

CHAPTER 1 FUNDAMENTALS OF PARTNERSHIP

LEARNING OBJECTIVES

The study of this Chapter would enable students to understand:

- Definition, legal context, and the nature of partnership
- Essential Features or Characteristics of Partnership Rights of Partners
- Partnership Deed: Meaning, Clauses and Importance
- Provisions of the Partnership Act, 1932 Affecting Accounting Treatment in the Absence of Partnership Deed

DEFINITION OF PARTNERSHIP

A partnership is a popular form of business organization where two or more persons come together to carry on a business and share its profits and losses. In India, this is governed by the Indian Partnership Act, 1932.

ACCORDING TO THE INDIAN PARTNERSHIP ACT, 1932:

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

Partnership is a form of business where two or more persons agree to carry on a business together and share its profits and losses.

IMPORTANT TERMS

- **Partners** – Persons who join together in a partnership.
- **Firm** – The collective name of partners.
- **Firm Name** – The name under which the business is carried on.

LEGAL CONTEXT OF PARTNERSHIP

The law governing partnership firms in India is the Indian Partnership Act, 1932.

KEY POINTS OF THE ACT

- The Act came into force on 1 October 1932.
- It regulates the formation, operation, and dissolution of partnership firms in India.
- It defines the rights, duties, and liabilities of partners.
- The Act also explains rules related to profit sharing, admission of partners, retirement, and dissolution.

Nature of Partnership

The nature of partnership can be understood through its main characteristics.

1. Two or More Persons

- At least two persons are required to form a partnership.
- According to the Companies Act, 2013, the maximum number of partners is generally 50 (unless prescribed otherwise). Companies Act, 2013 (Section 464) empowers the Central Government to prescribe number of partners in a firm subject to maximum of 100 partners. The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) Rules, 2014.

2. Agreement

- Partnership arises from an agreement between partners.
- This agreement may be written or oral.
- Usually, it is written in a Partnership Deed.

3. Lawful Business

- The partnership must be formed to conduct legal business activities.

4. Sharing of Profits

- Partners agree to share profits of the business.
- Losses are usually shared as well unless agreed otherwise.

5. Mutual Agency

- This is the most important feature of partnership.
- Each partner is both:
 - **Principal** (owner)
 - **Agent** (representing other partners)

This means the act of one partner binds all partners.

6. Unlimited Liability

- Partners have unlimited liability.
- If the firm's assets are insufficient, partners must pay debts from their personal assets.

7. Voluntary Registration

- Registration of partnership is not compulsory under the Indian Partnership Act, 1932.
- However, an unregistered firm faces legal limitations in court.

Partnership, from the legal viewpoint, is not a separate legal entity from its partners since firm's debts are payable from personal assets of the partners, if the firm is unable to repay its liabilities.

However, Partnership is a separate business entity from the accounting viewpoint.

RIGHTS OF PARTNERS

The rights of partners are mainly given under the Indian Partnership Act, 1932. These rights ensure that every partner can participate fairly in the business and protect their interests.

1. Right to Participate in Business: Every partner has the right to take part in the management and conduct of the business unless the partnership agreement states otherwise.

2. Right to Be Consulted: All partners have the right to be consulted on important matters of the firm.

- Decisions are usually taken by majority.
- However, fundamental changes require unanimous consent of all partners.

3. Right to Access Books of Accounts: Every partner has the right to inspect and examine the books of accounts and records of the firm.

4. Right to Share Profits: Each partner has the right to share profits of the business according to the agreed profit-sharing ratio. If no ratio is mentioned in the agreement, profits are shared equally.

5. Right to Interest on Capital: If it is mentioned in the partnership agreement, a partner has

the right to receive interest on capital contributed to the firm.

6. Right to Interest on Advances: If a partner gives loan or advances to the firm beyond the capital amount, they are entitled to interest at 6% per year, as per the Indian Partnership Act, 1932.

7. Right to Indemnification: A partner has the right to be compensated (indemnified) by the firm for expenses or losses incurred:

- while conducting normal business of the firm
- while performing acts in emergency to protect the firm.

8. Right to Prevent Admission of New Partner: A new partner cannot be admitted into the firm without the consent of all existing partners.

9. Right to Retire: A partner has the right to retire from the firm according to the terms of the partnership agreement.

10. Right to Dissolve the Firm: A partner may dissolve the firm according to the provisions of the Indian Partnership Act, 1932.

PARTNERSHIP DEED

Meaning of Partnership Deed

A Partnership Deed is a written agreement between partners that defines the terms and conditions of the partnership business. It contains rules regarding the management, profit sharing, rights, duties, and responsibilities of partners. Although partnership can be formed orally, a written deed helps avoid misunderstandings and disputes among partners.

In simple words: A Partnership Deed is a written agreement that clearly states all rules and conditions of the partnership business to avoid disputes between partners.

The concept of partnership and related agreements are governed by the Indian Partnership Act, 1932.

DEFINITION OF PARTNERSHIP DEED

A Partnership Deed can be defined as:

A legal written document that contains the terms and conditions agreed upon by the partners for running the partnership business.

CONTENTS OF PARTNERSHIP DEED

A partnership deed generally includes the following important points:

- 1. Name of the Firm:** The official name under which the partnership business will operate.
- 2. Names and Addresses of Partners:** Details of all partners, including their names and addresses.
- 3. Nature of Business:** The type of business activity the firm will carry out.
- 4. Place of Business:** The location or address where the business will operate.
- 5. Capital Contribution:** The amount of capital contributed by each partner.
- 6. Profit Sharing Ratio:** The ratio in which profits and losses will be shared among partners.
- 7. Interest on Capital:** The rate of interest on capital, if agreed upon by partners.
- 8. Interest on Drawings:** The interest charged on drawings (money withdrawn by partners for personal use).
- 9. Salary or Commission to Partners:** Details about salary, bonus, or commission payable

to any partner.

10. Duties and Powers of Partners: The roles, responsibilities, and authority of each partner.

11. Admission, Retirement, or Death of a Partner: Rules regarding:

- admission of new partners
- retirement of existing partners
- settlement in case of death of a partner.

12. Method of Valuation of Goodwill: Procedure for calculating goodwill of the firm.

13. Settlement of Accounts: Rules for settlement of accounts in case of dissolution of the firm.

14. Duration of Partnership: The period for which the partnership will continue, if specified.

IMPORTANCE OF PARTNERSHIP DEED

A Partnership Deed is very important for the smooth functioning of a partnership firm. It clearly defines the rules and terms of the partnership and helps avoid conflicts between partners. The provisions related to partnership are governed by the Indian Partnership Act, 1932.

1. Avoids Disputes Among Partners: A written partnership deed clearly states the rights, duties, and responsibilities of partners, which helps prevent misunderstandings and disputes.

2. Defines Profit and Loss Sharing: It clearly mentions the profit-sharing ratio among partners, ensuring fairness and clarity in the distribution of profits and losses.

3. Provides Clear Rules for Business Operations: The deed includes rules regarding management, decision-making, capital contribution, and drawings, which helps the firm operate smoothly.

4. Clarifies Duties and Powers of Partners: It defines the roles, responsibilities, and authority of each partner in the business.

5. Helps in Settlement of Accounts: In case of retirement, admission, or death of a partner, the partnership deed provides clear rules for the settlement of accounts.

6. Prevents Legal Problems: A properly written partnership deed helps partners avoid legal complications by clearly mentioning agreed terms.

7. Provides Evidence in Court: If a dispute arises, the partnership deed acts as a legal document and proof in court.

PROVISIONS WHEN PARTNERS START A BUSINESS WITHOUT PREPARING A PARTNERSHIP DEED:

Sometimes partners start a business without preparing a Partnership Deed. In such cases, the accounting treatment is done according to the rules given in the Indian Partnership Act, 1932.

These provisions determine how profits, interest, salary, and drawings will be treated.

1. Profit Sharing Ratio: If there are no partnership deed, profits and losses are shared equally among partners, regardless of their capital contribution.

2. Interest on Capital: No partner is entitled to interest on capital if the partnership deed does not mention it.

3. Interest on Drawings: If there is no agreement, no interest is charged on drawings made by partners.

4. Partner's Salary or Commission: No partner is entitled to salary, bonus, or commission for participating in the business unless it is specified in the partnership deed.

5. Interest on Partner's Loan: If a partner gives a loan or advances to the firm, they are entitled to interest at 6% per year,

ACCORDING TO THE INDIAN PARTNERSHIP ACT, 1932. : SUMMARY TABLE

Particular	Treatment without Partnership Deed
Profit Sharing	Shared equally among partners
Interest on Capital	Not allowed
Interest on Drawings	Not charged
Partner's Salary/Commission	Not allowed
Interest on Loan by Partner	6% per year

MOST EXAM-IMPORTANT SECTIONS OF PARTNERSHIP ACT 1932

- Section 4 – Definition of Partnership
- Section 13 – Mutual Rights and Liabilities of Partners
- Section 30 – Minor admitted to benefits of partnership
- Section 31 – Admission of Partner
- Section 32 – Retirement of Partner
- Section 39 – Dissolution of Firm
- Section 48 – Settlement of Accounts
- Section 69 – Effects of non-registration

DUTIES AND LIABILITIES OF PARTNERS

Partners in a partnership firm must follow certain duties and responsibilities while running the business. These duties ensure trust, fairness, and proper management of the firm.

DUTIES OF PARTNERS

1. Duty to Carry on Business to the Greatest Common Advantage: Every partner must work honestly and efficiently for the benefit of the firm and all partners.

2. Duty to Be Just and Faithful: Partners must act honestly and faithfully towards each other in all business dealings.

3. Duty to Provide True Accounts: A partner must provide complete and accurate information about all matters affecting the firm.

4. Duty to Indemnify for Fraud: If a partner causes loss to the firm due to fraud or dishonest conduct, they must compensate the firm.

5. Duty to Attend Diligently: Every partner should actively participate in the business and

perform their duties responsibly.

6. Duty Not to Earn Secret Profits: Partners must not earn any personal profit from the firm's business without the consent of other partners. If they do, the profit must be given to the firm.

7. Duty Not to Compete with the Firm: A partner should not start a competing business without permission of other partners. If they earn profit from such business, it must be shared with the firm.

LIABILITIES OF PARTNERS

1. Unlimited Liability: Partners have unlimited liability, meaning their personal assets can be used to pay the firm's debts if business assets are insufficient.

2. Joint Liability: All partners are jointly responsible for the debts and obligations of the firm.

3. Liability for Acts of Other Partners: Since every partner acts as an agent of the firm, the act of one partner binds all partners.

4. Liability for Wrongful Acts: The firm and all partners are liable for any wrongful act or negligence committed by a partner during business.

Case-Based Questions on Partnership Deed (When Deed (Oral/Written) is Silent or Absent)

The partners do not have a Partnership Deed. Therefore, provisions of the Indian Partnership Act, 1932 will apply to resolve the Following matters:

Q1. A and B are partners with capitals ₹50,000 and ₹80,000. Profit for the year is ₹30,000. No partnership deed exists.

Solution: Profits are shared equally when deed is absent. Each partner gets ₹15,000.

Q2. X and Y invested ₹1,00,000 and ₹2,00,000 respectively. Profit is ₹40,000. There is no agreement regarding profit sharing.

Solution: Profit shared equally. Each partner receives ₹20,000.

Q3. A and B have capitals ₹60,000 and ₹40,000. No interest on capital clause is mentioned.

Solution: No interest on capital is allowed.

Q4. Partners P and Q withdraw money during the year. Deed is silent about interest on drawings.

Solution: No interest on drawings is charged.

Q5. R gives a loan of ₹50,000 to the firm. Deed does not mention interest on loan.

Solution: Interest on loan allowed at 6% per annum.

Q6. A works full time in the firm and claims salary ₹5,000 per month but deed is silent.

Solution: No salary or commission allowed unless agreed.

Q7. B spends ₹4,000 from his personal money for firm expenses.

Solution: He will be reimbursed by the firm.

Q8. Partner C spends ₹2,000 on behalf of the firm in an emergency.

Solution: He is entitled to reimbursement from the firm.

Q9. A partner manages the business and asks for commission.

Solution: No commission allowed without agreement.

Q10. A and B share profits equally. Loss for the year is ₹20,000.

Solution: Loss also shared equally. Each partner bears ₹10,000.

Q11. Partners invested unequal capitals but deed is silent on profit ratio.

Solution: Profit shared equally.

Q12. Partner D lends ₹20,000 to the firm.

Solution: Interest allowed at 6% per annum.

Q13. Partner E withdraws ₹5,000 monthly but deed has no rule on drawings interest.

Solution: No interest on drawings.

Q14. Partners F and G run a firm without specifying profit ratio.

Solution: Profit shared equally.

Q15. Partner H claims 10% interest on capital but deed has no clause.

Solution: Interest on capital not allowed.

Q16. Partner J claims salary for managing the firm but deed is silent.

Solution: No salary allowed.

Q17. K and L have capitals ₹1,50,000 and ₹50,000 but deed absent.

Profit ₹60,000.

Solution: Profit shared equally → ₹30,000 each.

Q18. Partner M gives loan of ₹1,00,000 to firm.

Solution: Interest allowed at 6% per annum.

Q19. Partner N incurs ₹10,000 for purchasing goods urgently.

Solution: Firm must reimburse the amount.

Q20. Partners O and P share profits equally. Firm incurs loss ₹50,000.

Solution: Each bears ₹25,000.

Q21. Partner Q works more hours than others and demands salary.

Solution: No salary allowed without agreement.

Q22. Partner R withdraws large drawings but deed silent.

Solution: No interest charged.

Q23. Partner S lends ₹30,000 to firm.

Solution: Interest allowed at 6% per annum.

Q24. Partners T and U have unequal capitals but deed silent.

Profit ₹40,000.

Solution: Each gets ₹20,000.

Q25. Partner V pays legal expenses of ₹8,000 for the firm.

Solution: Firm must reimburse the partner.

Q26. Partner W claims commission on sales.

Solution: Commission not allowed.

Q27. Partners X and Y invested different capitals but loss occurs.

Loss ₹30,000.

Solution: Loss shared equally → ₹15,000 each.

Q28. Partner Z gives emergency funds of ₹50,000 as loan.

Solution: Interest allowed at 6% p.a.

Q29. Partner A claims interest on drawings from other partners.

Solution: Interest on drawings not charged if deed silent.

Q30. Partner B spends ₹6,000 for firm travel expenses.

Solution: Firm must reimburse the expenses.

Q31. Amar had invested more capital than other partners and asks for interest on capital at 10% p.a. But Lalit and Charu do not agree with him.

(i) Interest on capital is not to be allowed to the partners. Therefore, Amar will not be allowed interest on the capital.

Q32. Lalit devotes more time in handling the business and demands a salary of ₹ 5,000 p.m. But Amar and Charu do not agree with him.

(ii) Remuneration is not payable to the partners. Therefore, Lalit will not get salary.

Q33. Charu demands interest on the loan of ₹ 50,000 given by her @ 12% p.a.

(iii) Interest on Loan by Partner is payable @ 6% p.a. Therefore, Charu will get interest ₹ 3,000 (i.e., ₹ 50,000 x 6/100) and not @ 12% p.a.

Q34. Amar withdrew ₹ 10,000 from the firm for his personal use. Lalit and Charu demand that interest on drawings be charged from him @ 10% p.a.

(iv) Interest on drawings by Amar will not be charged.

Q35. Profit for the year before the above claims was ₹ 50,000. Amar demands profits to be distributed in the capital ratio.

(v) Profit after Interest on Loan by Charu, i.e., ₹ 47,000 (₹ 50,000 - ₹ 3,000) will be distributed equally.

Q36. Lalit wants to introduce his son Inder as partner. Charu objects to his proposal.

How will be the above issues resolved?

(vi) A partner cannot be admitted without the consent of all the partners. Therefore, Inder cannot be admitted as partner because Charu has objected to it.

Q37. Harry demands that his son Sherry be admitted as partner for 25% share to be given out of his share of profits. Garry does not agree to Sherry's admission as partner.

Sherry will not be admitted as partner because Garry has objected to his becoming a partner.

CASE (38-40). X, Y and Z started a firm without a partnership deed.

Capitals: X – ₹2,00,000 Y – ₹1,50,000 Z – ₹1,00,000

During the year:

Q38. Y withdrew ₹4,000 per month. What will be interest on Drawing.

Solution: No interest on drawings

Q39. Z gave a loan of ₹60,000 on 1 July 2024. What will be interest on Z's Loan.

Solution: No partner's salary or commission.

Q40. X demanded commission of 10% of profit for managing the business. What will be in X's Commission.

Solution: Interest on partner's loan = 6% per annum

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