CHAPTER-1 ACCOUNTING FOR PARTNERSHIP FIRMS— FUNDAMENTALS

concept no.



Partnership Intro, Deed, Agreement, Act-1932

concept no.1

Partnership Intro,Deed,Agreement,Act-1932

Partnership is defined by Indian Partnership Act, 1932, Section 4, as follows:
"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

ESSENTIAL FEATURES OR CHARACTERISTICS OF PARTNERSHIP

1.) Lawful business :The business must have a legal purpose. Activities like smuggling, trafficking, or dealing in banned substances are illegal, and a partnership cannot be formed for such purposes.

2.) Agreement: written or oral. The written agreement among the partners is known as **Partnership Deed.**

3) Mutual Agency This means that every partner has the authority to act on behalf of the partnership and can bind the firm and the other partners by their actions in the course of the firm's business.

4). **Profit Sharing:** Equally or any other ratio

5). Two or More Persons: except the following is competent to contract:
(a) Persons of unsound mind, and
(b) Persons disqualified by any law.
Maximum Number of Partners: The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) **Rules, 2014**. As a result, a partnership firm cannot have more than **50 partners**.
Minor as a Partner: A minor can be a partner in the firm but only in profits of the firm and not in losses.

6). Business: A partnership is established for a business.

PARTNERSHIP DEED



This written document, known as Partnership Deed details the terms and conditions of partnership. It is a legal document signed by all the partners and normally has clauses on the following:

PRINCIPAL

(i) Profit-sharing Ratio: Ratio in which profits or losses are to be shared by the partners.

(ii) Remuneration to Partners: Amount of salary, commission etc. if agreed, to be paid.

(iii) Interest on Capital: Rate of interest, if allowed, on capital.

(iv) Description of the Partners : **Names**, description and addresses of the partners

(v) Capital Contribution: The amount of capital to be contributed by each partner, whether the Capital Accounts shall be fixed or fluctuating.

(vi) Interest on Drawings: Rate of interest, if to be charged, on drawings.

(vii) Accounting Period: The date on which accounts shall be closed every year. Normally, accounts are closed on 31st March every year because every entity must submit the return of income for its income for the period or year ended on 31st March every year

(viii) Settlement of Account: The manner in which accounts of partner(s) shall be paid in case of his (their) retirement or death or at the time of dissolution of the firm.

(ix) Interest on Loan: Rate of interest on loan by a partner to the firm and interest on loan to a partner by the firm.

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((x) **Valuation of Goodwill:** Method by which goodwill of the firm will be valued at the time of reconstitution of the firm, i.e., change in profit-sharing ratio, admission, retirement or death of a partner.

(xi) Valuation of Assets: The manner in which assets of the firm shall be valued at the time of its reconstitution

(xii) Bank Account Operation: How shall the Bank Account be operated? Whether it shall be operated by any of the partners or jointly.

(xiii) Rights and Duties of Partners: The rights and duties of partners are defined.

(xiv) Description of the Firm: Name and Address of the firm.

(xv) Nature of Business: Nature of business that the firm shall carry on.

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(xvi) Duration of Partnership: The period of partnership, i.e., whether it is for a specified period or for a venture or at will.

(xvii) Death of a Partner: Whether the firm will continue on the death of a partner.

(xviii) Principal Place of Business: Address of the principal place of business.

(xix) Commencement of Partnership: Date of commencement of partnership.

(xx) Settlement of Disputes: Disputes, if any, among the partners—how they shall be settled.

Absence of Partnership Deed

Accounting Treatment in the Absence of Partnership Deed

Matters Provisions of the Indian Partnership Act, 1932

1). Admission of Partner New partner cannot be admitted unless **all** the partners **agree** to it.

2). Sharing of Profits/Losses Profits/Losses are shared **equally** by the partners

3). Interest on Advance/Loan by a Partner Interest on loan by partner is paid (allowed) **@ 6% p.a.**

Interest on loan by partner Is a charge against profit. It means interest is paid whether the firm earns profit or incurs loss.

4). Interest on Capital Interest on capital is **not paid (allowed)** to partners.

5). Interest on Drawings Interest on drawings is **not charged** from partners.

6). Remuneration to Partners Remuneration (salary, commission, etc.,) is **not paid (allowed)** to any partner.

Important Provisions of the Indian Partnership Act, 1932

(i) If all the partners agree, a **minor** may be admitted for the **benefit** of partnership. [Sec. 30]

(ii) A person may be **admitted** as a partner either with the consent of **all**

(iii) A partner may **retire** from the firm either with the **consent of all** the other partners or in accordance with an agreement" among the partners. [Sec. 32]

(iv) Registration of the firm under the Partnership Act, 1932 is **optional** and not compulsory. [Sec. 69]

(v) Unless otherwise **agreed** by the partners in the **Partnership Deed**, a firm is **dissolved** on the death of a partner. [Sec. 35]

Liabilities of Partners

Subject to agreement among the partners,

1). If a partner carries on a business in competition with the **firm without** the consent of **other partners** and **earns profit** from it, the profit earned from such business shall be **paid to the firm**. However, **losses incurred, if any**, are borne by him alone.

2). If a partner earns **profit for himself from any transaction of the firm** or from the use of firm's property or business connection, the profit so earned shall be paid to the firm. For example, a partner gets commission from the buyer of goods on goods sold by the firm, the commission so earned shall be paid to the firm

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Questions

Q.1). Gupta and Sharma were partners in a firm. They wanted to admit two more members in the firm. List the categories of individual other than minors who cannot be admitted by them.
[Ans. (i) Persons of unsound mind;
(ii) Persons who have been declared insolvent]

Q.2) In the absence of Partnership Deed, state the provisions of the Partnership Act, 1932 relating to:
(a) Salaries of partners, (b) Interest on partners'capitals,
(c) Interest on loan by partner, (d) Division of profit,
(e) Interest on partners'drawings, (f) Interest on Loan given to partners?
[ANS.: (a) Not allowed; (b) Not allowed; (c)6%p.a.; (d) Equal; (e) Not charged; (f) Not charged.]

Q.3). Barun, Tarun and Shivam are partners in a firm and do not have a Partnership Deed. Barun introduced further capital of₹ 5,00,000 on 1st October, 2023. Whereas Shivam took loan of ₹ 50,000 from the firm on 1 st October, 2023. Disputes have arisen among them on the following:
(a) Barun demands interest @ 10% p.a. on ₹ 5,00,000 being his extra capital.
(b) Tarun desires that his son Deep should be admitted as partner and he will give him half of his share. Barun and Shivam do not agree.
(c) Barun and Tarun are of the view that Shivam should be charged interest on loan from the firm at the lending rate of the banks, which is 12% p.a.
(d) Tanun has withdrawn ₹ 50,000 from the firm for his personal use. Barun and Shivam are of the view that Tarun should be charged interest @ 10% p.a.
Give solution to each issue of dispute.
[Ans.: In the absence of Partnership Deed, the provisions of Indian Partnership Act, 1932 will apply: (a) Interest will not be paid on extra capital introduced, (b) Deep cannot be admitted as Barun and Shivam don't agree, (c) No interest will be charged from Shivam as rate of interest was not agreed, (d) Interest on drawings will not be charged from Tarun.)

Q.4) Following differences have arisen among P, Q and R. State who is correct in each case:
(a) P used ₹ 50,000 belonging to the firm and earned a profit of ₹ 5,000. Q and R want the amount to be given to the firm.
(b) Q used ₹ 10,000 belonging to the firm and incurred a loss of₹ 1,000. He wants the firm to bear the loss.
(c) P and Q want to purchase goods from Star Ltd., R does not agree.
(d) Q and R want to admit W as partner, P does not agree.
(e) R had given loan of₹ 2,00,000 to the firm and demands interest @ 10% p.a. P and Q do not want to pay the interest.
[Ans.: (a) P must pay–₹ 55,000; (b) Q must pay– ₹ 10,000; (c) Goods may be bought from Star Ltd.; (d) W cannot be admitted; (e) R will get interest @ 6% p.a.]

Q.5) Harshad and Dhiman are in partnership since 1 st April, 2023. No partnership agreement was made. They contributed ₹ 4,00,000 and ₹ 1,00,000 respectively as capitals. In addition, Harshad had given loan of ₹ 1,00,000 to the firm on 1st October, 2023. Due to long illness, Harshad could not participate in business activities from 1st August, 2023 to 30th September, 2023. Profit for the year ended 31st March, 2024 was ₹ 1,80,000. Dispute has arisen between Harshad and Dhiman.
Harshad Claims:
(i) He should be given interest @ 10% per annum on capital and loan;
(ii) Profit should be distributed in the ratio of capital.
Dhiman Claims:
(i) Profits should be distributed equally;
(ii) He should be allowed ₹ 2,000 p.m. as remuneration for the period he managed the business in the absence of Harshad;
(iii) Interest on Capital and loan should be allowed @ 6% p.a.
You are required to settle the dispute between Harshad and Dhiman. Also prepare Profit & Loss Appropriation Account. (NCERT, Modified)
[Ans.: Harshad and Dhiman each gets ₹ 88,500 as profit and Harshad gets ₹ 3,000 as Interest on Loan.] [Hints: Harshad's Claim: (a) Harshad is not entitled to any interest on capital, but he is entitled to interest on his loan @ 6% p.a.;
(b) Profits will be distributed equally as per Partnership Act, 1932.
Dhiman's Claim: (a) His claim is right that profits should be shared equally;
(b) No remuneration will be allowed to Dhiman; (c) Interest on capital will not be allowed.]