legal entity from its partners, notwithstanding this.

The Supreme Court has issued a few decisions in this area;

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<sup>6</sup> *Dy. CST v. K Kelukutty*, 1985 SCC (4) 35.

<sup>7</sup> *Cox v. Hickman* (1860) 8 HLC 268.

<sup>8</sup> Partnership Act 1932, s.4.

For example, The Supreme Court ruled in *Tanna & Modi v. CIT*<sup>9</sup> that a firm comprises all of its partners. It's not a legal person. A partner represents a firm under the Partnership Act. Unless otherwise stated, every action taken by a partner of a firm against the firm binds the firm itself.

Likewise, the Supreme Court ruled that the Partnership firm is not a separate legal entity in the case of *N. Khadervali Saheb v. N. Gudu Sahib*.<sup>10</sup> The partners are the true owners of the partnership's assets; a business name is only a phony name provided to the partnership.

The Supreme Court ruled in *Comptroller & Auditor-General v. Kamlesh Vadilal Mehta*<sup>11</sup> that a partnership concern is a set of individuals partners rather than a legal entity like a company.

In the case of *V. Subramaniam v. Rajesh Raghuvandra Rao*,<sup>12</sup> it was also determined that unlike a company registered under the Companies Act, a partnership business is merely a collection of its members and not a separate legal body. Even the act of registering a firm does not make it a separate legal person like a company. In contrast to shareholders in a company who are not co-owners of the company's property, partners in a firm are co-owners of the firm's assets.

Given these and other similar judgments of the Supreme Court and the provisions of the Partnership Act, 1932,<sup>13</sup> it should thus be clear that a partnership firm is not a separate or independent legal entity, a separate juristic person, or a separate legal person.

### **Nature of Business:**

It is a business organization where two or more people have agreed to work together to run a business and make a profit. It functions as a sole proprietorship's extension. It is preferable to a sole proprietorship since a solo owner runs their business with little funding and little expertise. A larger firm requiring more resources and investment than the sole owner has access to cannot be considered such a business due to the limited resources of a sole proprietorship. On the other hand, in a partnership, several partners pool their resources to create a contract and run a business together.

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<sup>9</sup> *Tanna & Modi v. CIT* (2007) 7 SCC 434.

<sup>10</sup> *N. Khadervali Saheb v. N. Gudu Sahib* (2003) 3 SCC 229.

<sup>11</sup> *Comptroller & Auditor-General v. Kamlesh Vadilal Mehta* (2003) 2 SCC 349.

<sup>12</sup> *V. Subramaniam v. Rajesh Raghuvandra Rao* (2009) 5 SCC 608.

<sup>13</sup> *Supra note 1.*

### **Essential requirements for a partnership:**

- It must involve at least two other people.
- The partners must have an agreement.
- There must be a legitimate commercial endeavour or operation.
- The goal must be to make a profit that the partners can split.
- There must be mutual agency in the agreement for them to carry out the business either jointly or by one of them acting on behalf of the others.

### **The number of members:**

Any pair of people or more can create a partnership. The Partnership Act, 1932<sup>14</sup> places no restrictions on the minimum or maximum number of partners. According to the Companies Act, 2013<sup>15</sup>, a partnership must include a minimum of two partners and a maximum of 100 partners.

Under Section 464 of the 2013 Companies Act,<sup>16</sup> it shall be considered an illegal association if it in any way surpasses the upper limit.

In a partnership, two or more people have agreed to operate a business together and share profits and losses equally. Forming a partnership agreement is important to establish a legal relationship.

The foundation or basis on which it is found in the partnership agreement. It can be spoken or written. A partnership deed is a legal name for the written agreement.

### **Dissolution of a partnership firm:**

When a partnership business needs to be terminated by its owners and partners, whether on their initiative or as a result of outside circumstances, the process is known as the dissolution of the partnership. The partnership firm is not a distinct legal entity from its partners in the eyes of the law. The relationships between partners and their businesses are indivisible.

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<sup>14</sup> *Ibid.*

<sup>15</sup> *Supra note 2.*

<sup>16</sup> Companies Act 2013, s. 464.

### **Settlement of partnership account ([Section 48](#))**

Following the partnership's dissolution, the partners' accounts must be handled according to normal business procedures. Account settlement can be done in a variety of ways.

If it is paid out of profit, a loss or a lack of capital will result. If the profit is insufficient or none is made, the capital and the partners, as necessary, are used to make the payment. The profit-sharing ratio is a percentage that the partners each participate in.

### **The Arbitration Act, 1940**

Section 30<sup>17</sup> of this act lays down the Grounds for setting aside an award. An award shall not be set aside except on one or more of the following grounds, namely:

1. That an arbitrator or umpire has misconducted himself or the proceedings
2. That an award has been made after the issue of an order by the Court superseding the arbitration or after arbitration proceedings have become invalid under section 35<sup>18</sup>;
3. That an award has been improperly procured or is otherwise invalid.

## **CASE COMMENTARY**

*N. Khadervali Saheb*

v.

*N. Gudu Sahib*

**IN THE SUPREME COURT OF INDIA**

Vs

Ors.

CASE NO.: Appeal (Civil) 5680-81 of 1994

Citation: (2003) 3 SCC

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<sup>17</sup> Arbitration Act 1940, s. 30.

<sup>18</sup> Arbitration Act 1940, s. 35.

Decided On: 05/02/2003

**N. Khadervali Saheb by LRs. and Anr.**      *...petitioner*

v.

**N. Gudu Sahib and Ors.**

*...respondent*

Honorable Judges: M.B. Shah, Ashok Bhan & Arun Kumar.

## **FACTS OF THE CASE**

Briefly stated a partnership business made up of four members of the same family was established. The partners eventually turned to arbitration to resolve disagreements and disputes. The award was rendered by the arbitrators on October 2nd, 1972. Some of the partners filed complaints against the verdict following Section 30 of the 1940 Arbitration Act.<sup>19</sup> The other partners opposed the objection petition and urged that the award be made a court rule in place of it.

The award was contested based on the arbitrators' misconduct as well as another claim that the award needed to be registered under Section 17 of the Registration Act.<sup>20</sup> The trial court upheld both objections, concluding that the arbitrators had engaged in misconduct and that the award was inadmissible as evidence because it had not been compulsorily recorded.

This trial court's ruling was contested before the High Court through a Civil Revision filed under Section 115 of the Code of Civil Procedure.<sup>21</sup> According to the High Court, there was no evidence of any legal wrongdoing on the part of the arbitrators given the facts and circumstances of the case. As a result, it was determined that the first argument against the award was unsupported. On the second issue, however—that the award had to be compulsorily registered—the High Court

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<sup>19</sup> Arbitration Act, 1940 s. 30.

<sup>20</sup> Registration Act, 1908 s. 17.

<sup>21</sup> Code of Civil Procedure, 1908 s. 115.

accepted the trial court's conclusion. The award could not be turned into a court rule since it was not recorded.

## THE KEY ISSUES OF THE CASE

- Whether an award by which residue assets of a partnership firm are distributed amongst the partners on the dissolution of the partnership firm requires registration under [Section 17](#) of the Registration Act, 1908.<sup>22</sup>

## THE CONTENTION RAISED BY THE PARTIES

The arguments and contentions raised by the plaintiff and defendant are discussed in detail below-

### THE PLAINTIFF'S SIDE:

The first defense put out by the plaintiff was that a partnership firm is not a separate legal organization, but the partners are the true owners of the partnership business's assets, and the name of the partnership is only a fictitious name used for convenience.

The second argument was that the partnership's assets belonged to its members and were owned by its partners. Since each partner is the owner of the assets to the degree of his participation in the partnership, each partner has an interest in all the assets of the partnership company as long as the partnership exists.

The third argument was that when the partnership business is dissolved, the partners' accounts are settled and the partnership's assets are allocated to them by their ownership stakes. As a result, the distribution of assets to an individual partner upon the dissolution of a partnership business does not constitute a transfer of any firm assets. Following the dissolution of the business, the assets that were formerly owned by each partner are now divided among the partners individually. None of the assets have had their ownership transferred or assigned. This is the legal consequence of the distribution of assets on the dissolution of a partnership firm.

Their final counterargument was that the division of assets might be accomplished via mutual

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<sup>22</sup> *Ibid.*

agreement between the partners or through an arbitration ruling.

Since the document does not transfer or assign an interest in any asset, the award used to record the settlement in this instance does not need to be registered under Section 17 of the Registration Act.<sup>23</sup> They also accepted a plea in the case *S.V. Chandra Pandian and Others vs. S.V. Sivalinga Nadar and Others*<sup>24</sup> from the former Supreme Court. The court ruled in this case that the partner would naturally own all of the property that belonged to his share of the residual upon distribution. "But since in the eyes of law it is money and not an immovable property there is no question of registration under Section 17 of the Registration Act<sup>25</sup>."

The court further observed, "Even if one looks at the award as allocating certain immovable property since there is no transfer, no partition or extinguishment of any right therein there is no question of application of Section 17(1) of the Registration Act.<sup>26</sup> " As was noted in the preceding judgment, we are convinced that the award in the current case likewise intends to disperse the remainder following the settlement of accounts on dissolution. The arbitrators distributed their residue when allocating the properties to the partners. The award was exempt from Section 17 (1) of the Registration Act's registration requirements in such cases.<sup>27</sup>

#### **THE DEFENDANT'S SIDE:**

In the case of *Ratan Lal Sharma v. Purshottam Harit*<sup>28</sup>, the defendant entered a plea. This Court was made aware of the ruling in Pandian's case and was explained.

## **THE JUDGEMENT AND THE RATIONALE BEHIND IT**

The two instances can be distinguished, according to the court. They can nonetheless conclude that the award in this matter did not need to be registered under Section 17 (1) of the Registration Act<sup>29</sup>

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<sup>23</sup> *Supra note 22.*

<sup>24</sup> *S.V. Chandra Pandian and Others vs. S.V. Sivalinga Nadar and Others* 1993 SCC (1) 589.

<sup>25</sup> *Supra note 22.*

<sup>26</sup> Registration Act, 1908 s. 17 (1).

<sup>27</sup> *Ibid.*

<sup>28</sup> *Ratan Lal Sharma v. Purshottam Harit* 1947 SCC (1) 671.

<sup>29</sup> *Supra note 27.*

without being hindered by it.

As a result, the appeals are accepted. The High Court's decision will be overturned, the court declared. The objections to the award from October 2, 1972, would be rejected consequently, and the court would be instructed to make the award a rule. To proceed with the award by subsequent decree. The appeals were both dismissed.

## CONCLUSION AND ANALYSIS

The plaintiff made compelling arguments that the partnership business is not a separate legal entity and that rather, the partners are the true owners of the asset, which is the property or, in this instance, the firm, their arguments for making this the law and not registering the company were both valid. In this instance, it was noted that the court was convinced beyond a reasonable doubt that the award sought to divide the remainder after the settlement of accounts upon dissolution and that the arbitrators had distributed their residue when allocating the properties to the partners. The award was exempt from Section 17 (1) of the Registration Act's<sup>30</sup> registration requirements in such cases.

I believe the ruling was excellent; the court correctly cited the *S.V. Chandra Pandian and Others vs. S.V. Sivalinga Nadar and Others*<sup>31</sup> case, which made it apparent that registration under the registration statute is not required following dissolution. To fall under the purview of Section 17 of the Registration Act<sup>32</sup>, the supreme court of India also addressed the issue of whether such an award constitutes the formation or transfer of any new rights in moveable or immovable properties. The parties had exhausted their appeal rights, and the court's decision served as the final decision and a precedent for cases to come.

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<sup>30</sup> *Ibid*

<sup>31</sup> *Supra note 27.*

<sup>32</sup> *Supra note 17.*

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