Dissolution of Partnership Firm

Meaning of Dissolution of Partnership Firm

"Dissolution of Partnership Firm means dissolution of partnership among all the partners in the firm." In such an event, all the assets of the firm are realised, i.e., sold and liabilities are paid. The balance, if any, is paid to the partners in settlement of their accounts. If there is shortfall in meeting outside liabilities, it is met by the partners from their private assets.

Difference between Dissolution of Firm and Dissolution of Partnership

S.No.	Basis	Dissolution of Firm	Dissolution of Partnership
1	Meaning	Closure of the firm and end of business relationship among all the partners.	Change in the business relationship among the partners. The firm continue it's business.
2	Court's Intervention	It can be either voluntarily or compulsorily by order of court.	It is always voluntary.
3	Closure of books of accounts	Books of accounts are closed	No need to close the books of accounts
4	Business Conditions	Business of the firm comes to an end.	Business of the firm continues.
5	Economic Relationship	Economic relationship of partners come to an end.	Economic relationship of the partners changes.
6	Assets and Liabilities	Assets are sold and liabilities are paid.	Assets are revalued and liabilities are reassessed.
7	Effect	Dissolution of firm also means dissolution of partnership.	Dissolution of partnership may or may not involve dissolution of the firm.

Modes of Dissolution of a Firm

The modes by which a firm may be dissolved are:-

1. **By Mutual Agreement**
2. **Compulsory Dissolution**
3. **By Notice**
4. **On Happening of an Event**
5. **Dissolution by Court**

1. By Mutual Agreement (Sec. 40)

A firm may be dissolved when all the partners agree for the dissolution. A partnership firm is set up by an agreement, similarly, it can be dissolved by an agreement.

2. Compulsory Dissolution (Sec. 41)

1. **When all the partners or all the partners except one become insolvent.**
2. **When business of the firm become unlawful.**

3. On Happening of an Event (Sec. 42)

A firm may be dissolved in any of the following events, if partnership deed so provides:-

1. **On expiry of the term for which the firm was constituted.**
2. **On completion of the venture.**
3. **On death of a partner.**
4. **On adjudication of a partner as insolvent.**

4. By Notice

In case partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm (Section-43)

5. Dissolution by Court (Sec. 44)

Court may pass order for the dissolution of the firm when:-

1. A partner becomes a person of unsound mind.
2. A partner becomes permanently incapable of performing his duties as a partner.
3. A partner is found guilty of misconduct, which is likely to adversely affect the business of the firm.
4. Partnership agreement is breached persistently by a partner or partners.
5. Court finds dissolution of the firm justified.
6. When the business of the firm cannot be carried on except at a loss.

Settlement of Accounts (Section 48)

Section 48 of the Indian Partnership Act, 1932 deals with the settlement of accounts when the firm is dissolved. These are as follow:-

1. **Treatment of Losses:-** Loss, including deficiencies of capitals, is paid first out of profit, then out of capital and lastly, if necessary, by the partners individually in the proportion in which they share profits.

2. **Application of Assets:-** Assets of the firm, including amount contributed by the partners to make up deficiencies of capital, are applied in the following orders:-

   (a) for payment of firm's debts to the third parties;

   (b) for payment of partner's loan or advances;

   (c) for payment of partner's capital;

   (d) if profit any, is distributed among the partners in their profit sharing ratio.

Payment of Firm's Debt and Private Debts (Section 49)

Debts which the firm owes to outsiders are known as firm's debts, whereas the debts which a partner owes in his personal capacity are known as private debts.

Following provisions apply in case of firm's debts and partner's private debts:

1. **Firm's property is applied first towards payment of firm's debts then the surplus, if any, is applied towards payment of partner's private debts to the extent the concerned partner is entitled to share in the surplus.**
2. **Private property of each partner is applied first towards the payment of his private debts and surplus, if any, is applied towards payment of firm's debts.**

Accounting Treatment on Dissolution of Firm

Dissolution process starts by opening the following accounts in the firm's books:-

1. **Realisation Account**
2. **Partner's Loan Account**
3. **Partner's Capital Account**
4. **Bank or Cash Account**

Payment of Realisation Expenses

(i) When realization expenses are borne and paid by the firm

Realisation A/c Dr.

To Cash/Bank A/c

(For amount paid for the realization expenses)

(ii) When realization expenses are borne by the firm and paid by any of the partner

Realisation A/c Dr.

To Partner's Capital A/c

(For realization expenses paid by a partner)

Illustration 1

(i) Realisation Expenses amounted to ₹6,000.

(ii) Realisation expenses ₹10,000 paid by a partner Ratan.

(iii) When the firm pays fixed amount of remuneration to a partner for dissolution of the firm and the partner is to bear the dissolution expenses

Realisation A/c Dr.

To Partner's Capital A/c

(For remuneration due to the partner)

(iv) If realization expenses are paid by firm on behalf of the partner

Partner's Capital A/c Dr.

To Cash/Bank A/c

(For realization expenses paid by firm on behalf of a partner)

Illustration 2

(i) **Anil a partner, was allowed a remuneration of ₹10,000 to carry out dissolution of the firm. He was to bear all expenses of realization which amounted to ₹8,000.**

(ii) **Suresh a partner, is allowed a remuneration of ₹15,000 for dissolution work and is to bear all expenses of realization which were ₹20,000.**

Illustration 3

(i) **Realisation expenses amounted to ₹5,000 were paid by the firm on behalf of a partner Gautam.**

(ii) **Realisation expenses amounted to ₹7,000 were paid by the firm. Mr. Batra, a partner has to bear these expenses.**

(iv) When the firm pays remuneration to a partner for dissolution of the firm and the firm is to bear the dissolution expenses

Realisation A/c Dr.

To Partner's Capital A/c

(For remuneration due to the partner)

Realisation A/c Dr.

To Cash/Bank A/c

(For realization expenses paid by firm)

(v) When realization expenses borne by one partner (A) and paid by another partner (B)

A's Capital A/c Dr.

To B's Capital A/c

(For realization expenses borne by A and paid by B)

Illustration 4

(i) Sargam, a partner, was allowed a remuneration of ₹10,000 to carry out dissolution of the firm. She was to bear all expenses of realization which amounted to ₹12,000 were paid by the firm.

(ii) Pratham, a partner, was allowed a remuneration of ₹20,000 to carry out dissolution of the firm. He was to bear all expenses of realization which amounted to ₹15,000 were paid by the firm.

Illustration 5

(i) Anupam, a partner was to bear the realization expenses, which amounted to ₹2,000 were paid by Aradhana, one of another partner.

(ii) Pratham, a partner, was to bear all expenses of realization which amounted to ₹15,000 were paid by the other partner Sarika.

Format of Realisation Account

Particulars	Rs.	Particulars	Rs.
To Land and Building A/c	------	By Provision for D/d	------
To Plant and Machinery A/c	------	By Sundry Creditors	------
To Stock A/c	------	By Bills Payable A/c	------
To Furniture A/c	------	By O/s Expenses A/c	------
To Debtors A/c	------	By Bank Overdraft	-------
To Goodwill A/c	------	By Investment Fluctuation Reserve A/c	-------
To Investment A/c	------	By Cash/Bank A/c (Assets Realised)	------
To Cash/Bank A/c (liability paid)	------	By Partner's Capital A/c (Assets taken)	-------
To Cash/Bank A/c (Expenses paid)	------	By Loss transfer to Partner's Capital A/c	-------
To Partner's Cap A/c (Liability taken)	------		
To Partner's Cap A/c (Realisation Exp.)	------		
To Profit transferred to partner's cap. A/c	------		
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