

Dissolution of Partnership on Adjudication of a Partner as an Insolvent in India and Garner v Murray Case Judgment

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ABSTRACT

On adjudication of a partner as an insolvent in India, provision of Section 34 of Indian Partnership Act, 1932 is applicable for safeguarding the interest between insolvent partner and firm. Judgment in case of Garner v Murray held at England in 1905, which was based upon Section 44 of United Kingdom Partnership Act, 1890. In India, provision of Section 48 of Indian Partnership Act, 1932 are applicable on dissolution of firm on adjudication of a partner as an insolvent. Provision of section 44 of United Kingdom Partnership Act, 1890 and Section 48 of Indian Partnership Act, 1932 are similar or the mirror image of each other. Therefore, on adjudication of partner as an insolvent, if firm is dissolved and partnership deed is silent to the contrary then, it is safe to apply the judgment in Garner v Murray case in India until Indian court rules against it.

Keywords: Garner v. Murray Rules, Partnership, Insolvency

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INTRODUCTION

As per section 42 (d) of the Indian Partnership Act, 1932, partnership firm will be dissolved on the happening of adjudication of a partner as an insolvent (MCA, Indian Partnership Act, 1932). Dissolution of partnership firm is the process by which the existence of a partnership firm comes to end. On dissolution of partnership firm all assets will be sold and thereafter all liabilities will be settled as per the provision given in the section 48 of Indian Partnership Act, 1932. Generally, a solvent partner who; (a) unable to pay debts as they fall due in the usual course of business (b) having liabilities in excess of a reasonable market value of assets.

There is difference between dissolution of partnership and dissolution of firm. If a partner in partnership firm adjudicated as an insolvent then it will be dissolution of partnership. The business of firm continues in it and it does not necessarily mean dissolution of firm. It is voluntary and may not require books of account of business to be closed. But in case of dissolution of firm, the business of firm will discontinue and it also necessarily mean dissolution of partnership. It may be both voluntary and compulsory and it requires to closes books of accounts of business which leads to dissolute of all agreement among partner.

The scope of this paper is to discuss the provision relating to the dissolution of partnership on adjudication of a partner as an insolvent as per the Indian Partnership Act, 1932 and applicability of Garner v Murray Case Judgment in India. The famous Garner v Murray case was heard in the Chancery Division of the English High Court in October and December 1903 and final order of the case was made by Joyce, J on 15 June 1905 (Brooker, 1968). This dispute was first field by partner G. R. Garner on 14th November, 1900 by submitted an affidavit in support of application for appointment of a receiver in Garner v Murray and Wilkins case in the court. The final order of court showed a considerable change in the process of closing books of account and settlement of account of partners in dissolution of firm due to adjudication of a partner as an insolvent. The purpose of this research paper is to examine that at what extent the judgment of Garner v Murray case applicable in India at present time. To serve this purpose research papers relating to the Garner V Murray case, English Partnership Act, 1890 along with Indian Partnership Act, 1932 were examined and final conclusion is drawn that Garner v Murray case

judgment are applicable in India in the absence of any clause of partnership deed to the contrary and it would be safe to follow it till an Indian court rules against it.

REVIEW OF LITERATURE

Various books on financial accounting in Australia, England and in India refer the case of *Garner v Murray*, if partnership deed is silent of any clause to the contrary on dissolution of firm due to the insolvency of partner (Bhupinder, 2016). Houghton (1982) argued that the decision in *Garner v Murray* is regard as the source of law in relation to the dissolution of a partnership where one partner is insolvent. There is evidence of some confusion regarding the treatment of any shortfall in the contributions required from the partners. The conventional treatment of that shortfall described in accounting textbooks appears to be not in accordance with the decision and to be at odds with a clearly stated point of law. However, Ashton (1984) not satisfied with the decision in *Garner v Murray* case and he argued that judgment in *Garner V Murray* case was a departure from what had been accepted in partnership practice. In the elementary accounting, the decision of this case is widely quoted although. Surprisingly, the legal merits of the case have not been examined so far in the literature. The analysis showed that the main points in the case were incorrectly decided and would have provided grounds for an appeal. He further argued that the decision in *Garner v Murray* was wrong but the intent of the relevant provision of the English Partnership Act, 1890 is 'clear'. This comment suggests that the intent is far from clear and that are reasons for agreeing with one critical aspect of the 'Rule in *Garner v Murray* (Houghton, 1986). Due to insolvency of partner Wilkins, the partnership between M/s *Garner, Murray and Wilkins* was dissolved.

In India, Section 34 of Indian Partnership Act, 1932 deals with the insolvency of partner in a partnership firm which is explained-

1. A partner in a firm is declared insolvent on the date on which he adjudicated an insolvent and his association as partner in firm will cease from the date on which he adjudicated as an insolvent. On such event, it will be voluntary on the remaining solvent partner to continue the business after adjudication of a partner as an insolvent firm. There is a difference between dissolution of partnership and dissolution of

firm. Firm's business can't be continued after dissolution of firm but in case of dissolution of partnership due to one outgoing partner in a firm, remaining partner in firm can continue business of firm with their new partnership among them.

2. Section 34 of Indian Partnership Act, 1932 further explains the provision regarding the safeguard of any act between firm and adjudicated partner as insolvent. If remaining solvent partner continues the partnership business after the adjudication of a partner insolvent, then, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made (MCA, 1932).

Vats (2016) expressed that the judgment in case of *Garner v Murray* held at England in 1905, is applicable in India until an Indian court definitely rules against it. This is because the provision of section 44 of United Kingdom Partnership Act, 1890 for settling the account between the partner after a dissolution of partnership, are similar to the Provision of Section 48 of Indian Partnership Act, 1932. A detail explanation of these two sections is given below.

<p>Provision of Section 44 of the Partnership Act, 1890 for settling accounts between the partners after a dissolution of partnership, the following rules shall subject to any agreement are observed:</p> <ol style="list-style-type: none"> (a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits: (b) The assets of the firm including the sums, if any, contributed by the partners to make up losses or deficiencies of capital shall be applied in the following manner and order: <ol style="list-style-type: none"> (i) In paying the debts and liabilities of the firm to persons who are not partners therein (ii) In paying to each partner rate what is due from the firm to him for advances as distinguished from capital 	<p>Provision of Section 48 of The Indian Partnership Act, 1932 for settling the accounts of a firm after dissolution, the following rules shall subject to agreement by the partners are observed:</p> <ol style="list-style-type: none"> (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 were 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: <ol style="list-style-type: none"> (i) In paying the debts of the firm to third parties (ii) In paying to each partner rate what is due to him from the firm for advances as distinguished from capital
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<p>(iii) In paying to each partner rate what is due from the firm to him in respect of capital</p> <p>(iv) The ultimate residue, if any, shall be divided among the partners in the proportions in which profits are divisible (Govt, 1890).</p>	<p>(iii) In paying to each partner rate what is due to him on account of capital</p> <p>(iv) The residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits (MCA, Indian Partnership Act, 1932).</p>
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After analysis the above two Acts, it is found that the decision in *Garner v Murray* will also apply in India on the following two grounds:

- a) The section 44 of United Kingdom Partnership Act, 1890 is the mirror image of section 48 of Indian Partnership Act 1932. Moreover, the decision in *Garner v Murray* based on the section 44 of United Kingdom Partnership Act, 1932.
- b) There has been no case in law in India, which has examined this issue in India until now (Tulsian & Tulsian, 2014).

Therefore, the objective of the present paper is to examine the review of literature in the *Garner v Murray* case and seek the applicability of this rule on adjudication of a partner as insolvent in India while finalizing settlement of accounts on dissolution of firm.

History of Partnership between Garner, Murray and Wilkins and its Dispute

From March, 1899 three partner viz., Murray, Wilkins and H.A. Curtis were entered into a partnership business as woolen cloth merchants under the style of Curtis, Murray & Co at Heytesbury, Wiltshire, England (Brooker, 1968). £2500 loan provided to this firm by H.A. Curti's father, Murray contributed £ 200, and Wilkins had not provided any capital. Murray and Wilkins were not happy to do business with H.A. Curtis. Therefore, they gave offer to him to buy his share in business for £150. To give compensation to H.A. Curtis for surrendering his share in Curtis, Murray & Co, Murray and Wilkins borrow £150 from Garner for that purpose. On the same time, Murray and Wilkins requested to Garner to enter into new partnership business with them as cloth merchant. Capital to be contributed in new firm was planned in proposal as £2500 will be contributed by Garner, £1000 by Murray, and £500 by Wilkins. On 1st March, 1900 a new

partnership was formed under the name M/s Garner, Murray & Wilkins between Garner, Murray and Wilkins to run cloth merchant business and actual capital contributed by them as £2500 by Garner, £200 by Murray and £250 by Wilkins. Contribution made by Garner of £2500 was used to pay the claims of H.A. Curti's father in Curtis, Murray & Co. In addition to contribution of Garner a share in capital in new firm, he also gave advance £300 to new firm, which was used by new firm to discharge its liabilities. New partnership deed between Garner, Murray and Wilkins was signed with equal share of each partner in profit or loss of firm. This partnership deed was short lived and unsatisfactory venture, which can be seen from the court order dated 14 May, 1901 in which court mentioned that there was a partnership between Garner, Murray and Wilkins and the partnership was dissolved with effect from 30 June, 1900 (Brooker, 1968). At the time of dissolution, Wilkins was indebted to the firm and Garner and Murray seem to have accepted that firm will not be able to recover any money from him. When dissolution process was started, it was found that the property of the firm was sufficient to pay the claims of the creditors and advances made by partners apart from their capital contribution into the firm, but insufficient to pay the whole of their claims for capital contributed. When the process of settlement of capital account of partners on dissolution of firm was initiated, dispute emerged between Garner and Murray and consequent of this, Garner filed a case in the court for recovery of his share from the firm on dissolution of firm.

Monetary Calculations in the Garner v Murray Case

Actual capital contributed at the time of formation of firm was as £2,500 by Garner, £200 by Murray and £250 by Wilkins. When case started in court the sum held at the time of hearing in court was £4794.9s.4d, which including £147.9s.8d, the balance due to Murray in respect of advances. All creditor's claims had been paid off together with Garner's advance. On the same time £616.19s.8d, was the profit on realization of assets the partnership. In addition, £1,300 had been paid to Garner in respect of his capital contribution. It was mutually accepted between Garner and Murray that calculation of the distribution of the loss accepted that the capital contributed of Garner and Murray were £2,500 and £314.3s.4d respectively, which further for convenience of calculation were considered to be in the proportion of 8:1 between them. The deficiency of assets on the time of dissolution was £897.3s.8d. As the partners share equally profit or

loss in the firm, therefore, the three partners contributions towards that deficiency was £299.1s.3d each. It founded that due to insolvency of Wilkins, his share of loss was irrecoverable. Thus, the other two solvent partners were considered to have contributed their equal contributions, and £598.2s.6d was added to the assets available for the repayment of capital contributions. Thereafter, sum available for repayment of capital contributions become £2,515.2s.2d, which was £1,300 (as Capital paid to Garner) + £616.19s.8d (as profit on realization of assets) + £598.2s.6d (as contribution of insolvency loss by solvent partner) and ratio of sharing loss was revised as eight ninth-parts to Garner, and one ninth-part to Murray. Due to this, Garner became entitled to £2,235.13s.2d to be satisfied by £1,300 already withdrawn, £299.1s.3d (his contribution to the losses of the partnership), and £636.11s.11d from the amount held in Court. Murray was entitled to £279.9s.6d, which was less than the amount of his contribution towards the losses of the partnership (£299.1s.3d). The balance of the sum required from Murray was set off against the amount due to him for advances, £147.9s.8d money was still held by the court and finally net sum £794.9s.4d were paid to Garner.

The Final Order of Court in Garner v Murray Case

On 26th April, 1905 the final order in the case of Garner v Murray case was given by Joyce, J. (Brooker, 1968) and it provides that

- 1) The receiver be discharged and the bond of his surety vacated
- 2) The master's certificate as to the sum due to Murray in respect of capital be varied from £199.0s.2d to £314.3s.4d
- 3) The sum of £263.3s.1d due from Wilkins is to be treated as irrecoverable
- 4) The deficiency to repay the capital of Garner £2,500 and Murray £314.3s.4d will be £866.6s.0d after payment to Murray of £147.9s.8d liabilities incurred for the firm
- 5) Garner and Murray are each liable to contribute £288.15s.4d as one-third part each of the deficiency of capital
- 6) The remaining assets including contributions are to be distributed ratably
- 7) The capital is agreed to be in the proportions eight-ninths to one-ninth.

- 8) The rate of proportion due to Murray is £139.6s.4d
- 9) The taxed costs due to Murray are £45.15s.3d
- 10) Wilkins to pay £263.3s.1d
- 11) If Wilkins pays £263.3s.1d then the deficiency will be £603.2s.11d
- 12) If Wilkins pays the sum, net of costs up to £175.8s.0d is to be shared equally by Garner and Murray and any sum in excess of £175.8s.0d in the proportions eight-ninths to one-ninth.

The Garner v Murray Case and Adjudication of Partner as Insolvent in India

The applicability of Garner v Murray case in India can be observed in most of leading books on financial accounting. Practical guidelines in case of insolvency of a partner according to the decision in Garner vs Murray are explained in Tulsian's Financial Accounting Book (Tulsian & Tulsian, 2014). When a partner is unable to pay his debt due to the firm, he is said to be insolvent and share of loss is to be borne by other solvent partner in accordance with the decision in the English case of Garner vs. Murray (Gupta & Gupta, 2014). The ultimate result is that deficiency of assets due to insolvency of Wilkins is share by Garner and Murray in their capital ratio (Sehgal, 2014). There was a dispute between the solvent partners regarding the ratio of sharing of loss due to insolvency of Wilkins (Goyal & Tiwari, 2016). Although their capitals were unequal, they shared profits and losses in equal proportions (Goal & Goel, 2015). The judge, Mr. Joyace J., held that loss arising through the default of one of the partners must be distinguished from an ordinary trading loss or loss on realization. Loss due to insolvency of a partner is not a trading loss but a capital loss. Loss on realization is a trading loss and should be divided amongst the partner in profit sharing ratio. On the other hand, loss due to insolvency is a capital loss and should not be share in profit sharing ratio (Gupta N. , 2012). In India, when one of the partners become insolvent and other partner are remain solvent then the problem of bearing the loss of insolvent partner by the remaining solvent partner will be tackled as per the partnership deed. But if partnership deed is silent on the above said problem, then rules of Garner v Murray case will be applied to solve this problem (Bhupinder, 2016). It mean that, in the absence of any agreement to the contrary, the deficiency on the insolvent partner's capital account must be borne by the

other solvent partner in proportion to their capitals, after each solvent partner has brought in cash equal to his own share of loss on realization (Monga & Aggarwal, 2016).

Non-Applicability of Garner V. Murray Case Judgment on Adjudication of Partner as Insolvent in India

In India, the rule of Garner V. Murray will not be applicable to individual partner or to the firm.

- 1) Non-Applicability of Garner V. Murray Rule to Individual Partner** - When the solvent partner has a debit balance in the capital account. Only solvent partner will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.
- 2) Non-Applicability of Garner V. Murray Rule to firm** - In following situation the rules of Garner V. Murray case will not be applicable to a partnership firm in India.
 - (1) When the firm has only two partners
 - (2) When there is an agreement between the partners to share the deficiency in capital account of insolvent partners.
 - (3) When all the partners of the firm are insolvent

CONCLUSION

On adjudication of partner as insolvent in a firm in India and if partnership deed is silent to the contrary, then judgment in Garner v Murray case rule will be applicable in settlement of account on dissolution of firm in the following order:

- 1) Solvent partners are required to make up their share of the realization loss from their private estate.
- 2) Loss due to insolvency of a partner will be adjusted amongst solvent partners in the ratio of their adjusted capitals just before dissolution.

This is because judgment in case of Garner v Murray held at England in 1905, are applicable in India until an Indian court definitely rules against it. Due to the provision of Section 44 of United Kingdom Partnership Act

1890, for settling the account between the partner after a dissolution of partnership are similar to the Provision of Section 48 of Indian Partnership Act, 1932. Therefore, leading textbooks on financial accounting in India following the judgment of Garner v Murray case for dissolution of partnership on adjudication of partner as insolvent.

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