

RESTRICTIONS IN HOLDING SHARES IN A COMPANY BY A PARTNERSHIP FIRM IN ITS OWN NAME.

Author Introduction

Author Profile

Name: Morla Chaitanya Babu,

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The author is a Company Secretary and practices his profession in the fields of Corporate laws, FEMA, NBFCs, GST, NCLT appearance, handling litigations, structuring corporate actions, due diligence, handling the process of investments and related matters and Income Tax related matters.

Previously employed in two large conglomerate group of companies in south India, collectively for a period of 6 years.

Before taking employment, was trained by Venkat & Vasani, Chartered Accountants, for 4 years which became base for knowledge hunger, taking ethical decision in challenging situations and clarity in thinking.

Presently working on developing a website viz. "CSconnect.in" exclusively for the development of Company Secretaries, where Company Secretaries can share their overload work with other Company Secretaries willing to provide their services, due to which quality of work can be maintained and increase development and employment opportunities to Company Secretaries.

He is also working on research, development and training activities in the areas of Corporate laws, FEMA, NBFCs, GST, RERA, NCLT appearance, due diligence, Income Tax related matters and other statutory matters related to business.

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He is also working on financial education of Micro and Small businesses by informing them the benefits of maintaining financial records, filing income tax return and availability of Government MSME benefits.

Believes in the following statement

"A person should get trained properly in a specific area, get clarity and then only proceed in his/her carrier, let it be any area of work, over a period a person by gaining experience will become an expert. Initially, everyone will be like a wet clay which can be brought into any shape by working on it constantly (training) and after burning in the flames of experience, make the person expert in that field. It cannot be achieved overnight."

ARTICLE

This article is focused on why a partnership firm cannot hold shares of a company in their own name.

This article is based on the following:

1. Partnership Act, 1932;
2. Indian Contract Act, 1872;
3. Companies Act 1956 and 2013;
4. Civil Procedural Code (CPC);
5. Circulars issued by Department of Company Affairs; and
6. Settled cases of Supreme Court of India.

In one of the WhatsApp Group of professionals where we share knowledge, the question popped up asking why a partnership firm cannot hold shares in a company in its own name. By experience, I know that a partnership firm cannot be registered as a member in a company but can have beneficial ownership in those shares.

What does the above statement mean and why a partnership firm cannot hold shares in its own name?

I came to know that there are companies having partnership firms as shareholders in their Register of Members, which is not correct at all. This means there is no conceptual clarity and hence decided to do research on this topic and write this article.

To understand the reason, first we need to understand what do you mean by "Partnership Firm".

We need to understand

- The nature or identity;
- Constitution of firm;
- Its powers, rights and obligations; and
- Its purpose.

Basically we need to understand what do you mean by a partnership firm and why it is said that in a partnership, partners liability is not limited.

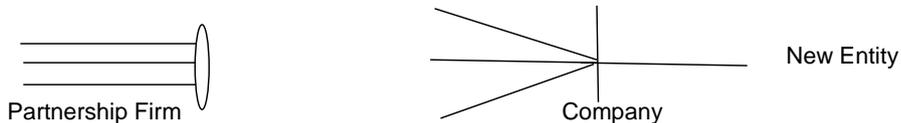
In a partnership firm (firm) **partnership deed** is the core and all action or activity are undertaken based on it.

What is Partnership Deed?

Partnership Deed is a **contract** between or among the partners which governs the actions of all partners. Any partner acts on behalf of the firm beyond the powers provided in partnership deed will be individually and solely liable for such actions.

Partnership Firms have very few laws to follow like Contract Act, Income Tax Act, GST which are not specific to partnership. All these Acts are also similarly applicable to individuals with little bit change in Income Tax Act. Even Partnership Act is also very liberal.

I would like to explain the relationship between or among the partners by referring to the following diagrams:



As you can see from the above partnership diagram (left side), the partners of a partnership firm do not merge, have their own identity while doing business through a Firm. The second diagram (right side) shows the nature of a company where shareholders i.e. investors bring capital but once it comes into the company it becomes the capital of the company whereas in partnership firm always an account with their name "Partner's Capital Account" individually, is maintained and never clubbed.

Partnership is nothing but shaking hands for sharing profits of lawful business. Here both or all partners comes together but their identity is not compromised or taken away by another entity. In other words partnership firm doesn't create any new entity different from its partners.



*Here the shaking hands i.e. the **relationship** is known as partnership.*

As one can refer definition of Partnership as per section 4 of the Partnership Act, Partnership is the **relation** between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Persons who have entered into partnership with one another are called individually "Partners" and **collectively** a Firm, and the name under which their business is carried on i.e. the name of the business is called the firm name.

Here collectively means together but they will not have cover of any separate entity. I can explain it further by giving an example, it is like bunch of sticks tied together but individual stick can be recognised whereas in a company all the sticks (shareholders) are covered by a mask and the outsider cannot identify what all sticks are available in it. Here the mask is the separate legal entity.

Further, act of partnership firm is defined in Partnership Act, as any act or omission by all the partners or by any partner as agent of the firm which gives rise to a right enforceable by or against the firm.

In Partnership firm, subject to the provisions of Partnership Act, the mutual rights and duties of the partners of a firm may be determined by contract between partners and such contract may be express or may be implied by course of dealing.

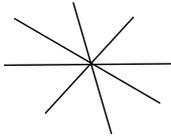
The firm doesn't have its own identity other than its partners.

It is possible and practically happening that same name is used for many firms and there is no restriction on it. For example, ABC & Co. is a partnership firm in Punjab, another firm with the same name can be available in Kerala, not only in Kerala, but it can be there in Punjab itself.

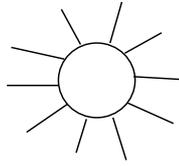
Naming a partnership firm means naming a relationship.

The Supreme Court of India in the case of *Champan Cane Concern Vs State of Bihar and another*, has held that in partnership each partner acts as an agent of another (as there is no separate entity created). The Partnership business belongs to the partners and each one of them is an owner thereof. A firm is not a collective name of all partners. A decree in favour of or against a firm has same effect as a decree in favour of or against all the partners.

While comparing Partnership and Company, the primary difference between the organisation of a company and that of a firm is that a company is a "person" in the eyes of the law, whereas joining of people (partners) to earn profit by doing lawful business under the umbrella of a written agreement known as Partnership Deed without creation of any legal entity is partnership firm. Rest of the differences are effect of this fundamental difference.



1. Partnership Firm



2. Company

One can see in the in the first Diagram all partners are linked with other partners without losing their identity, i.e. they are bound by contract (Partnership Deed) with each other.

In 2nd diagram one can see that all the shareholders invest in an independent entity. One shareholder doesn't have any connection with any other shareholder(s). Once they invest, their identity is diluted and only company dose the business.

Let us understand the relationship of partners as per Civil Procedure Code (CPC).

CPC clearly demarcates the relationship of Firm and its Partners.

Where a suit is instituted by partners in the name of their firm, the plaintiff or their pleader shall, on demanding writing by or on behalf of any defendant, forthwith declare in writing the names and places of residence of all persons constituting the firm on whose behalf the suit is instituted.

Where the plaintiff or their pleader fails to apply to the Court for a statement of names and address of the persons who were at the time of occurring of the cause of action were partners in such firm, all proceedings in the suit may, upon an application for that purpose, be stayed upon such terms as the Court may direct.

Where the names of the partners are declared in the manner referred to in the suit shall proceed in the same manner, and the same consequences in all respects shall follow, as if they had been named as plaintiff in the plaint:

Provided that all proceedings shall nevertheless continue in the name of the firm, but the name of the partners disclosed in the manner specified shall be entered in the decree.

Where persons are sued as partners in the name of their firm, they shall appear individually in their own names, but all subsequent proceedings shall continue in the name of the firm.

Where a summons is served upon a person having the control or management of the partnership business, no appearance by him shall be necessary unless he is a partner of the firm sued.

Any person served with summons as a partner may enter an appearance under protest, denying that when the event happened, he was a partner. On such appearance being made, either the plaintiff or the person entering the appearance may, at any time before the date fixed for hearing and final disposal of the suit, apply to the Court for determining whether that person was a partner of the firm and liable as such.

If, on such application, the Court holds that he was a partner at the material time, that shall not preclude the person from filing a defence denying the liability of that firm in respect of the claim against the defendant.

If the Court, however, holds that such person was not a partner of the firm and was not liable as such that shall not preclude the plaintiff from otherwise serving a summons on the firm and proceeding with the suit; but in that event, the plaintiff shall be precluded from alleging the liability of that person as a partner of the firm in execution of any decree that may be passed against the firm.

As per Indian Contract Act, 1872, persons who have entered into partnership with one another are called individually "partners" and collectively a "firm" and the name under which their business is carried on is called the firm name.

A firm or a partnership is not a legal entity separate and distinct from the partners. Firm is only presenting the essential facts in a detailed but concise description of individuals who constitute the firm.

The concept of partnership law is that a firm is not a legal entity or a person in law but only an agreement between or among person to carry on the business or profession and share profits of lawful activity in partnership.

The above explanation makes it clear that partnership firm is nowhere different from its partners.

Wherever, partnership firm enters into a contract either all the partners have to enter the contract or they have to authorise one of the partners through partnership deed to enter into contract on behalf of all of them.

Companies Act and restriction on Partnership to hold shares in their name.

While discussing this issue with other professional friends, they brought to my knowledge that many companies in India without knowing the above facts have entered partnership firm's name instead of the partners name in their Register of Members which is totally wrong treatment.

Department of Company Affairs in their circular No.4/72 dated 9th March, 1972 has clarified that a Partnership firm not being a person, cannot be registered as a member of a company

except where the company is licensed under Section 25 and companies which have firms registered as shareholders should be advised to take steps to rectify the position within a specified time. In case the irregularity persists, despite a warning, necessary action can be taken.

The Department has further clarified in Circular No.5/75 dated 31st March, 1975, that a partnership firm is not a person capable of being a member within the meaning of section 41 of Companies Act, 1956, and since a partnership is not a legal entity by itself but only a compendious (containing or presenting the facts of something in a comprehensive but concise way) way of describing the partners constituting the firm, it is necessary that the names of all the members of the partnership firm should be entered in the register of members in order that the right of the partnership as a whole to the shares in question may prevail. The holding of shares by only one or more partners on behalf of other partners of a firm should not, therefore, ordinarily arise. *However, where, in a given case, the name or names of only one or some of the partners is entered in the register of members, while the intention is that the partnership as a whole should have the right of membership in respect of the shares in question, it is obviously necessary for such partners who hold shares not only for themselves but for the benefit of all partners constituting the firm whose names are not entered in the register of members, to comply with the rules framed under section 187C under Companies Act, 1956 (Corresponding Section 89 of Companies Act, 2013).*

CONCLUSION

I conclude by stating that a partnership firm is a relationship between or among the partners who agrees to do business together and share its profits without incorporating a new entity. Partners are nowhere different from partnership firm. Each one is individually recognised and liable to outsiders. As partnership firm doesn't have any existence than from its partners, it by itself cannot become a member of any company. Whereas, one or more than one partner, jointly can hold shares on behalf of all other partners and inform the Company about beneficial ownership of other partners. If any company has entered partnership firm as a shareholder in their Register of Members, it need to be corrected immediately.