Dissolution of Partnership Firm

Financial accounting

Dr. Rudra Kinker Verma,
Asst professor(Guest Faculty),
Dept of Commerce, BNMV College, Sahugarh, Madhepura (Bihar)o

Dissolution of Partnership Firm

means the firm closes down its operations and comes to an end. On the dissolution of the firm, the assets of the firm are sold and liabilities are paid off. 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. For such settlement Garner Vs. Murray Rule is to be applied.

When a partner is unable to contribute fully or partially the debit balance appearing in his capital account, the portion of the debit balance which he is unable to contribute is known as insolvency loss.

Loss arising on account of insolvency of a partner is not treated as an ordinary business loss to be shared by partners in their profit-sharing ratio.

Section 48 of Indian Partnership Act, 1932 requires that the assets of the firm including any sum contributed by partners to make up deficiency of capital are utilized in first place to settle liabilities and partner loan and the rest of the amount, if any, shall be applied in paying each partner. The amount is payable in the ratio of what due to the partners.

EXAMPLE

Suppose the balance of the firm is as follows:

LIABILITIES	Amount	ASSETS	Amount
Garner's Capital Murray's Capital	600 400	Cash Deficiency of capital (Realisation loss) William's Capital	500 300 200
	1,000		1,000

The deficiency of capital Rs. 300 being realization loss, is divided among partners in their profit sharing ratio. Then each partner contributes to the assets an equal share of the deificiency i.e. Rs. 100 each. After this is done, the assets then available of Rs. 800 (300+500) plus the debit balance of Rs. 200 in the capital account of the William is distributed between Garner and Murray with the result of which each partner will suffer a loss of Rs. 100. In actual practice, the matter is worked out on the basis of the notional cash contribution by Garner and the Murray, so that William pays Rs. 300 and out of the amount of (500+300), Garner takes Rs. 500 and Murray takes Rs. 300.

The difficulty will arise when the deficiency in assets is caused by the inability of the William to contribute Rs. 300 or a part of it. If nothing is recoverable from William, the assets of Rs. 500 are distributed as follows:

Garner and Murray in first place to contribute their share of the deficiency of capital of Rs. 100 each. The cash (500+100+100) then available is distributed between Garner and Murray in the proportion of their contribution to the capital i.e. 3:2. The ultimate result is that the deficiency of assets due to insolvency of William is shared by the Garner and Murray in their capital ratio. This settlement was in accordance with the Garner Vs. Murray Rule.

CASE: GARNER VS. MURRAY RULE

The details of Garner Vs. Murray Rule is as follows:

Garner, Murray and Wilkins were equal partners with unequal capitals. The assets of the firm on dissolution, after satisfying all the liabilities to creditors and advance from partners was insufficient to repay the capitals in full. There was a deficiency of Rs. 635 and the capital account of Wilkins was showing a debit balance of Rs.263. Nothing could be recovered from Wilkins owing to insolvency.

DECISION OF THE CASE

The solvent partners are only liable to make good their share of deficiency, and that the remaining assets should be divided among them in the proportion of their capitals.

EFFECT OF THIS CASE

The solvent partner should contribute to the deficiency of capital in cash of their share only and not the insolvent partner's share.

The net effect is that the deficiency of capital of the insolvent partner gets distributed among the solvent partners in the ratio of their last agreed capitals.

CRITICISM OF GARNER VS. MURRAY RULE

It does not apply when the firm is having only two partners.
It considers only the book capitals of the partners, ignoring the private assets of the solvent partners. If a partner contributed more capital than that of the other partners, he will have to bear more burden than the other partners who had contributed less capital.
If a partner having zero capital balance or debit balance, will not have to bear the deficiency of the insolvent partner.

Introduction of cash by the solvent partners to make good their share of loss on realization is unnecessary, when the balance of capital accounts of the solvent partners are sufficient to bear the deficiency of insolvent partner.

APPLICABILITY OF GARNER VS. MURRAY RULE IN INDIA

Section 48 of Indian Partnership Act 1932 is similar to the Section 44 of the Partnership Act in Great Britain and further there has been no case law in India to deal with such situations. So, in India these are applicability with respect to following considerations:

Garner vs. Murray is applicable only when there is no agreement between the partners for sharing the deficiency in capital account of insolvent partner.

Realisation loss should be divided in the profit sharing ratio in the usual manner.

The solvent partners should bring in cash to make good the loss on realization.

Final debit balance of insolvent partner should be distributed amongst the solvent partners in proportion in their last agreed capital.

A solvent partner having debit balance in capital account will not share any loss due to insolvency of a partner.

CONCLUSIO N

To conclude, it can be said that it is not unjust and inequitable law to ask a partner with larger capital to bear the larger portion of the loss. Psychologically, the partners with the lesser capital will not react unfavourably.

Thank you