

Course Name- LL.B 2nd sem

Subject- Special Contract Law

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Concept –Dissolution of Firm

MEANING OF DISSOLUTION

- Dissolution means discontinuance. When it relates to the relationship between the partners, it is called dissolution of partnership and when it relates to the business of partnership, it is called dissolution of the firm.
- According to the Partnership Act, 1932 "The dissolution of partnership between all the partners of a firm is called the dissolution of the firm. Therefore, the act distinguishes between the dissolution of partnership and dissolution of the firm. Dissolution of partnership means that the relationship between the partners changes while the firm may continue its business under the same name, if the partners so decide. On the other hand, dissolution of the firm means the complete closure of the business of the firm. All the assets are disposed off and all the liabilities are discharged. Therefore, under dissolution of the firm, the partnership is automatically dissolved. On the other hand, dissolution of partnership does not necessarily result in the dissolution of the firm.

Dissolution of Partnership

- The partnership is deemed to have been dissolved in any of the following circumstances:
 - i) expiry of the period of partnership
 - ii) completion of the venture for which it was formed
 - iii) admission of a partner
 - iv) retirement of a partner
 - v) death of a partner
 - vi) insolvency of a partner

Dissolution of a Firm

- In addition to the dissolution of the partnership, there is also the dissolution of the firm under the following circumstances:
 - i) Where all the partners agree that the firm be dissolved.
 - ii) Where all the partners but one are insolvent.
 - iii) Where the business becomes unlawful.
 - iv) In the case of partnership at will when a partner gives notice of dissolution.
 - v) When a competent court orders dissolution.

MODES OF DISSOLUTION

- There are essentially two modes of dissolution of the firm :
 - (a) Dissolution without the order of the court,
and
 - (b) Dissolution by the order of the court.

Dissolution without the order of the court

- A firm is dissolved without the order of the court in any one of the following ways:
 - 1) Dissolution by agreement (Sec. 40): A firm may be dissolved
 - (i) with the consent of all the partners or
 - (ii) in accordance with a contract between the partners.
 - 2) Compulsory dissolution (Sec. 41): A firm is compulsorily dissolved under the following circumstances:
 - i) When all the partners or all the partners but one are adjudicated insolvent. The reason is simple that an insolvent person ceases to be a partner and there cannot be a partnership firm without at least two persons.
 - ii) When one of the partners is adjudicated insolvent unless there is a contract to the contrary.
 - iii) When the business becomes unlawful on the happening of some event.
 - 3) Dissolution on the happening of certain contingencies; These are as follows:
 - i) the expiry of the term for which the firm was constituted
 - ii) the completion of the adventure
 - iii) the death of a partner
 - iv) the adjudication of a partner as an insolvent
 - 4) Dissolution by Notice
in case of partnership at will

Dissolution by Court

Section 44,

The court can order dissolution of the firm on the following grounds:

- 1) Where a partner becomes of an unsound mind
- 2) Where a partner is permanently incapacitated to perform his duties
- 3) Where a partner is guilty of misconduct
- 4) Where a partner persistently commits breach of the partnership agreement
- 5) Where a partner has transferred the whole of his interest in the firm
- 6) Where the business cannot be carried on except at a loss
- 7) Where the court is satisfied that it is just and equitable that the firm should be dissolved. After dissolution, the rights and obligations of all the partners continue as before in all the things necessary for the smooth winding up of the business of the firm.

SETTLEMENT OF ACCOUNTS

Normally partnership agreement governs the mode of settlement of accounts between partners after the dissolution of a firm. But in the absence of any specific agreement between the partners as to the mode of settlement of accounts between the partners after the dissolution of the firm, the relevant provisions of the Partnership Act shall apply, particularly **Section 48** which states:

In settling the accounts of a firm after dissolution the following rules, subject to agreement by the partners, be observed:

a) Losses including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportions in which they are entitled to share profits.

b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

- i) in paying the debts of the firm to third parties
- ii) in paying to each partner rate ably what is due to him from the firm for advances as distinguished from capital
- iii) in paying to each partner rate ably what is due to him on account of capital and
- iv) the residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits..

SETTLEMENT OF ACCOUNTS

- The overall effect of the above provisions may be summarized in simple terms as
 - 1) The assets of the firm must be first utilized in paying off the claims of third parties against the firm.
 - 2) The balance should be applied in repaying the advances (loans) made by the partners to the firm as distinguished from the capital. If the amount is insufficient to pay off the loans, they should be paid off rate ably (proportionately).
 - 3) The balance should be utilized in paying the claims of the partners in respect of their capitals which should be after adjusting all accumulated profits or losses and also drawings and realizations profit or loss

Private Debts of Partners and Firms' Debts

The creditors of the firm (third party liabilities) should be paid out of the assets of the firm. If there is any surplus, it will be divided among the partners as per their claims which can be utilised for paying the private liabilities of the partners. Similarly, the private creditors of partners should be first paid out of the private assets of partners and if there is any surplus, it can be utilised for paying off the partnership Debt.

