

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 4 | Issue 2

2021

© 2021 *International Journal of Law Management & Humanities*

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com>)

This Article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in International Journal of Law Management & Humanities after due review.

In case of **any suggestion or complaint**, please contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication at **International Journal of Law Management & Humanities**, kindly email your Manuscript at submission@ijlmh.com.

Legal Consequences of Partners Coming in and Going Out

VIDHI SHARMA¹ AND POULOMI OJHA²

ABSTRACT

Even a slight change in the relationship between partners in a firm would result in reconstitution of the firm, thus whenever a new partner is introduced or when an existing partner is removed from the partnership firm, a firm is bound to be reconstituted.

The article talks about the legal consequences of the addition of/ removal of partners in a partnership firm as stated in the Indian Partnership Act, 1932.

I. INTRODUCTION

The Indian Partnership Act, 1932 is the law that guides about a partnership³. The question that comes to any layman's mind is how does one identify that a firm or an association is that of a partnership? Well, the true test to identify a partnership is namely the deed and that of profit sharing and it is a mutual agency. A partnership is a contract that is governed by the Partnership Act, 1932 as well as by various provisions of the Contract Act where the Partnership Act does not mention of anything.

Thus, a partnership is a business organisation where two or more persons have agreed to join together to carry out business for the purpose of earning profits and it is an extension of a sole proprietorship and the members of the partnership are called partners.

With every membership comes the question of rights and duties of the members, similarly even in a partnership the rights and duties of a partner are clearly defined as per the partnership deed.

II. INCOMING PARTNERS

A person who is admitted as a partner into an existing firm with the consent of all the existing partners is called an "incoming partner", such a partner is not liable for any act of the firm done before his admission as a partner.

¹ Author is an Advocate at Calcutta High Court, India.

² Author is an Advocate at Fast Info Legal Services, Kolkata, India.

³ Section 4 of the Act, defines partnership as "a relationship between two or more persons who agree to share the profits of a business run by them all or by any one or more persons acting for them all"

Where a person becomes the member of a firm already constituted, he is known as an incoming partner, it is herein important to note that an incoming partner can be admitted into a firm only with the consent of all the partners. The relations of partners is that of trust and confidence and only such persons can be admitted in whom all the partners have faith.

According to Pollock & Mulla, “that where a person nominated is not acceptable to the other partners, the court cannot force them all to enter into the partnership with him, because the foundation of the partnership is mutual confidence, which the court cannot supply where it does not exist”

Section 31 of the Act, defines the various ways in which a new partner may be introduced into a firm; this can be done mainly:

1. With the consent of all the existing partners: Before the admission of a new partners, the existing partners must agree to the admission of the person into the firm as a partner, no such person can be introduced into the firm without the consent of all the partners.
2. In accordance with a contract between the partners: If a contract between the partners permits the introduction of a new partner even without the consent of all the existing partners that can possibly be done. For example, the contract provides the majority of the partners shall be competent to admit a new partner or anyone of them may nominate a partner or appoint his successor, a new partner could be introduced accordingly.
3. In accordance with the provisions of Section 30 (minors): A minor admitted to the benefits of partnership can become a partner according to the procedure mentioned in Section 30(5).

III. A MINOR’S POSITION IN A PARTNERSHIP

As one knows, under the Contract Act it is clearly stated that a minor cannot be bound by a contract and a contract with a minor is void. Thus one can clearly state that a minor cannot be a partner in a partnership as that too is based on contracts. Though a minor cannot be a partner in the firm, they may be admitted for benefits of the partnership under Section 30 of the Act i.e. he can be given share in the partnership profits and this can be done only with the consent of all partners.

RIGHTS OF A MINOR:

1. The minor partner has the right to agreed share of profits in the firm.
2. The minor partner has the right to access, inspect and copy the accounts of the firm.

3. The minor may sue the partners on the account for payments when he is serving as a partner of the firm.
4. On attaining majority, he may within 6 months of attaining majority, he may elect to be or not be a partner in the concerned firm. If he elects to be a partner in the firm, he shall continue to have the same share as he had as a minor. But, he doesn't choose to be a partner, then he shall not be liable or have a share once the public notice has been served.

LIABILITIES OF A MINOR:

A. On attaining majority:

Within 6 months of attaining majority, or, on obtaining knowledge that he had been admitted for the benefits of partnership, whichever date is later. The minor partner has the right to make a choice whether he wishes to continue being a partner or not. If he doesn't want to be a partner, he must give a public notice and on failing to do so, he shall be bound to continue as a partner.

a. When he becomes a partner:

If the minor becomes a partner on his own willingness or because of the failure to give a public notice, his rights and liabilities are mentioned under

Section 30 (7) are as follows:

- i. He becomes personally liable to all the third parties, for the acts of the firm to which is entitled as a minor partner.
- ii. His share of the property and the profits of the firm, remains the same as that as he was entitled as a minor.

b. When he chooses not to become a partner:

1. His rights and liabilities are same as that of a minor till the date of the public notice
2. His share shall not be liable for any acts of the firm from the date of the public notice.
3. He shall be entitled to sue the partners, for his share of property or profits.

B. Before attaining majority:

1. The liability of a minor is limited to the extent of share in the profits and property of the firm.
2. The minor has no personal liability for the debts incurred in his presence as a minor.

3. He cannot declare insolvency, but if the firm is declared as an insolvent, his share lies with the Official Receiver.

IV. CHANGES IN A PARTNERSHIP

Whenever there is an admission of a new partner or retirement of a partner, or expulsion or insolvency of a partner, etc., the partnership firm undergoes reconstitution⁴. Sections 31 to 35 of the Indian Partnership Act, 1932 help us understand the legal consequences of a partner coming in or going out.

Admission or Introduction of a Partner:

According to the Section 31 of the Act, the consent of all the existing partners is necessary before introducing a new partner into a partnership firm. This is subject to the provisions of Section 30 regarding minors in the firm. Further, the new partner has no liability for any actions of the firm done before his admission.

As spoken of earlier, in the paper, the consent of all partners is necessary however if the contract permits the introduction of a partner without the consent of all the partners, in such a case, the partners shall be bound by the contract even if unwilling to do so.⁵

Similarly, in the case of *Byrne v Reid*⁶, A, B, C and D were four partners and they, in their partnership deed, authorised A to admit his son, S into partnership when S had attained the age of twenty-one years. After S attained the age of twenty-one years, A nominated him as a partner in accordance with the partnership deed and he accepted the nomination, but the other partners refused to recognize him as a partner. It was held that the son on accepting the nomination had become a partner.

Liabilities of an Incoming Partner:

Section 31 (2) states that an incoming partner “does not thereby become liable for any act of the firm done before he became a partner.” Thus, one can clearly understand that the liability of a partner begins from the date the partner has been admitted into the firm. However, nothing can prevent a partner from agreeing to become liable for the acts done in the firm before the admission of the partner. If he makes such an agreement with his co-partners, the same will be binding only between him and the co-partners and the third parties cannot take advantage of such an agreement. The creditors can make him liable if they can show that the incoming

⁴ Restructure; this could be on account of admission of a partner, retirement of a partner or simply a change of terms between partners.

⁵ *Lovergrove v Nelson*, (1834) 3 My & K 120.

⁶ (1902) 2 Ch. 735

partner had agreed with them, expressly or impliedly, for being liable towards them for the acts done before his admission. The basis of liability for the past acts in such a case will be the agreement rather than the fact of his admission as a partner.

It can be seen as in that of *Central Bank of India v Tarseema Compress Wood Mfg. Co.*⁷, the firm consisting of three partners, admitted a fourth partner, and they gave an undertaking to the bank wherein all the firm partners of the newly reconstituted firm undertook the liability, herein since the fourth partner had undertaken the liability, he too became severally and jointly liable towards the liability.

Liabilities on Admission of a New Partner towards Pre-Existing Liabilities of the Firm:

A new partner may be held liable for acts done before the admission of the partner if the partner has agreed to do so by some agreement⁸ or if there is even slight evidence to prove the existence of any such agreement⁹ or if there has been an agreement between the partners for the substitution of any such liability which is binding towards the creditors of the firm or if such agreement of substitution is made enforceable by the creditors themselves¹⁰.

Thus, what one can interpret is that the consent of the creditors is a major requisite for making such transactions operative wherein the new partner is also liable towards the firm and the debts of the firm and unlike the concept of novation in contract, the mere agreement amongst the partners cannot operate as a novation of a contract unless the consent of the creditors is received. The incoming partner and the existing partner even if they have an agreement shall not make the new partner liable for the existing debt and will not ipso facto give the creditors of the firm either any right against him.

V. OUTGOING PARTNERS

“A partner who leaves the partnership firm in which the remaining partners continue the business is an outgoing partner.”

Section 32 to 38 of the Act, deals with different ways a partner may cease to be a partner and his rights and liabilities thereafter. These provisions pertain to situations when the outgoing partner ceases to be a partner, but the firm is not dissolved and it continues with the remaining partners.

A partner may cease to become a partner in the following situations:

⁷ AIR 1997 Bom. 225

⁸ Tarseema Compress Wood Mfg. Co. AIR 1997 Bom 225

⁹ P.B. Sarma V. Phanindra 35 C.W.N. 593

¹⁰ Smith V. Patrick (1901) A. C. 282

- a. **By retirement:** Retirement here means voluntary withdrawal of a partner from the firm, as opposed to expulsion, when a partner is made to quit. It covers such cases where on the withdrawal of a partner from the firm, the firm is not dissolved but the business of the firm is continued with the remaining partners.
- b. **By expulsion:** Section 33 that “a partner may not be expelled from a firm by any majority of the partners, save in the exercise in good faith of powers conferred by contract between the partners.”
- c. **By insolvency:** Section 34 (1) states that “Where a partner in a firm is adjudicated an insolvent he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is hereby dissolved”
- d. **By death**

Retirement of a partner: According to Section 32 (1), a partner may retire with the consent of all the other partners or with an agreement amongst the partners but if the partnership is at will, this shall be only after giving a notice in writing. A notice is however not necessary for a dormant partner¹¹ until and unless the partner is known as a member of the firm to the creditors¹².

Liability of a Retiring Partner:

As per section 32 (2)¹³-Every partner is liable for all acts of the firm done while he is a partner¹⁴. If liability has arisen during the period while a person was a partner, such liability does not come to an end by his retirement, he shall be liable for the debts contracted before his retirement¹⁵

A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the reconstituted firm, and such agreement may be implied by a course of dealing between such third party and the reconstituted firm after he had knowledge of the retirement.¹⁶

Further as per Section 32 (3) & (4)¹⁷- By retirement a person ceases to be a partner. The third parties can still presume mutual agency between the outgoing and the continuing partners until

¹¹ Heath V Sansom (1832) 4 B. & A.D. 172

¹² Farrar V Defline 1 Car & K. 580

¹³ Liability for acts done after retirement

¹⁴ Section 25

¹⁵ Maurice V Morley 29 C.W.N. 496

¹⁶ Evans v Drummond 4 Esp. 89; Reed v White (1804) 5 Esp. 122; K.J. George v State Bank of Travancore AIR 2000 Ker. 214

¹⁷ Liability for acts done after retirement

a public notice of retirement is given. However, if the public notice is not issued, the partners continue to be liable. In order to avoid such liability, it is in the interests of both the retiring and the continuing partners that public notice is given.

Expulsion of Partners: According to Section 33, expulsion of partner is possible only if the following two conditions are satisfied i.e.:

1. The power to expel has been conferred by a contract between the partners;
2. Such a power has been exercised in good faith.

If the power to expel has been exercised bona fide the same cannot be challenged in a court of law. In *Blissett v Daniel*¹⁸ according to the partnership agreement two-third or more of the partners were empowered to expel a partner by a notice, without assigning any reason for the same.

Liability of an Expelled Partner:

The liabilities of an expelled partner are same as that of a retired partner.

Insolvency of a Partner: An insolvent is not allowed to continue as a partner and, therefore, a person who is adjudicated insolvent ceases to be a partner on the date on which order of adjudication is made. The position of an insolvent partner is different from the retiring and expelled partner who need to give a public notice.

Liability of an Insolvent Partner:

The estate of an insolvent partner is not liable for the acts of the firm which are done after the order of insolvency and neither the firm can be held liable for any acts once such order has been passed.

Death of a Partner: As per Section 35, on the death of a partner, a firm is dissolved but, if the other partners so agree, the firm may not be dissolved¹⁹ and the business of the firm may be continued with remaining partners. As regards the liability of his estate for the acts of the firm done after his death, the position is the same as in the case of an insolvent partner. If the firm is not dissolved on the death of a partner, the estate of the deceased partner is not liable for acts of the firm done after his death. An exception is a partnership consisting of only two partners where the firm shall then be dissolved.

¹⁸ (1853) 10 Hare 493

¹⁹ Section 42 (c)

VI. RIGHTS OF OUTGOING PARTNER

After a partner ceases to be a partner, the question of the following rights of the outgoing partner or his legal representatives generally arises:

1) Rights to carry on a competing business²⁰:an outgoing partner may carry on or advertise a competing business but is not allowed to use the name of the firm or represent himself as a partner or solicit persons he did before ceasing to be the partner of the firm²¹. Also he is not allowed to carry on any business similar to that of the firm within a specified period or local limits²².

2) Right to share subsequent profits until the amount due to him has been paid²³:if a member of the firm dies or otherwise ceases to be a partner of the firm, and the remaining partners carry on the business without any final settlement of accounts between them and the outgoing partner, then the outgoing partner or his estate is entitled to share of the profits made by the firm since he ceased to be a partner.

VII. CONCLUSION

Partnership is a very common type of business which prevails worldwide and it has its own set of advantages and disadvantages. A partner shall have legal rights whether the partner is incoming one or outgoing and all such guidelines and rules are covered under the act.

Thus one can summarise that:

1. Any person can become the partner in business but only with the consent of the other partners and the new partner shall be entitled to the share of assets and rights in the firm. And also be liable for every activity of the firm from the date of admission but not for any previous acts.
2. A partner may resign either with the consent of all partners or on the basis of any contract between the partners.
3. Expelling of a partner can be by majority votes only expect for bonafides interests of the firm.

Reconstitution of a firm has a wide impact on the firm, as it changes the existing partnership agreement. This is not just limited to the legalities of admission or outgoing of partners but also

²⁰ Section 36 (1)

²¹ Konski V Peet (1915)

²² Section 36 (2)

²³ Section 37

how it affects the profit sharing ratios.
