

Legal Compliance for Incorporating Startup
Prof. Indrajit Dube
Department of Humanities and Social Sciences
Indian Institute of Technology, Kharagpur

Lecture - 06
Law Relating to Partnership and Deed

I welcome you in my 6th Lecture relating to Legal Compliance for Incorporating Startup. In my last lectures I have covered that why we need to a business firm for a startup, then I talked with you how to choose an appropriate business firm for your startup, what are the compliance requirements which you need to do relating a comparative analysis of compliance requirement. And then I talked about that how costly or what are the cost analyses for different form of this particular business firm.

So, today I will talk with you the issues related to Incorporating of Partnership, LLP and the co-operatives, and more specifically now in this talk now relating to partnership and deed partner it is basically known as partnership deed. Now I have told you what the partnership is in my previous lecture. But nevertheless let me repeat some of the issue and then take you through what are the laws which govern this particular partnership. In my previous lecture I have told you that partnership governed by Indian Partnership Act and it is quite a old legislation, and it provide the basic structure that how the partnership can be formed and then how the partnership can be governed.

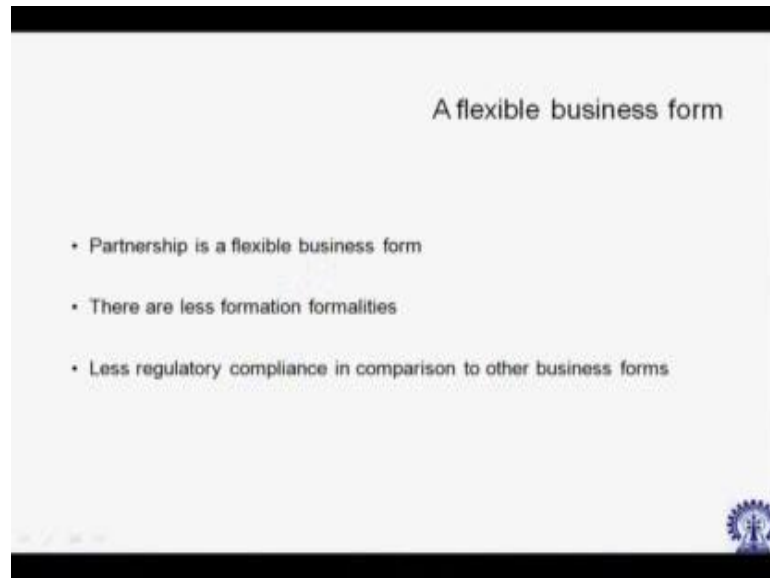
But please remember when we are talking of the partnership basically a very flexible business firm. So, the law has left out what are the terms and condition the partner is going to decide for the partner themselves only. But law provides some kind of a basic framework within which the partners need to negotiate the terms and then form the agreement.

So, partnership in compared to other form of business is a more flexible business, because the partners can negotiate at different terms and if you read the different section of the partnership it says that it is subject to the partnership agreement. That means, the benchmarking has been provided in the Partnership Act, but partnership agreement might provide something more than whatever has been prescribed in the act itself. Please remember whenever you are framing this particular agreement you are not allowed to contradict any provision of this particular act, if you do so or if you enter into a

agreement or create a provision in the agreement which subordinate the provisions of the law than in that case that particular provision in the agreement will be inoperative.

Now, in case of the partnership it is a less formalities.

(Refer Slide Time: 04:04)



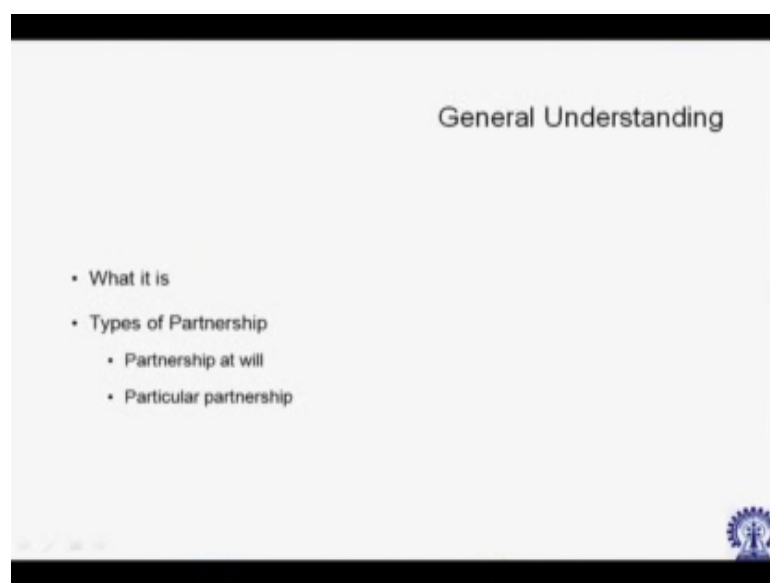
There is less formation formalities. Now partnership can be registered, even partnership can exist without registration. And for that matter according to the Section 6 of the Partnership Act; partnership even can be inferred from a certain situations. And you will find there are a several cases I mean filed by the tax directorate relating to determination of the partnership. Because this sometimes bring before the court that the particular business firm or the particular way the people are doing the business it is the partnership. And if there is the partnership structure is different than that of individual tax structure.

So, there is a possible three way one can talk about the partnership. One is which is formed through the formal process of agreement. And the second one is if you have entered into a formal process of agreement and then you have gone and registered that particular agreement as register and then that case it will be called as a registered firm. And the third scenario is that where your business relation will be inferred as a partnership because of some other legal compliances or regulatory reason. The last one in this particular category is it is a less compliance is required in case of the partnership in compared to the other forms of business.

Now, we are going to discuss more on these particular issue when I am talking about more or less regulatory issues, because if you are in incorporated form of business like if you are in LLP which I am going to discuss in my next lecture or if you are in companies either private limited company or public limited company in those circumstances your compliance requirement is quite high in compared to partnership. In case of the partnership there is a structural requirement is pretty less it might be only when there is a new partner has been admitted in the firm or one of the existing partner is retired from that particular firm then in that case you need to inform to the registrar of the company, or if you are going for the dissolution or of the partnership then in that case you need to inform to the registrar of the company.

At the same time if any partner is getting retired from this particular firm then in that case you need to provide a public notice. So, there is a very simple mechanism which has been provided for the purpose of structural compliance as a business firm. Apart from the structural compliance there is a several other compliance you need to do and which I have discussed with you in my previous lecture, but nevertheless let me repeat you might require to comply with the tax regulator laws, you might require to comply with the environmental regulated laws, you might require to comply with other local governance law so much so forth. Otherwise it is a quite simple form and your regulatory hassle is much lesser in compared to other form.

(Refer Slide Time: 07:56)



Now, let me take you more detail in understanding of the partnership. Now when you talk about the partnership what we basically try to understand, because I have said to you that partnership can happen in two a three way. So, what the law says that if some people are coming together with a common objective to do the business and then to share the profit then in those circumstances it will be called a partnership. Now there is a several question which might come in your mind, like if you are a co-sharer you are co-sharer because you have inherited that particular property from your father in his absence and then you are co-sharer of the property and you have given that particular property in the rent. Now you have a same objective to get the rent does it mean that you have formed a partnership, answer is no.

Now you and your wife is started doing a particular business; is it that both of you are a partner in that particular business, answer is no. So, what is important thing is that there should be some kind of business interest and that particular business interest with having a common objective which lead to the profit making. There is a test which has been provided. So, what I am trying to drawing your attention even if you write in a big letter that you are a partnership and you give the heading of your agreement as a partnership and you keep on defining what is the relation between both the parties that particular agreement might not remain might not be treated by the court as a partnership deed itself.

So, partnership is a matter of a subjective understanding by the interpretation of the law and if necessary the court will be going to interpret that this is a partnership or not. So, what I am trying to drawing your attention that even if you are entering into partnership agreement and if you are not able to satisfy the test of the law which has been provided in the Partnership Act then in that case your organization might not be treated as a partnership. Now there is two type of partnership are there; one partnership is known as Partnership at will and second one is known as Partnership particular or Particular partnership.

Now, partnership at will means you are continuing that particular partnership until unless the partners of that particular firm decide to dissolve that particular partnership. Now during the subsistence of the partnership there is a possibility that there is some partner admitted into that particular partnership and some partner are left the partnership or some partner retired the partnership, so whatever the situation is the partnership continue. Now please remember whenever new person is entering into the partnership or the existing

partner is going out of the partnership there is a change in the characteristic of the partnership, because the partners in a partnership firm is severally and jointly liable for the debt of the partnership. So, if the partnership incurs a business debt then in that circumstances all partner not only the partnership, but all the partners will be personally liable for that particular debt, and the creditor may choose any one of you to realize that particular debt itself.

So, that is a reason law says that the moment there is a new admission of a new partner in a existing partnership or one partner is going out of the existing partnership there is a change in the characteristic of the partnership itself which we need to take care of this particular provision. I am going to talk about the detail about the admission as well as retiring of the partnership in the subsequent in this particular lecture after sometime.

Now, when we are talking about the particular partnership it means that we have promoted that partnership for a particular event, like it might be relating to sports event, it might be related to some expedition in some of the exotic destination may be in Himalaya or some other places, or it might be a particular event to a particular event to organize.

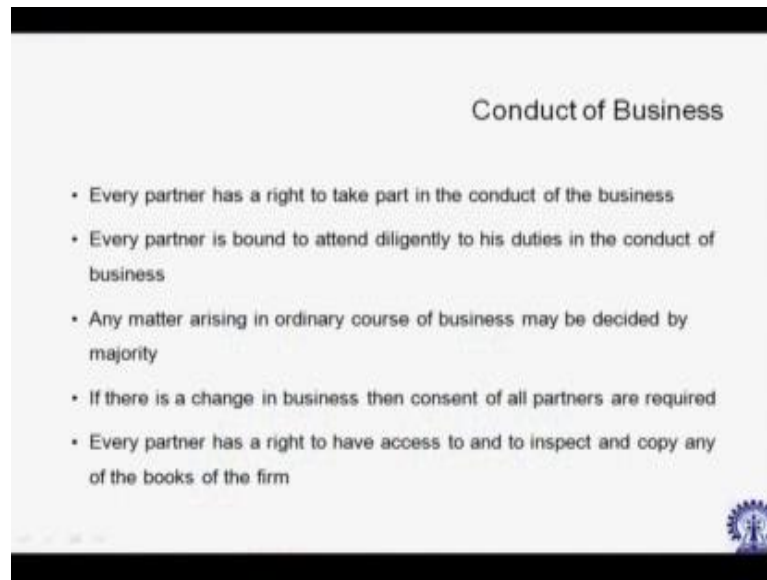
So, in those particular circumstances it is known as particular partnership. That means, the moment that particular event is over your partnership is diluted. There is a difference between this will partnership at will as well as partnership at particular. Partnership at particular is time bound and it is depending on happening of a particular event, but in case of partnership will it is almost perpetual in nature until unless you basically put down this partnership. Further talk about this partnership at will, sometimes you might find in some of the cities in India the partnership existing in more than hundred years and you will find that particular partnership in the inherited the family business from one generation to another generation.

But please do remember that the right of the partner cannot be inherited or the right of a partner cannot be inherited in the sense that the son of a partner cannot be automatically be a partner in a partnership until and unless it is expressly admitted until and unless the deceased partner's son is expressly admitted in that particular partnership.

So, what I am trying to drawing your attention that partnership is not a automated process, partnership is a exercising of one own clear wishes for entering into that

particular business venture and clear consent to be a part of that particular venture. Because the moment you are getting entering into the partnership you are also subject to the liability which might arises in course of business after you admitted into that particular partnership.

(Refer Slide Time: 15:13)



Now, let me take you to other issues relating to partnership that is relating to conducting of business of a partnership. And herein as the law goes it says every partner has a right to take part in the conduct of the business. Every partner is bound to attend the business diligently. Any matter arising ordinary course of business should be decided by the majority of the partner. If there is a change in the business then the consent of all the partners are required. And further more he said that every partner has the right to access and inspect the copy of books and account.

Now according to the law and further interpretation the partners are the mutual agent to each other. So, in the ordinary course of business the partners can bind the other partner or partnership if he is acting in bona fide interest of that particular firm. But if he is acting for his own good or making some kind of a secret profit by exploiting the position of the partnership then in that case he need to make it good to the all partners or if the firm is suffering losses then he has to make it good. So, what I am trying to drawing your attention is that, the partners are need to act in good faith you cannot do some kind of a

secret business on the asset of the partnership or based on the common asset of the partnership.

(Refer slide Time: 17:01)



Now, let me come to the next issues relating to the mutual rights and liabilities of the partners. And here in, a partner is not entitled to receive any remuneration for taking part in the business of the firm. That means, if the person is the partner of the firm again he cannot be appointed as employee of the firm. And if he is employee of the firm then he cannot be appointed as a partner or enter in the partnership agreement. So, partners are only entitled to share the profit.

So, if there is any circumstances happen wherein there is a two person who are carrying the business and they are proposing themselves that they are the partner of a particular firm and they have entered into a partnership deed and later on people realize or the court realize that one of them was drawing the salary from this particular business, then in that particular circumstances this particular organization cannot be called as a partnership even though you have entered drafted a partnership deed or entered into a partnership agreement and you have gone and registered the particular agreement which I was talking with you little before.

Partners are entitled to share equally in the profit earned and shall contribute equally to the losses sustained by the firm. Now, as I have told you little before that partners are jointly and severally liable, so in the course of the business if the firm incur any debt

then in that circumstances the creditor can choose any of the partner to realize the debt. It is not necessary that he has to receive all the partners or he has to show firm along with all the partners, but he can choose any of them. Now if it has been enforcing against one of the partner then in that case the other partner whatever the loss he has sustained because of that particular litigation other partner need to indemnify him. So, the process is first it will be paid from the partnership property and if it is not sufficient then in that case the other partner has to pay from their own property or from their own assets to the person to the to the partner who has paid the money to the creditor.

Now, here before I go further let me draw your attention that in case of the partnership it is a joint property. So, everybody has the right over that particular common property. And as the law says that any particular partner cannot ask for a division of the partner at any point of time, people can serve the notice for dividing the partnership property and then in that case there might be the dissolution of the firm. But otherwise, the property which is belongs to the partnership it has a joint ownership of all the partners who are the partner at that particular point of time in that particular partnership firm. Because as I told you that in a life of a partnership at will there might be different number of partner or different partner coming in and going out. So, that is the reason I said whoever the partner at that particular point of time in that partnership.

Now even the partner can decided to share the profit equally. But there is a possibility that you can redesign these particular two provisions that sharing of the profit as well as sharing of the liability, because if you read this particular section it says that is subjected to partnership agreement. In the partnership agreement there might be a partner who might not bring any capital and also decide that to take a more shares in that particular partnership profit, like we were discussing these business models in the context of the technology.

So, may be one of the partner who is joining this particular firm with another partners bring the technology which form core business of the partnership and that gentleman might demand a more profit which is coming out of the venture, because he says the technology which I am giving is my own innovation I got the patent on that particular technology and that particular technology the product which is coming out of the technology is a marketable product or there is a high demand of that particular product

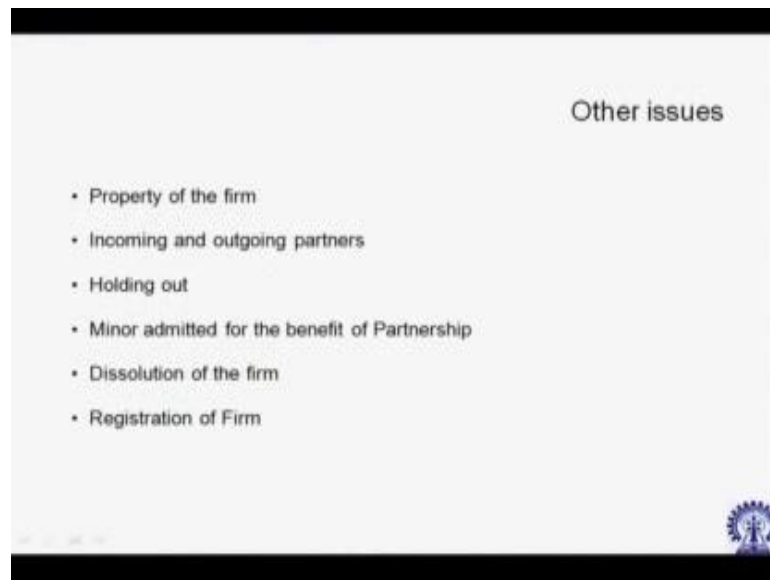
itself. So, in that circumstances the person who is the partner, the person who is bringing the technology in the firm he might ask for a larger share.

Similarly, there can be a further designing of sharing the losses. The losses that the liability of a partner to the outside world is joint and severe, so there you cannot do the any designing but you can have a provision wherein you might say that even though the partners are equally liable to pay this particular debt they can further indemnify themselves against each other, if that kind of a provision has been made within the partnership agreement itself.

Partner is entitled to the interest on the capital subscribed by him such interest shall be payable out of the profit. That means, if the partners is bringing other capital apart from that whatever he has agreed to contribute under the partnership deed or partnership agreement he is supposed to receive the interest for that, and that particular interest should be paid from the profit of the partnership firm. Many of the time you will find the partners bring the capital in the form of a debt to the particular firm or they might even bring the capital and make an equity investment. So, whatever way they bring that particular fund in that particular company in that particular form they are supposed to get the interest out of that particular thing.

Now again the partners are indemnified for any losses caused to it by his willful neglect and the conduct of the business of that particular firm. So, if there is a willful neglect or whatever the duty and skill and care which a partners is needs to demonstrate in ordinary circumstances failed to do that he will be liable to make good to that particular losses which is the firm suffers during the ordinary course of business. Let me give you example, you are the partners who has been designated that you are going to pay all the regulatory taxes or all the taxes, and you have you have not taken care of this particular thing and because of that you have to pay lot of extra money for this. In that circumstances that person will be liable because he has not taken due care for paying the taxes in due time.

(Refer Slide Time: 25:40)



Now, there is another issue which you need to take care or need to know relating to the partnership it is related to the property of the firm. As I have told property of the firm is a joint property for all the partners and the partners cannot divide that particular property at their own ways during the subsistence of that particular firm itself. So, everybody has a common right over that particular property. The second thing is, incoming and outgoing partner. I have touched upon this particular point few minutes before that you can admit a new partner for the interest of your business and there might be some partner who might go out of this particular venture or they might retire from that particular venture. So, in that circumstances if it is incoming partner he is going to get all the benefit which as the partner of the partnership enjoys at the same time his liability in the partnership business will start from the day he is joining.

Now let me draw your attention in this particular point of time that whenever you are admitting a new partner you might need to admit the new partner or there might be a provision that the new partner might bring a premium or give the premium for getting the partnership in a particular partnership firm and he also need to bring a new kind of business to that particular firm. Now whatever this particular scenario is if the partner is given a premium for admission and then you find that particular partner is dissolved within a very short period of time then in that case the premium which he has paid to the partnership need to be pay back to the newly admitted partner.

Similarly, if the partner is going out then whatever the interest he has or rights and liabilities he has you need to satisfy that. That means, his stake in that partnership firm and in addition to his stake if he has got certain right relating to the technology or innovations or improvement which you have made or maybe some kind of patent you have got on a particular technology because of further development of that particular product then in that case you need to pay that particular interest or that particular price for that particular right to the outgoing partner.

Now there is another concept which is pretty common in case of the partnership and we are going to discuss this particular concept is common in both partnerships in general and limited liability partnership is known as holding out. Holding out means where the person given the impression that he is a partner of a particular firm and based on his impression the creditors have extended the credit to that particular firm, he cannot later on wash out his hand by saying that I do not have any relation with that particular partnership. He has to you know take the liability or responsibility to make it good to this particular firm itself whatever the liability is incurred from the creditors.

Now, there is another interesting thing is in case of the partnership is the minor can be admitted for the benefit of the partnership. But please remember until minor became a major, that means attained the age of 18 years he will not have any liability of the partnership, but he can get the benefit of the partnership itself.

And then you know there is a procedure which has been prescribed relating to the dissolution of the firm. Now, when you are talking about the dissolution of the firm we basically indicate the equitable distribution of partnership property after satisfying the debt of the business. So, whatever the creditors is going to get from the particular partnership firm you need to pay to the creditor all whatever the due is and then after that you need to equitably distribute.

Now when I am talking about the equitably distribute it means whatever the share you have by bringing the capital in that particular firm or whatever the agreement you have entered upon or with that whatever the interest which you have accumulated over the years during this particular business of the partnership everything you need to account for during the dissolution of the firm. So, there is a common concept which you will find quite common is known as the valuation of the firm and there is a process which has

been developed or market standard which has been developed relating to how to value this particular firm or valuation can be done in case of the firm itself.

Now the last one which I will like to draw your attention and which I have started with is now known as a registration of the firm. Now it is not necessary that the firm need to be registered, but if you are not registered then you will suffer from some of the disabilities like, if somebody want to sue a particular firm in that case it is a difficulty, at the same time if you wanted to sue somebody for nonpayment of the credit which you have lend to them then it is also difficulty.

It is always advisable that you register the firm, the moment you register the firm you are you getting some kind of a legal status even though it is not incorporation, but some kind of a legal recognition of existence of partnership as a business organization or business firm. So, I will advise to you that you go and register this particular firm, because registration of the firm is not very costly at the same time it is not very tedious, but registration of the firm is required if you are interested to get the credit from some of the bank under MSME scheme or if you wanted to get some kind of a finance as a startup then in that circumstances it is advisable that you should go and register your firm.

(Refer Slide Time: 32:55)



Now, the last one which I would want to draw your attention relating to the partnership deed, because as I told you that partnership is governed by the partnership agreement and commonly we call that partnership agreement when it is written form or reduced in

writing called as a partnership deed. Now in the partnership deed in addition to whatever I have discussed until now you should have some more point inserted. But please do remember whatever the point you are inserting in the partnership deed it might be the governing document to you, but there should not be any provision which will subordinate the provision of the legislation.

So, in a partnership deed you can have a provision relating to the definitions you can define some of the activities in that particular partnership deed. Then you can have some kind of general provision relating to what is the relationship between this particular partnership, what circumstances and what situation what are the right and liabilities partners can mutually enjoy against each other. In addition to whatever the statutory rights and duties has been prescribed.

You might further talk about the contribution of the ownership and I have said that in addition whatever the provision has been prescribed in the Partnership Act you can have a additional provision or additional benchmark relating to this particular relation. You can talk about the management right, that means that will have managerial power or all the partner will have a managerial power or there should be some procedure relating to the decision making or one of the partner among yourselves should have a power of the management and who can be designated as management managing partner. There can be some partner who might not be interested to take part in day to day activity of the partnership that is generally known as a sleeping partner.

So, whatever the way you wanted to carry forward the business in the partnership you can define the role of each and everybody's role of that particular partner. Let me tell you in some of the professional firm when it is big then in that case these roles are become very important. Like you might find that sometimes a partnership is used for a startup or maybe for providing some kind of a service and they might have different divisions. So, like there might be marketing division, there might be a production division, there might be a technology acquisition division, there might be innovation division in that case if there is a number of partners might be assigned with the each division.

So, you need to understand and distribute this particular management right amongst yourselves so which can help you reduce the conflict and at the same time you can also

decide that in which stages and how many people can take a decision on what matter. Like as statute provide that if it is ordinary course of business then it is a matter of the majority. Now you can further define this particular majority and you can also say that in which circumstances the majority decision is required and which circumstances you can authorize the managing partner to take the decision on behalf of all other partner. And you can also say is that what is the meaning of the change in the business. And wherein law says that you need to have all the partner consent, so you can decide or and define all this particular thing in detail.

Then you can have a provision relating to the admission or retirement of the partner and you can detail out that what are the rights one can get at the time of retirement, what are the procedures, what are the notice requirement, to whom he has to serve the notice, do he has required to put the notice in the public domain or there is particular procedure to in addition to whatever the procedure has been prescribed under the act if you wanted to prescribe you can put in the deed itself.

At the same time you can talk about how a new partner can be admitted, like I have mentioned about the admission of the partner with the premium. You can also mention that how the premium can be calculated when the partner will be admitted in the firm itself. So, all this detail thing you can work out then there can be other interest which I have said that if you are a technology firm and your business is evolved around the technology and if you have made an improvement on the technology which has been you know licensed to your firm or which has been assimilate with the firm as a part of the joint venture then in that circumstances also you need to understand that how you are going to reward your partners because of that particular technology.

It might be relating to the different permits and you have got those particular permits because of the influence of some of your partners. If he wanted to go out now from the firm then you have to re award those particular partners. So, when I am talking of the other interests you can list it out what are the other interests for the purpose of the firm for your firm itself, and accordingly you can reward the person when he is leaving the firm or you can also charge the premium when somebody is entering in a firm.

And at the same time you can also talk about the dissolution procedure. How you can dissolve your firm, what is the procedure you should follow and what are the mechanism

which you want in addition to whatever has been prescribed under the act itself. You can talk about the procedure, you can talk about appointment of the liquidator, you can even suggest that your firm you want to wind up under the Companies Act as a unincorporated organization and that is that is possible.

So, if your firm is big complex and it has a complex ownership structure then in that case you might choose Companies Act also for winding of your firm itself.

Thank you.