

PARTNERSHIP FIRM

INTRODUCTION:

Section.4 of the Indian Partnership Act, 1932 defines Partnership in the following terms: “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.”

A Partnership is a business structure in which two or more individuals manage and operate a business in accordance with the terms and objectives set out in the Partnership Deed. This structure is thought to have lost its relevance since the introduction of the Limited Liability Partnership (LLP) because its partners have unlimited liability, which means they are personally liable for the debts of the business. However, low costs, ease of setting up and minimal compliance requirements make it a sensible option for some, such as home businesses that are unlikely to take on any debt.

A partnership firm is a business structure in which two or more individuals manage and operate a business in accordance with the terms and objectives set out in a Partnership Deed that may or may not be registered. In such a business, the members are individually partners and share the liabilities as well as profits of the firm in a predetermined ratio. A Partnership is easy to form, and the compliance is minimal as compared to companies. The partners in a partnership firm are the owners, and thus, are not a separate entity from the firm. Any legal issues or debt incurred by the firm is the responsibility of its owners, the partners. A partnership must have at least two partners. A partnership firm can have up to 50 partners (as per Rule 10 of The Companies (Miscellaneous Rules, 2014). These partners can divide profits and losses equally or unequally.

SALIENT FEATURES OF PARTNERSHIP FIRM:

1. Minimum Compliance:

For Partnerships, there is no need for an auditor to be appointed or, if the company is still in the process of registration or is unregistered, annual accounts filing with the registrar is not necessary either. When compared to LLP, annual compliances are also fewer. Further, taxes depending on turnover, Goods and Service Tax, etc also need not be filed in Partnerships.

2. Simple to Begin:

Partnerships can begin simply with an unregistered deed of the partnership within 2-4 business days. However, having registration for the same has its own perks and advantages. The primary advantage for having a registered firm is that it will allow you to book lawsuits in courtrooms opposing another business or the business associates in the firm for the administration of rights addressed in the Partnership Act.

3. Economical as compared to LLP:

In comparison to LLP, a General Partnership is much cheaper to begin. Even in the longer run, it will still work out inexpensive as the compliance requirements are very minimal. For example, there is no need for an auditor. Therefore, Home businesses still opt for this, although it offers unlimited liability.

4. Not a Separate Legal Entity:

The partners in a partnership firm are the owners, and thus, are not a separate entity from the firm. Any legal issues or debt incurred by the firm is the responsibility of its owners, the partners.

5. Registration of Partnership deed not mandatory:

No, partnership registration is not necessary. However, it is advisable for you to have a partnership firm registration online. Also, remember that for a partner to sue another partner or the firm itself, the partnership should be registered. Moreover, for the partnership to bring any suit to court, the firm should be registered. For this reason, it is recommended that larger businesses register the partnership deed.

ADVANTAGES OF PARTNERSHIP:

- **Ease of Formation:**

Any two persons capable of entering into contract can start partnership. The partnership deed can be oral or written. Registration is not compulsory. Thus, partnership is very easy to form. However, business conditions or requirements may force partnerships to be formed through a partnership deed, which is in writing. For example, banks may not allow a partnership firm to open a banking account unless there is a written partnership deed.

- **Flexibility of Operations:**

There is considerable freedom in carrying out business operations. There is no need for taking approvals from Government or any other authority, to change the nature, scope or location of the business.

- **Greater Financial Resources:**

Partnership combines the financial strength of all partners, as the liability of partners is joint and several. Not only is the ability to contribute capital greater, it also enhances the borrowing capacity of the firm.

- **Greater Managerial Resources:**

Partnerships are often formed by people looking for advantages of synergy. If one partner has technical knowledge, other could be marketing or finance expert. Thus, the managerial resources of the firm are enhanced. The financial resources available with the firm enables the firm to employ a good manager on salary basis for taking care of the business in a professional manner.

- **Greater Creditworthiness:**

When a lender evaluates the proposal for loan, he looks at the creditworthiness of the borrower. A partnership firm, by definition, has more than one person responsible for the business. All partners are jointly and severally liable for the debt taken by the firm. The personal assets of all the partners can be used for repayment of the loan. All this gives greater confidence to the lenders. Thus, a partnership firm enjoys greater creditworthiness and therefore raise more debt for the business.

- **Balanced Judgement:**

In a partnership, the day to day management might be taken care of by one or few partners. However, in case of major issues, partners are likely to discuss the circumstances and arrive at a balanced judgement. Decisions are unlikely to be taken in haste, or in emotion.

- **Specialisation:**

Partnership can benefit from division of labour. Partners may choose to specialise in an area of interest. Partners can clearly define responsibilities and duties amongst themselves. This will result in expertise in management, apart from increase in efficiency, thereby maximising profits.

- **Maintenance of Secrecy:**

A partnership firm is a closely held business. It is not required by law to share its performance and position with others. Thus, all knowledge about the firm is restricted to only the partners of the firm.

- **Personal Contacts with Staff and Customers:**

A partnership concern is a relatively small organisation, whose activities can be managed by a group of people. Thus, partners keep in close contact with customers and staff. They are thus able to note the changing tastes and attitudes and react faster to such changes.

- **Economies in Management:**

Partners have a stake in the profits of the business. They ensure that wastage is kept at the minimum. All expenses are closely supervised. Thus, expenses of management are controlled.

- **Conservative Management:**

Partners have unlimited liability. Unlimited liability prevents the partners from taking reckless decisions. They not only ensure that the decisions taken by them are acceptable to all, but also confirm that no other partner is acting needlessly aggressive.

- **Protection of Minority Interest:**

A partner being jointly and severally liable for any action of the firm, he has a right to stop the firm from taking action that is not in the interests of the firm. Such a partner cannot be ignored even if majority of partners feel otherwise. Decisions of partnership need the consent of all partners.

- **Incentive to Hard work:**

Partners have share in the profits of the firm. Partners put in hard work and try to increase profits of the firm. A sincere and committed effort brings in extra rewards.

- **Risk Reduction:**

The profits and losses are shared by all partners. Similarly, if the firm is unable to meet any of its payment obligations, all partners are responsible. Thus, partnership offers risk reduction as the risk is spread across partners.

- **Greater Scope for Expansion:**

As number of partners is larger, the firm can plan for faster expansion. It can also have geographical expansion, as a partner can be mobile and sufficiently experienced to handle the organisational activities from a new place.

- **Easy Dissolution:**

It is very easy to dissolve the partnership firm. Any partner can ask for dissolution of firm by giving a 14 day notice. The firm can be dissolved on death, insolvency or lunacy of any partner. No legal formalities are required.

- **Taxation:**

The Income Tax Act, 1961 treats a Partnership as a separate 'person' and its tax is calculated separately. This allows scope for partners to do tax planning and reduce total tax payable to minimum.

DISADVANTAGES OF PARTNERSHIP:

- **Unlimited Liability:**

Partners become fully liable for all claims against the firm to an unlimited extent. The partner might lose all the savings of his life on account of a loss or a mistake in business. This is one of the reasons that the selection of a partner or association with a like-minded partner is the most important thing in forming a partnership business.

- **Restriction on Transfer of Interest:**

One of the golden rules of any investment is that there must be an easy exit. If partner needs money, or is not in agreement with others, he cannot transfer his interest in the firm to outsiders without the consent of outsiders. A partner will not be able to reduce or increase his stake in the partnership.

- **Inadequacy of Capital:**

The number of partners in a firm is restricted to a maximum of twenty persons. Thus, a partnership firm may not be in a position to raise the required capital to finance its expansion plans. Hence, businesses that need large amounts of capital are generally organized as Joint Stock companies. For example, an oil refining business like Reliance Industries Limited or a car manufacturing business like Tata Motors Limited, cannot be imagined as Partnership firms.

- **Mutual Conflicts:**

Partnership requires close cooperation and a lot of understanding amongst partners. If there is a serious difference of opinion amongst partners, with different partners trying to pursue different goals then it is not good for the health of the business. Friction between partners will eventually lead to closure of business.

- **Uncertain Continuity:**

Partnership may be dissolved on account of death, insolvency, insanity or incapacity of any of the partners. There is always a serious threat to continuity of business in its existing form. Hence, partnership firms are not suited to businesses requiring long term capital and plans.

- **Delay in Decision Making:**

While day to day management is handled by one or more partners independently, any major decision requires the consent of all partners. A discussion and consensus on decision to be taken might be time consuming, resulting in the firm losing out on prompt action.

- **Risk of Implied Authority:**

A partner can bind all other partners of the firm by his actions. This is a great risk to the other partners, as any hastily taken action may result in wiping out the life savings of all partners. It is seen that mistrust and wrong decisions by managing partners usually lead to dissolution of partnership firms.

- **Lack of Public Confidence:**

The affairs of the firm are not subject to public scrutiny. The performance and position of the firm is not published. Hence, the firm does not enjoy any public confidence.

- **Aversion to Risk:**

The liability of all partners is unlimited. Also, the partners are jointly and severally liable. In other words, a wrong step taken by one partner can result in all or some of the partners becoming bankrupt. Keeping this in mind, partners have a very high aversion to risk.

- **Limited Scope for Expansion:**

A partnership firm can have only a limited number of partners. The liability of these partners is unlimited. Therefore, their ability to take risk is limited. This limits the ability of the firm to expand and grow.

- **Continuation of Responsibilities:**

Normally, the responsibilities pertaining to a business end with closure of the business. However, in case of Partnership firms, unless the liability of the firm is limited (LLP or Limited Liability Partnership), the responsibility of partners continues even after the firm is closed down (dissolved). This continues till the claims of all outsiders are completely settled.

- **No Independent Legal Status:**

Partnership firm is not separate or distinct from its members. It does not have a separate legal entity of its own. Partners enter into contracts on behalf of each other.

FORMATION OF A PARTNERSHIP FIRM:

The steps involved in formation of a Partnership Firm are as under:

1. Finalising Name of the Firm:

The partners to first decide the name of the partnership firm. The name of the firm should not be too similar or identical to the name of any other existing company performing relevant business to regret duplication in the name of firms.

2. Drafting of Deed of Partnership:

A Partnership Deed is a record in which the terms and conditions of the members of a partnership are included. The Partnership deed consists of the following components as below:

- Both Firm and Partners address as well as name.
- Nature of Business of the Firm.
- Commencement date of business or firm.
- The duration of Partners (whether for a project/ fixed period).
- Profit distribution ratio among the partners.
- Capital contribution from each partner.

The components specified above are the essentials that are needed in all partnership deeds. If required, the partners may also cover any further clauses. Some of the additional provisions which can be involved in the deed of the partnership are listed here:

- Interest on Partners' Loan, Partner's Capital and Interest, if any.
- Commissions, Salaries, etc., if any, chargeable for partners in the firm.
- The process of making accounts and audit arrangement.
- Division of responsibility and task, i.e. the powers, duties, and commitments by all the partners in the firm.
- Rules and Regulations in case of retirement, death and admission of a partner.

REGISTRATION OF A PARTNERSHIP FIRM:

Indian Partnership Act, 1932 governs the partnerships. Registration of partnership firm is optional and at the discretion of the partners. However, It is always advisable to register the firm since a registered firms enjoy special rights which aren't available to the unregistered firms.

For Registration of Partnership Firm, an application needs to be made in prescribed form. For Firm registration, following documents are required:

- Form No.1 duly filled and affixed Rs.3 court fee stamp.
- A photocopy of Partnership deed on minimum stamp paper or Rs.200.
- Ownership Proof of Principal Place (any one of the following)
 - Registered document of the property

- House tax receipt.
 - Water bill.
 - Electricity bill in the name of the property owner.
- Affidavit/NOC on Rs.10 and Rs.5 Notary stamp.
- Rent agreement (If rented property).
- Residential proof of all the partners (any one of the following)
 - Voter card.
 - Passport
 - Driving Licence.
- Affidavit/NOC on Rs.10 and Rs.5 Notary stamp and ownership proof of other places (if mentioned in Form no.1).

Procedure for Registration:

Step-1: Submission of above mentioned documents along with requisite fee with the Registrar of Firms. The screenshot of Form 1 is as below for reference.

Form No. 1Filing Fee Rs. 3/-
(Affix Court fee Stamp).**THE INDIAN PARTNERSHIP ACT, 1932**

Application for Registration of Firm by the Name

Presented and forwarded to the Registrar of Firm for filing by

We, the undersigned being the partners of the firm M/s _____ *
hereby apply for registration of the said firm and for that purpose supply the following particulars in
pursuance of section 58 of the Indian Partnership Act, 1932:-

The firm name*		
Places of Business	(a) Principal Place (b) Other Places	
Name of partners in full	Date of joining the firm	Permanent address in full
1.		
2.		
3.		
4.		
5.		
6.		
Duration of the firm:-		

Station:-

Date:-

Signature of all partners or their specially
authorised agents.

(*) Enter the name of the firm.

If any partner is a minor the fact whether he/she is entitled to the benefit of partnership should be set out
herein.

P.T.O.

I, son of, aged
years of religion do hereby declare that the above statement is true and correct to the
best of my knowledge and belief.

Date

Signature

Witness (Name, address & signature with official rubber stamp)

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Signature

Witness (Name, address & signature with official rubber stamp)

N.B :- 1. This form must be signed by all partners or their agents specially authorised in this behalf in
the presence of a witness who must be either a Gazetted Officer, Advocate, Magistrate 1st class
or Registered Chartered Accountant with their official rubber stamp.

2. Making a false, untrue or incomplete statement is punishable under section 70 of the Indian
Partnership Act, 1932

Step-2: After submission of application, an Application ID shall be allotted by the Registrar of Firms. The same shall be useful to track the status of the Application made with the Registrar of Firms.

Step-3: After successful verification of documents by the Registrar, the Registrar shall issue the Certificate of Registration of Firm.

Usually, the registration of Partnership Firm in India can take up to 12 to 14 working days. However, the time taken to issue a certificate of incorporation may vary as per the regulations of the concerned state. The registration of Partnership Firm is subject to Government processing time which varies for each State.

COMPLIANCES FOR FIRM:

In case of a partnership firm, the major compliance is filing of Income Tax Return in ITR-5 as per the Provisions of Income Tax Act, 1961.

The audit of the annual accounts of the firm depends upon the turnover of the firm. If the turnover of the firm is less than or equal to Rupees One Crore in case of business and Rupees Fifty Lakhs in case of receipts from profession, there is no requirement of Tax Audit as per the provisions of the Income Tax Act, 1961.

Update: The threshold limit of Rs 1 crore for a tax audit has been increased to Rs 5 crore with effect from AY 2021-22 (FY 2020-21) if the taxpayer's cash receipts are limited to 5% of the gross receipts or turnover, and if the taxpayer's cash payments are limited to 5% of the aggregate payments.