

# Partnership Law

## AAT Level II BLA - Business Law

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# Partnership Law

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## Partnership Law



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## Applicable law



### English law

- England Partnership Act of 1890
- Sri Lankan Partnership Ordinance No 21 of 1866
- Prevention of frauds Ordinance No 07 of 1840
- Business Names Act no 06 of 1918
- Company Act No 07 of 2007
- Inland Revenue Act
- No. 24 of 2017 and sine provisions of Civil Procedure Code

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## Definition of Partnerships

### Section 01 of the Partnership Act no 1890

A partnership is, the relation, which subsists between persons carrying on a business in common view of profit.



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## Main elements of Partnerships

1. Existence of a business

2. The business must be carried on by persons in common

3. Profit motive

4. Agreement between parties

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## Main elements of a partnership

### 1. Existence of a business

#### **Section 45 of the Partnership Ordinance of 1840**

A partnership can be formed for every trade, occupation or profession.

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## Main elements of a partnership

- The ordinance has not restricted partnerships to engage in any commercial activity



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## Main elements of a partnership

- According to the financial market regulations, a banking business, insurance business or a financial institution cannot be operated as a partnership.
- A business should have a continuous existence

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- Ex:

An agreement between two people to buy and repair a motor cycle with the intention of resale of the same to divide the profit out of it would amount to a partnership business



Is this a partnership?



NO

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## Main elements of a partnership

- A Partnership does not mean joint ownership of a property.

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## Main elements of a partnership

### 2. Association of two or more persons and carrying on of business

- Minimum: **Two**
- Maximum: not restricted under the Partnership Ordinance, restricted to **twenty** Partners under section 519 of the Companies Act No 07 of 2007.(this rule does not apply for a partnership formed for the purpose of carrying on practices as attorneys - at -law and chartered accountants.)

## Main elements of a partnership

### 3. Profit motive

- The intention should be profit.
- Differ from clubs and associations



## Main elements of a partnership

### **4. Contract for Partnership**

- Partners should have a common agreement to do their business together and to share profits and losses among them.

## Main elements of a partnership

Person is not considered as a Partner of a Partnership based on the mere fact that or she receives a part of profits earned.

Ex:

- A creditor receiving a share of profit made by the partnership for the loan he granted to the partnership does not consider as a partner.
- A subagent or an employee who is engaged in some business, getting an amount of partnership profit will not make that person a partner.
- Successors of s death partners will not automatically become partnership by mere fact of giving them a part of profit.
- A person getting an amount of profit for his good name, which was sold to the Partnership will not become a partner.



## Registration of Partnerships

Requirements of a written agreement

Name of the partnership

## Registration of Partnerships

Partnership agreement can be formed by,

- Writing
- Verbally
- Impliedly

## Section 18 of the prevention of Frauds Ordinance No 07 of 1840

- If the initial capital of the Partnership **exceeds thousand rupees** such partnership agreement should be in writing and signed by the partners.

### Pate v Pate

Dias v Perera

Samuel Gnanam and Others v Ismail  
Lebbe

The term “initial capital” does not include any capital invested after commencement of the partnership

- **Sivakumaran v Rajasekaram**

- In this case, there was no written agreement for the Partnership; a number of documents were shown to prove that the business was carried on as a Partnership.
- But the privy council (court) held that these documents are insufficient to full fill the requirements under section 18 of the Prevention of Frauds Ordinance. In present, since initial capital of thousand rupees in anyway not sufficient to start a Partnership, all the Partnerships should fulfill the legal requirement of having a written Partnership agreement.

## **Names of partnerships**

- The Business Name Ordinance No. 06 of 1918, which was amended by the Act No 07 of 1987.



## Names of partnerships

- **Section 02**

If the name of the business does not contain the true full names of the partners, such names will have to be registered within 14 days of commencement of business.

## Names of partnerships

- A Partnership name, not having full names of partners should be registered by Provincial Business Names Registrar.
- Necessary information from Divisional Secretariats in the relevant Province

## Names of partnerships

### **Section 8 of the Business Names Act**

The name of a partnership must not contain words such as “president”, “presidential”, “national”, “state”, “Sri Lanka”, “Corporation”, “Society”, “Municipal”, “incorporate”, “company” or likely words.

## Names of partnerships

- Partnership cannot appear before the law under the name of partnership, but partners should appear under their individual personal names.

## Rights and Duties of Partners

### With partners

- Section 24 of Partnership Ordinance
- Disclose of information
- Earning secret profits
- Engage in competing business

### With third parties

- Agency relationship
- Delictual liability
- Criminal liability
- Liability for debts

## Rights and Duties of Partners

### • Partnership Ordinance of 1890

A partner is

- firstly liable to other partners in the partnership
- secondly, he is liable to the partnership
- finally he is liable to the third parties

## Rights and obligations of a partner with partnership and other partners

- 19 to 31 in the Ordinance
- Generally decided by the partnership agreement
- If there is no agreement - **section 24 of the Partnership Ordinance.**

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## Legal Provisions of section 24 of Partnership Ordinance

- All the partners are entitled to share equally in the capital and profits of the business
- contribute equally towards the losses which a partnership sustains
- The partnership must indemnify every partner in respect of payments made and personal liability incurred by him.
- When a partner is lending money for the Partnership he or she is entitled to interest at rate of five percent per annum from the date of the payment.

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## Legal Provisions of section 24 of Partnership Ordinance

- A Partner is not entitled before ascertainment of profits, to interest on the capital subscribed by him.
- Every partner may take part in management of the partnership business
- No partner shall be entitled to remuneration for acting in the Partnership business.
- No person may be introduced as a partner without the consent of all existing partners.

## Legal Provisions of section 24 of Partnership Ordinance

- Any difference arising as to ordinary matters connected with the partnership business may be decided by a **majority of the partners**
- Change made in nature of the partnership business should be made with the consent of **all existing partners**.
- The partnership books are to be kept at the place of business of the partnership.



- **Byrne v Reid (1902) 2 CH 735**

- In this case, as per the partnership agreement, B and R had agreed to join B's son to the partnership once he reaches the age of 21 years. When his son was 21 years, B's proposal to join him as a partner was refused by R. The court decided that since R has consented to join him in the partnership agreement, R is not in a position to reject the proposal.

## **Section 26 of the Partnership Ordinance**

- All partners must agree to expel a partner



## Section 28 of the Partnership Ordinance

- Every partner should submit true accounts and full information regarding his dealings to other partners.



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- **Transparency**



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- **Bently v Craven (1853) 18 Beav 75**

- In this case, a partner (Craven) was assigned to buy goods on behalf of the partnership, He bought a bulk of sugar for a much-discounted price for his personal usage but without disclosing of any such information, he provided sold sugar to the partnership for the market price. The court decided that he has earned a personal profit out of this transaction and further he has not disclosed sufficient information relating to this transaction to other partners. Therefore, the partnership was entitles to recover the profits from him.

## **Section 29 of the partnership Ordinance**

- Every partner must disclose full information with regard to all benefits derived by him for all transactions concerning the partnership or from any use by him of the partnership property, name or business connection

- **Pathirana vs Pathirana (1967)**

- In this case, Pathirana (P1) and Pathirana (P2) are two partners of motor vehicles supplying company. P2 made a notice of 3 months to dissolve the partnership. During that period P2 has conducted some meeting to make contracts between some other parties for his individual benefit without the knowledge of P1. After the dissolution of the Partnership, P2 started another similar organization and continued the business.
- The court decided that agency relationship is an asset of the partnership and P2 has earned profits by using that asset. Therefore, P2 should pay over to the firm (P1) all profits made by him in that business.

## **Section 30 of the Partnership Ordinance**

- There is a duty of every partner not to compete with the partnership by carrying on a business of the same nature as and competing with that of the firm without the consent of other partners. If he does so, he must account for any profits made by him in that business to the partnership.

- Section 160 of the intellectual property Act also provides protection against unfair competition

- Pillan Bros v Pilan Bros
- In this case, there was a partnership between three brothers, one acquired a rival business of a similar nature.
- The court held that the profit of the rival business should be shared between the other two partners.

## Right and duties of partners in partnerships when dealing with third parties.

- Section 5 to 19 of the Partnership Ordinance



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- Every partner is an agent of the firm and his other partners within the scope of the partnership (section 05 of the Partnership Ordinance)

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- If one partner entered into a contract with a third party using his or her actual authority or implied authority, other partners also will be bound by the same contract.
- Even if the other partners were not aware or without their consent any contract was made by a one partner in his capacity as a partner of the said partnership, the contract he made with the third party is binding in the entire partnership.

**Any partner will have an implied authority to engage in following acts in a partnership.**

- to sell good of the partnership
- to sell materials of the partnership
- to recover debts of the partnership and issue receipts for them
- to recruit employees for the partnership
- other than above activities, partners may have implied authority to engaged in following activities as well.
- provide negotiable instruments in the business name and acceptance and issuance of such.
- To take loans for the instruments in the business name and acceptance and issuance of such.
- To appoint Attorney at Law to take care of business loans.

• **Mercantile Credit co. Ltd v Garrod [1962]**

- Mr. Garrod and Mr Parkin formed a partnership to engage in the business of repairing of motor vehicles. Parkin without consent of the Garrod, sold a vehicle to the plaintiff, which was kept in their business premises for repair. The plaintiff paid \$ 700 to Parkin. Plaintiff who had not been informed that the partnership agreement excluded from its scope the buying and selling of cars, bought this car believing that he was dealing with a partner. The plaintiff claimed his \$700 from the partnership. The court held that the sale of the car was an act in keeping with the usual business of the firm, and under a provision equivalent to section 8 of the Partnership Act, the firm was bound by the act of Parkin, notwithstanding the exclusive of the buying and selling of cars form the partnership agreement. Garrod was liable for the account claimed.

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• **Samuel Gnanam and others v Ismil Lebbe**

- In this case, four partners who operated a partnership entered into a contract with a company for distributions of goods and the contract was signed by only few partners. The partnership filed an action against the company for breach of contract and company argues that partnership is cannot maintain the action, as all partners have not signed the contract. However, the court decided that other partners have the right to file an action to recover debts even for a contract made by any partner with a third party.
- Another important element of agency relationship between partners is that such relationship occurs only in the case of ordinary course of business. Other partners will not be liable for contract made by a partner for a course other than ordinary business course of the partnership.

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- **Golberg v Jenkins (1889) VLR 36**

- In this case, a partner obtained a loan for partnership under 60% interest rate. However, court decided that when market interest rates are at lower level like 10% decision to take a loan for a rate of 60% is not ordinary. Therefore, other partners are not liable for that debt only the partner who took the loan is personally liable.

## **Tort / Delictual Liability**

- Civil wrong
- If an action of a person by reasons of negligence or recklessness caused a detriment to another person a delictual action can be filled against such action



## Section 10 of the Partnership Ordinance

- When a tort is committed during the ordinary course of the partnership business, the partners are jointly liable to the person who has suffered the loss.

### Humlyn v Huston & Co (1903) 1 KB 81

- In this case, partners A and B had a partnership business. A tried to obtain information of a rival business by bribing a clerk of that business. The rival business filed an action against the partnership to obtain damages for actions of A. The court held that since the tort happened with the approval of B, Partners were held liable to pay the damages to the rival business.

### **Blyth V Fladge (1991) 1 CH 337**

- In this case, the court held that legal firm (partnership) is liable for the negligent act of the unqualified lawyer of the partnership

## **Criminal Liability of Partnerships**

- In case of any crime committed by a partner unless other partners have joined in conspiracy, acted in similar intention and aid and abetted the crime, other partners will not have any criminal liability.



## Liability of Partners regarding external debts

### Section 9 of the Partnership Ordinance

Every partner in a partnership is liable jointly with other partners and severally for all debts and obligations of the partnership incurred while he is a partner. This liability extends up to personal assets/property of the partners.

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### Liability of Partners regarding external debts

Liability of a new partner regarding previous debts of the partnership

Will not have any liability regarding previous debts of the partnership

Liability regarding debts of a partner who is leaving the partnership.

- YES- by a mutual contract made by other partners, retiring partner can be excluded from the liability of debts after retirement.
- YES- for debts incurred in partnership after him leaving the partnership
- YES- estoppels relationships regarding loans even after the retirement

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## Partnership by estoppel

- A person who by conduct or words represents, or allows him/herself to be represented, as a partner in a firm is liable for the credit or loans obtained by firm on the basis of such representation.
- Partners of the said partnership and that person shall personally be liable for every action of that person

### • **Tower Cabinet Co ltd V Ingram (1940) 2 KB 397**

- In this case, A and B had a partnership and it was later dissolved. But they failed to inform third parties about the dissolution. However, after the dissolution, A used the letter head of the partnership to order some goods from a third party. Later, when A failed to pay for that third party, they filed an action against B to recover the money under notion of partnership by estoppels.
- The court held that third party was not aware that B was a partner even before the dissolution of the partnership. Therefore, it was concluded that no partnership has been created by estoppel.

## Liability of partners regarding tax payments.

### Section 53 of the Inland Revenue Act No 24 of 2017 (IR Act)

- Partnerships shall not be liable to pay income tax.
- Partnerships are liable to pay withholding tax on share of partnership's income.
- Every partnership should pay income tax at end of each year from the calculated profit or loss of the partnership

- The portion of tax of each partner will be divided between them.
- Such divided tax amounts are considered as tax debited to their personal accounts.

# Dissolution of Partnership

## With a court order

- A partner is found lunatic
- A partner is permanently incapable of performing his part of the partnership contract.
- A partner is guilty of conduct which is prejudicial to partnership contract.
- A partnership breaches the partnership agreement
- A partnership can only be carried on at a loss or the court thinks it is just and equitable to dissolve.

## Without a court order

- If the partnership is fixed period, by the expiration of that period.
- If the partnership was made for a single undertaking, when the undertaking is over.
- If partnership was made for an undefined time by approval of proposal for dissolution of partnership by all other partners for the partnership
- On the death or bankruptcy of any partner
- When a partner sells his shares to any outsider for debts, he owes to the outsider
- When the business of the partnership has become illegal

## • **Carmichael v Evans (1904) 1 ch 486**

- In this case, a partner of the partnership was guilty of offence of travelling in train without a ticket.
- The court decided that the behavior of the partner is harmful for the existence of the partnership, the partnership should be dissolved.

After dissolution the partnership property will be divided in the following order,

- To pay the debts and liabilities of the firm to persons who were not parties.
- To pay each partner, what is due to him for advances to the firm.
- To pay each partner, what is due to him in respect of capital.
- The balance, if any, must be divided among the partners in proportion in which profits are divisible.

Q&A



## JULY 2020

(a) Raja, Nimal and Sumana are partners of Helarasa Partnership, a business of buying spices from small vendors across the country and then packing and selling those spices under the trade mark "Helarasa". They follow the provisions of Partnership Ordinance 1890 to conduct the partnership. Sumana started a similar business with her husband using the contacts from partnership business. However, it was not informed to other partners by Sumana.

You are required to:

Explain whether Sumana has breached her duties as a partner. (06 marks)

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## JULY 2020

(b) While continuing Helarasa Partnership, Nimal bought a bulk of cinnamon and pepper from Piyal a regular supplier, for a sum of Rs.500,000/- on credit and sold them to another third-party buyer for a sum of Rs.600,000/-. Amount received was deposited to his wife's personal account by mistake. Subsequently, bank has recovered two installments of her personal loan from that money and now she does not have that amount in her account. Piyal requested the amount due from Helarasa Partnership and Raja & Sumana denied to pay Piyal. You are required to: Explain whether Piyal has a legal right to recover his money from Helarasa Partnership. (04 marks)

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## **JANUARY 2020**

**Q. Perera and Soysa are in a partnership business of buying and selling stationery items. There is no partnership agreement between them and they follow the Partnership Ordinance 1890 to conduct the partnership business. Soysa has bought some stationary items at a 50% discount on market price. Those items were sold to the partnership at the market price and a profit was earned from that transaction by Soysa.**

**You are required to:**

**Explain whether the partnership is entitled to recover the profit earned by Soysa from the above transaction. (05 marks)**

## **JULY 2019**

**Q.**

**Raja and Kamani started a partnership business to produce baby clothing. They both worked hand in hand to develop their business. However, Kamani found that though Raja has purchased clothing materials at a discounted price from a whole seller, he has sold it to the partnership business at the market price. Raja earned a secret profit out of this transaction and he did not share it with Kamani.**

**You are required to:**

**Explain Kamani's legal rights and Raja's duties in this regard. (05 marks)**

