

# Partnership Firms Registration & Deed

S.S. Sareen

Despite the immense growth of the corporate sector in the country in the last two decades, the partnership firms still continue to play a vital role in the trade - both wholesale as well as retail. Partnership firms handle more than 75% of the wholesale trade in India whereas the remaining 25% of the wholesale trade is transacted by the sole proprietors and the Private Limited Companies. However, in retail trading sole proprietorship is much more popular as compared to partnership firms. Partnership firms account for only 13 percent of the total retail trade activities, leaving the rest of the 17 percent to sole proprietors.

The law of partnership is one of those branches of law which is very ancient in its nature. The law as it stands now is the result of steady growth over the years. The earliest reference to the laws of partnership is found in Bhriḡu's version of the Manusmṛiti. No doubt the Hindu Law Makers even in the ancient times had considered this branch of law important enough to merit their attention. The most important event to take place in the history of partnership law in the last century was the enactment of English Partnership Act in 1895. In India, the Indian Partnership Act was passed on April 8, 1932. Prior to the enactment of this legislation the law of partnership was covered under chapter xi of the Indian Contract Act, 1872. Later on, due to immense growth of trade and commerce and the vital role which partnership firms started playing in the retail and whole sale trade in the country it was felt that provisions contained in the Indian Contract Act relating to Partnership were not adequate & exhaustive. Hence the demands for the enactment of a separate legislation on partnership kept on growing and eventually culminated in the passing of the Indian Partnership Act, 1932. The Act is quite simple when compared to Companies Act. It consists of 74 Sections divided into eight chapters and a single schedule (of fees). The present Act deals with the nature of partnership, relations of partners *inter se* and with outsiders, changes in the membership and consequences, dissolution of firms, registration of firms, and the effect of non-registrations, the mode of giving public notice by firms and

partnership. The said law seem to be so exhaustive that practically no amendment has been made in it since it was first enacted 50 years ago. The Indian Partnership Act is almost identical to English Law except on a few matters such as optional registration of firms as against compulsory registration in English Law, joint and several liability of Partners in India as compared to joint liability of partners in England. These changes were deemed to be proper keeping in view the different business custom conditions, and environs in India. The purpose of this article is to expatiate two most important matters concerning partnership firms.

### Partnership Deed

The Indian Partnership Act contains practically all such aspects which relate to the rights duties and liabilities of partners *interse* the relations of partners to third parties, admission and retirement of partners, dissolution of firms etc. But all these provisions are subject to any contract to the contrary. In practice the partners can and do make their own agreement in the form of partnership deed, on same of the important matters which have also been duly dealt with in the Act. While drafting the partnership deed the partners must be very careful so as to avoid hardships, litigation & frictions in the later years. The Partnership Deed is to be made on a general stamp paper. This stamp paper must bear the signature of the vendor and the name of the person to whom it is issued and the date of its issue. It should be remembered that the date on which the deed is executed has to be a date later than the date of the issue of the stamp paper. However, the date on which partnership comes into existence can be earlier to the date of the issue of stamp paper. In such a case, the deed must mention about it. The date on which the deed is executed should always be written in hand by any of the signatories to the said deed.

A partnership deed would normally lay down name of the firm, nature and principal place of the business, names and details about partners, capital contributions and whether these would carry any interest, interest on loans advances by partners, ratio in which profits and losses would be shared, mode of retirement, course of action on the death, retirement and insolvency of any partner, the books of accounts to be maintained, goodwill, remunerations, if any, and an arbitration in case of any dispute. Although capital contributions need not be specified in the deed but in some cases it is advisable to do so particularly when a minor is admitted to the benefits of partnership. That will be helpful for the purposes of the Income Tax Act and also to determine the liability of the minor partner to share the firms' losses to the extent of his capital and his share in the profits and property of the firm. If no interest on capital is payable there is no need to mention it in partnership deed yet in such cases too it would be desirable to do provide that no interest would be paid on capitals. It may be noted that interest paid to a partner on his capital is not considered as the firm's expenditure for determining the income of the firm but if the interest is charged to a partner on his debit balance, the same is treated as income of the firm. Again it is not necessary to specify the share of partners in the profits and losses of the firm, and its property if the partners are sharing that equally but



section 184 (I) (II) of the Income Tax Act affirms upon the partners to specify the profit sharing ratio of partners in the partnership deed. The deed must also contain a clause on a dissolution of the firm particularly if the partners desire that the firm be not dissolved in the event of death, retirement or insolvency of any partner. If there is no such clause then as per the partnership law, on the happening of any of the above events the firm would be dissolved automatically.

On the retirement of a partner goodwill can be treated in three ways :- (1) retiring partner not to be paid for goodwill, (2) payment on account of goodwill in lump sum, (3) payment of goodwill by way of annual fee or charge towards the use of goodwill. In case, a firm decides to pay for goodwill in the form of annual fee, such payment is allowed as a deductible expenditure. Therefore, while drafting the deed on this point, utmost care be taken to see that all the points which have been mentioned in 'the judgement of Supreme Court in *Devdas Vitheldas v/s CIT* have been considered.

Registration:—

In India, registration of firms is not compulsory. However, if the firm is not registered, it suffers from some disabilities which are in fact so harsh and severe that prudent partners would always go for registration of firms. Effects of non-registration are mentioned in section 69 of the Indian Partnership Act. According to this section an unregistered firm can not sue an outsider to enforce any right arising from a contract. A partner of such an unregistered firm also can not sue a firm or his colleagues to enforce his rights arising out of a contract or conferred by this Act, except for the dissolution of the firm or for accounts or for realisation of the property of such a firm if already dissolved. It must be remembered here that the scope of this provision is limited to suits for enforcing the rights arising out of partnership contracts (*Krishnarao Naryanrao v/s Shankar Sahadeo*, 1954 Bom. 1409) Thus, a suit for damages for breach of covenants of a dissolution deed by a continuing partner against an outgoing partner does not fall within the scope of section 69 as it concerns a right not as a partner but as per a distinct subsequent agreement. Similarly an unregistered firm can file a suit to enforce its rights arising otherwise out of a contract, such as for an infringement of patent rights, trade marks, etc. In *Ghelabhai and Co. v/s Chunilal & Co.* 1941, Rang. 219 it was held that a partner cannot sue the other partners to obtain from a court a mandatory injunction for registration of the firm. Such a suit fall within the purview of section 69. In *Babulal Dhandhamia v/s Gautam & Co.* 1949, Cal. L.J. 139, it was held that the word 'proceedings, in sec. 69 (3) does not cover a reference of a dispute among partners to arbitration and accordingly, an unregistered firm's reference to arbitration was held valid.

The registration of the firm may be affected any time and therefore a subsequent registration of the firm instead of registration before the setting up of the firm is also valid. However, a firm which has been dissolved cannot be registered. Once the firm is registered, it will be conclusive proof of the facts in the registrar's records. No partner whose name is on

the register can deny his partnership. The registrar of the firms must be duly informed of : 1) change in the firm name or change of the principal place of business, (ii) discontinuation of business at any other place, or setting up of business at a new place (iii) changes in names & addresses of partners (iv) a change in the constitutions of the firm by the admission, retirement or death of a partner. (v) dissolution of the firm.

Effective date of registration :

In *Sita Ram Agrawal v/s Harnath* AIR 1970 Raj. 99 1969, Raj. LW 561 the plaintiff had submitted papers for registration on 20.4.1957 and paid fees on 15.5.1957. The suit was instituted on 15.7.57 and the Registrar of Firms recorded the entry on 26.8.57. The suit was dismissed although application for registration was filed much earlier to the filing of the suit on the ground that the firm was duly registered only after the suit was filed. On the effective date of the registration of the firm *Andhra Pradesh High Court (CITM.P. Hyderabad V/s Jayalakhishmi Rice & Oil mills Contractor Co. AIR 1967, AP 99)* was of the view that registration of the firm when made is effective from the date of the application of registration instead of the date when the Registrar actually records the entry. This is on the ground that Registrar has to record the entry in the Register of Firms if nothing is against the firm applying for registration. But *Kerala High Court* held a different view. In *Kerala Road Lines Corporation V/s CIT (1964) 51, ITR 711*, it was held that the registration is effective only when the entry of the statement filed by the firm is recorded in the Register of the Firms and the statement is filed by the Registrar of the Firms as provided in sec. 59. The Supreme Court concurred with the view of the Kerala High Court thus setting at rest the controversy relating to the effective date of Registration.

Since in actual practice Registrar of Firms take a lot of time after the receipt of the application for registration, to record the entry in the register of firms as a result of which the firm till that period remains only an unregistered firm thereby causing, in many cases hardship to the partners as well as to such firms. To do away with such problems it may be suggested that either the firm applying, for registration be granted a provisional registration on the receipt of the application for the purposes of sec. 69. But the best remedy would be to make the registration effective from the date of the submission of the application in such cases where the application is found to be free from any defect.