

# DISSOLUTION OF A PARTNERSHIP



## ➤ Concept of dissolution of Partnership

The dissolution of a partnership means **termination or end of every contractual tie between partners**. This indicates that the operation of a partnered company is suspended and the assets are issued to fund a different set of liabilities.

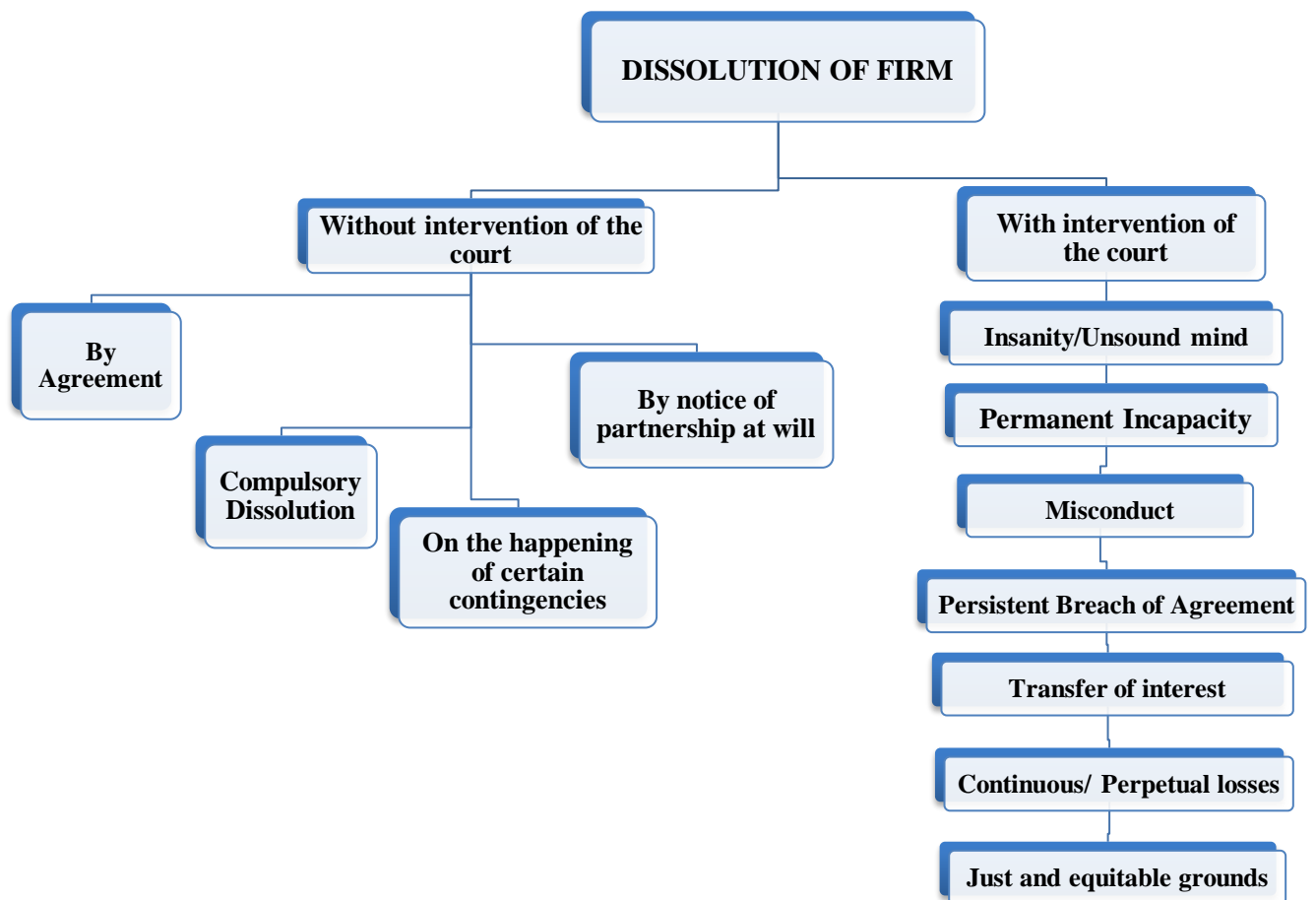
But, there is a distinction between these two concepts - dissolution of partnership and partnership firm. **Dissolution of partnerships** means the end of the **partnership business**, whereas, **dissolution of partnership firm** indicates the **termination of the partnership among the partners** and the firm. Suppose, if a current partner expires, retires, and is unable to settle the debt then rest of the partners can buy the share percentage of the departing partner and resume the operation of the firm under the same title.

## ➤ Difference between Dissolution of a firm and Dissolution of a Partnership

Parameters	Dissolution of a Firm	Dissolution of a Partnership
<b>Continuation of business</b>	The business discontinues.	The business continues. However, the partnership is reconstituted.
<b>Winding up</b>	The firm is wound up. Assets are realized and liabilities are settled.	Assets and liabilities of the firm are only revalued.
<b>Court order</b>	A Court Order can dissolve a firm.	A Court Order cannot dissolve a partnership.
<b>Scope</b>	It involves the dissolution of partnership between all partners.	It does not involve the dissolution of the firm.
<b>Final closure of books of accounts</b>	It requires final closure of books of accounts of the firm.	It does not require final closure of books of accounts of the firm.

➤ **MODES OF DISSOLUTION OF PARTNERSHIP FIRM**

*A firm may be dissolved either without or with the intervention of the Court*



❖ A firm may be dissolved without the intervention of the Court in the following situation

### **1] By Agreement (Section 40)**

According to Section 40 of the Indian Partnership Act, 1932, partners can dissolve the partnership by agreement and with the consent of all partners. Partners can also dissolve the partnership based on a contract that has already been made.

### **2] Compulsory Dissolution (Section 41)**

An event can make it unlawful for the firm to carry on its business. In such cases, it is compulsory for the firm to dissolve. However, if a firm carries on more than one undertakings and one of them becomes illegal, then it is not compulsory for the firm to dissolve. It can continue carrying out the legal undertakings. Section 41 of the Indian Partnership Act, 1932, specifies this type of voluntary dissolution.

### **3] On the happening of certain contingencies (Section 42)**

According to Section 42 of the Indian Partnership Act, 1932, the happening of any of the following contingencies can lead to the dissolution of the firm:

- Some firms are constituted for a fixed term. Such firms will dissolve on the expiry of that term.
- Some firms are constituted to carry out one or more undertaking. Such firms are dissolved when the undertaking is completed.
- Death of a partner.
- Insolvent partner.

### **4] By notice of partnership at will (Section 43)**

According to Section 43 of the Indian Partnership Act, 1932, if the partnership is at will, then any partner can give notice in writing to all other partners informing them about his intention to dissolve the firm. In such cases, the firm is dissolved on the date mentioned in the notice. If no date is mentioned, then the date of dissolution of the firm is the date of communication of the notice.

❖ *A firm may be dissolved with the intervention of the Court in the following situation-*

**According to Section 44 of the Indian Partnership Act, 1932, the Court may dissolve a firm on the suit of a partner on any of the following grounds:**

**1] Insanity/Unsound mind**

If an active partner becomes insane or of an unsound mind, and other partners or the next friend files a suit in the court, then the court may dissolve the firm. Two things to remember here:

- The partner is not a sleeping partner
- The sickness is not temporary

**2] Permanent Incapacity**

If a partner becomes permanently incapable of performing his duties as a partner, and other partners file a suit in the court, then the court may dissolve the firm. Also, the incapacity may arise from a physical disability, illness, etc.

**3] Misconduct**

When a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business and the other partners file a suit in the court, then the court may dissolve the firm.

Further, it is not important that the misconduct is related to the conduct of the business. The court looks at the effect of the misconduct on the business along with the nature of the business.

**4] Persistent Breach of the Agreement**

A partner may willfully or persistently commit a breach of the agreement relating to

- the management of the affairs of the firm, or
- a reasonable conduct of its business, or
- conduct himself in matters relating to business that is not reasonably practicable for other partners to carry on the business in partnership with him.

In such cases, the other partners may file a suit against him in the court and the court may order to dissolve the firm. The following acts fall in the category of breach of agreement:

1. Embezzlement
2. Keeping erroneous accounts
3. Holding more cash than allowed

4. Refusal to show accounts despite repeated requests, etc.

### **5] Transfer of Interest**

A partner may transfer all his interest in the firm to a third party or allow the court to charge or sell his share in the recovery of arrears of land revenue. Now, if the other partners file a suit against him in the court, then the court may dissolve the firm.

### **6] Continuous/Perpetual losses**

If a firm is running under losses and the court believes that the business of the firm cannot be carried on without a loss in the future too, then it may dissolve the firm.

### **7] Just and equitable grounds**

The court may find other just and equitable grounds for the dissolution of the firm. Some such grounds are:

- Deadlock in management
- Partners not being in talking terms with each other
- Loss of substratum (the foundation of the business)
- Gambling by a partner on the stock exchange.