

PARTNERSHIPS UNDER KANSAS LAW AND THEIR RELATION TO
MODERN ACCOUNTING THEORY AND PRACTICE

by

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B. S., Kansas State College of Agriculture
and Applied Science, 1944

A THESIS

submitted in partial fulfillment of the

requirements for the degree

MASTER OF SCIENCE

Department of Economics and Sociology

KANSAS STATE COLLEGE
OF AGRICULTURE AND APPLIED SCIENCE

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INTRODUCTION

The lawyer and the accountant must realize the importance of a unity of interpretation and practice between their respective fields. This study is an attempt to compare accounting theory and practice regarding partnerships with Kansas partnership law and its interpretation by a study of actual court cases.

The leading authorities of accounting theory were compared with textbooks which stress the legal aspect of partnerships. The General Statutes of Kansas regarding partnerships were studied and their interpretation was determined through a study of actual cases arising in Kansas courts.

This study begins with a discussion of some of the general considerations regarding partnerships. A brief history and a definition of partnerships from both the accounting and legal viewpoint are presented. A brief discussion is given of the conditions under which partnerships are generally found with the reasons why this form of organization is desirable. The first part concludes with some advantages and disadvantages of the partnership form of business organization.

The second part deals with partnership formation and begins by a discussion of the major classifications of partnerships to be followed by a presentation of the various types of partners. This part concludes with a study of some of the problems of formation, emphasizing the partnership agreement.

The third part is concerned with partnership operation and discusses such topics as the peculiarities of partnership accounting, tests of the existence of a partnership, partnership property, partnership capital, and powers of a partner. Then follows a rather lengthy explanation of the sharing

of profits and losses.

The fourth part discusses partnership dissolution and after some general remarks on this subject, goes into a discussion of the methods of dissolution.

GENERAL CONSIDERATIONS

The partnership is probably the oldest form of business organization. In the early days of commerce, men soon discovered that there is strength in unity. In the United States, the partnership is one of the most common forms of business organization.

There are many reasons why the partnership form of organization is desirable in business. Competition may be lessened, capital increased, expenses reduced, and a division of labor made efficient. The partnership form of business organization makes it possible to combine the capital, ability, and experience of two or more persons so that collectively the partners have a stronger organization than they could have individually.

The partnership form of business organization is usually found in comparatively small enterprises which require no more capital than a few partners can readily contribute. This form of organization is commonly found in professional practices, such as law, medicine, and accounting, in which there is a personal responsibility existing between the firm and its clientele.

This personal responsibility which exists between the partners and the clientele is one of the major disadvantages of the partnership form of organization. With a few exceptions, a stockholder in a corporation is not liable for the payment of corporate debts, but each partner of a partnership is personally liable for all of the partnership debts. Each partner has the right to bind the partnership on business contracts and each partner's private fortune can be levied upon, if necessary, for the payment of the firm's debts. Thus, it is obvious that one partner with poor judgment might involve the partnership in losses and liabilities which would not only exhaust the firm's capital but would encroach upon the private resources of the partners.

According to the Business Executive's Handbook, the major advantages of the partnership form are:

1. Organization is comparatively easy; as a rule a partnership may be created simply by the partners' entering into a partnership agreement, either oral or written.
2. Business may be conducted freely in any state without government interference or regulation.
3. More capital may be raised for a partnership enterprise than for a single proprietorship because the resources of several individuals are combined.
4. Decisions may be made by the management of the business and changes in the enterprise may be effected simply by agreement among the partners, without the formalities necessary under a corporate form of organization.
5. The direct responsibility placed upon each partner is conducive to use of the partners' best efforts in behalf of the enterprise.
6. The ability and experience of several individuals is combined in furtherance of one enterprise.
7. Credit may be readily available because the partners are personally liable for partnership debts.

The Business Executive's Handbook lists the following as disadvantages of the partnership:

1. Each partner is personally liable for the partnership debts.
2. Control of the business is divided among two or more individuals, involving the danger of disagreement in policy and administration.
3. Each partner may bind the partnership by his acts with respect to partnership matters.
4. Large amounts of capital cannot be raised from public sources through the sale of securities, as is possible under a corporate form of organization.
5. Because death, disability, or withdrawal of a partner terminates the partnership, the organization is unstable as compared with a corporation.

The Uniform Partnership Act defines a partnership as "an association of two or more persons to carry on, as co-owners, a business for profit". A corporation cannot be a member of a partnership as this definition refers to living persons only; a corporation is an artificial being created by law. To further define a partnership, it might be said that a partnership is a number of individuals associated together for the purpose of conducting a lawful business enterprise for profit. By business enterprise, is meant any gainful trade, occupation, or profession. It will be noted from the above definition

that the partnership must be formed for the purpose of operating a lawful business for profit. Thus, a hunting club, a sewing circle, a trade union, or a similar organization cannot be treated as a partnership.

In terms of law, a partnership can be defined as an association of two or more persons competent to contract who have combined their money, property, or labor and skill, or some or all of them, as co-owners for the purpose of carrying on some lawful business for their joint profit.¹ In further defining a partnership in terms of law, it is a contractual relationship based upon an agreement, written, oral, or implied, between two or more persons who combine their resources and activities in a joint enterprise and share in the management and in the profits or losses. They find that the partnership agreement is founded upon the same basic principles that govern and control contracts in general so that the law applicable to contracts is also applicable to partnerships. Thus, any person competent to contract may enter into a contract of partnership. A contract of partnership, like other contracts, may be made by an infant for his own benefit, subject to his right to avoid it. Although an infant partner, on or before becoming of age, may avoid his partnership contract, he cannot recover money which he expended in partnership. A partnership has no legal existence so that when the partnership is sued, all the partners must be named as defendants and if the partnership wishes to bring action, it must sue in the names of all the partners as individuals.

The partnership form is widely used among the smaller business organizations and in the professional fields where the partners are closely identified with the operations of the business or profession. Partnerships are also frequently found in financial lines, particularly stock brokerage, and occasionally a large trading or manufacturing business is conducted as a

¹ Peters, Principles of Business Law, p. 202

partnership. In recent years there appears to be a trend toward the partnership form of business organization because of the increasingly unfavorable position of the corporation in regard to taxation and general political conditions. As a general rule, the larger the enterprise the less likely is the partnership form of business organization to be employed.

The persons forming the partnership are referred to collectively as a firm or a house; they are known individually as partners or co-partners. A partnership may be spoken of as a firm, but it should not be called a company as that term is properly applied only to corporations.

PARTNERSHIP FORMATION

Classification

Partnerships are usually classified as follows: Common-law or general partnerships, limited or special partnerships, and joint-stock companies.

Common-law or general partnerships are the most common type of partnerships and are generally engaged in a business of an industrial or commercial character. Each partner of an ordinary partnership is individually liable for all the debts of the partnership and his only recourse is against the other partners. In the event of his withdrawal from the partnership, a partner is not relieved of his liability for partnership debts outstanding as of the date of his withdrawal unless written releases have been secured from the creditors. Each member of an ordinary partnership is a principal as well as an agent, and the acts of each are binding upon all partners if the partners are acting for the firm and within the scope of its business. Transactions by a partner outside the usual course of the partnership business are not binding upon the other partners unless they consent to be bound. Such transactions include: the sale of the partnership name, guarantees or accommodation endorsements, the transfer of a partner's interest, and any act that would make it impossible to carry on the ordinary business of the partnership.

A special type of partnership called a "limited partnership" is provided for by the statutes of most states.¹ Limited partnerships may be formed in Kansas by two or more persons for the transaction of any mercantile, mechanical, or manufacturing business. Kansas law does not authorize a limited partnership for the purpose of banking or insurance.² A limited partnership in Kansas

1 Johnson, Elementary Accounting, p. 353

2 Corrick, General Statutes of Kansas, 1935, Sec. 56-101

must be formed and operated to comply with the limited partnership laws of the state. The persons intending to form a limited partnership in Kansas must draw up and sign a certificate which contains the following:¹

- (a) The name or firm under which the partnership business is to be conducted.
- (b) The general nature of the business to be transacted.
- (c) The names and addresses of all the general and special partners interested in the limited partnership, distinguishing which are general partners and which are special partners.
- (d) The amount of the capital stock which each special partner shall contribute to the common stock.
- (e) The date at which the partnership is to commence and the date when it will terminate.

The certificate must be acknowledged by the persons signing it before an officer authorized by the law to take the acknowledgment of deeds. This certificate, after being acknowledged and certified, is to be filed in the office of the county clerk of the county in which the principal place of business of the partnership is to be situated. It is then recorded by the clerk in a book which he keeps and which is subject to inspection at reasonable hours.

If the partnership is to have places of business situated in different counties, a copy of the certificate and of the acknowledgment, signed by the clerk in whose office it was filed, should be filed and recorded in a similar manner in the office of the clerk of each county.

At the time of filing the original certificate and its acknowledgment, an affidavit of one or more of the general partners should also be filed in the same office, stating the amount of money or other property, at cash value, which was specified in the certificate as having been contributed by each of the special partners to the common stock, which has been actually contributed and applied to the common stock.²

In a limited partnership, certain partners, but not all partners, are

¹ Ibid., Sec. 56-104

² Corrick, General Statutes of Kansas, 1935, Sec. 56-106

permitted to limit their personal liability to the amounts which they have contributed to the capital of the partnership. The partnership must have at least one general partner of unlimited liability. If a limited partner leads an active part in the management, he automatically becomes liable as a general partner.¹ In Kansas, if any false statement is made in the certificate or affidavit, all of the persons in the partnership making or consenting to the false statements shall be liable for all of the engagements of the partnership as general partners.²

This form of partnership is of a somewhat recent statutory origin and is not permissible in all states. Generally, the word "Limited" or the abbreviation "Ltd." must be added to the firm name, as "Methune & Co., Ltd."

Joint-stock companies are authorized and regulated by statutory law; they may be organized in some states under the common law and in others, under special statutes. The ownership of such a company is represented by transferable shares of stock and the transfer of the shares or the death of a member does not dissolve the company. The individual members are usually both jointly and severally liable for the debts of the firm contracted during their membership.

Corporations have largely supplanted joint-stock companies and limited partnerships since they possess practically all the desirable elements of joint-stock companies and limited partnerships but do not have the risks or other undesirable features of these organizations.

1 Johnson, Elementary Accounting, p. 354

2 Corrick, General Statutes of Kansas, 1935, Sec. 56-109

Kinds of Partners

The following is a classification of the members of a common-law or general partnership:

A general partner is one who is actively engaged in the management of the business and has unlimited liability in respect to the partnership debts. All members of a common-law partnership are general partners.

A secret partner is one who attempts to keep his connection with the firm concealed from the public.

A silent partner is one who does not take an active part in the management of the business and attempts to exercise none of the rights of a partner except that of receiving his share of the profits. He is liable for the firm's debts and he may or may not be known to the public as a partner.

A dormant partner usually combines the characteristics of both the secret and the silent partner. He is unknown to the public as a partner and takes no part in the management of the business. When he becomes known to the public as a partner, he is liable for the debts of the firm to the same extent as a general partner.

Formation

The individuals wishing to form a partnership must make a voluntary agreement which may be either express or implied. If two or more persons actually engage in business together as co-owners without making an express agreement, orally or in writing, the law implies a contract and a partnership exists.¹ To constitute a partnership in Kansas, it is not necessary that there

¹ Finney, Principles of Accounting, Intermediate, p. 57

be a series of transactions between the parties, nor that the relation be continued for a long period of time. It may exist for a single transaction or undertaking.¹

If the partnership is to exist for more than one year from the date of its formation, the agreement must be written to comply with the Statute of Frauds; if the partnership is to exist for a shorter period of time, the contract should be in writing and signed by the partners to avoid future disputes. The contract does not have to be in any particular form unless there is a state statute providing for a certain form. This written agreement is commonly known as the "Articles of Copartnership".

Regarding the importance of the partnership agreement, Kester, in his Principles of Accounting, writes:

Since a partnership is a contractual relationship, all the requirements governing legality of contracts, such as agreement, consideration, lawful object, competency of contracting partners, etc., apply. Inasmuch as there is so great an opportunity for disputes in a relationship of this sort, it is imperative, if efficient working relations are to be maintained, that very carefully drawn articles of copartnership be agreed upon before active business is begun.

Each partner should sign the article and retain a copy of the agreement. It is very desirable that a copy of the agreement be filed with the recorder, clerk, or other official designated to receive such documents, in the county in which the partnership has its principal place of business. In the case of a limited partnership, filing and publication of notice of the filing is imperative. A limited partnership in Kansas must publish the terms of the partnership for at least four weeks after their recording in a newspaper published in the county or having general circulation in the county in which the record has been made. If this publication is not made, the limited partnership is considered a general partnership. An affidavit of the publication of this notice, by the printers of the newspaper in which it was

¹ Marsh v. Davis, 33 Kas. 326

published or by some one in their employ who knew of this publication, may be filed with the clerk and is considered as evidence of the fact of publication.¹

The articles of partnership should contain express agreements on the following matters:

1. The names of the partners and the duties of each. The question as to whether partners may engage in outside business activities should be settled.

2. The name of the partnership and the nature and place of business.

3. The date on which the contract takes effect and its duration.

4. The capital to be contributed by each partner should be determined as well as the apportionment of future capital contributions if further increases in capital becomes necessary.

5. It should be determined if interest is to be charged for failure to contribute the agreed amount of capital. The treatment of any contributions in excess of the agreed amounts of capital should be discussed.

6. The problem of whether interest is to be allowed on capital should be mentioned.

7. The division of authority among the partners should be settled.

8. A statement should be included giving the dates on which profits and losses are to be computed and the method to be followed in dividing them. In the absence of an agreement, profits and losses are divided equally.

9. The disposition of the partners' drawing or salary accounts should be discussed to prevent any disputes as to the closing of these accounts.

10. Withdrawals to be allowed each partner should be mentioned as well as the treatment of undrawn salaries and profits and excess drawings.

¹ Corrick, General Statutes of Kansas, 1935, Sec. 56-110

11. An agreement concerning the method of liquidating the partnership should be included.

12. Persons may be mentioned who will act as arbitrators in the case of disputes.

Many partnerships have run into a great deal of difficulty through disagreements which could have been avoided if the partnership agreement had been drawn up properly.

A firm name is not a legal requirement for a partnership, but it is useful as a matter of convenience and for the purpose of identification. Any name which does not violate the rights of others or is not contrary to the law, may be adopted. In some states it is not permissible to use the name of a person who is not a member of the firm, or the words, "and Company" unless the firm consists of two or more persons. Many of the states now have laws which permit the use of fictitious or trade names. A partnership cannot bring suit at law in the name of the firm; the suit must be brought in the names of the individual members. Under the common law, real property must be held in the names of the partners, but under the Uniform Partnership Act, it may be held and conveyed in the name of the firm. In Kansas the business of the partnership is carried on under a firm in which the names of the general partners only are inserted, without the addition of the word "company", or any other general term. If the name of any special partner is used in the firm with his consent, he is considered a general partner.¹

¹ Corrick, General Statutes of Kansas, 1935, Sec. 56-114

PARTNERSHIP OPERATION

Peculiarities of Partnership Accounting

The accounting problems of the partnership are similar to those of other forms of business organizations in many respects. The basic pattern of accounting for various types of assets and current material and service costs is the same regardless of the type of ownership and the method of raising capital. This is also true for the recording of revenues and the treatment of liabilities. The distinct peculiarities of partnership accounting are concerned primarily with the recording and tracing of capital, the treatment of personal services furnished by the partners, the division of profits, and the adjustment of equities in case of reorganization or liquidation of the firm.

Opening the Books

In opening the books of a partnership, the assets should be recorded at their fair market values at the date of organization. This is very important because any profits or losses resulting from the disposal of the assets should be computed on the basis of the fair value of the assets at the date when the partnership acquired them.¹

¹ Finney, Principles of Accounting, Intermediate, p. 59

Partners by Implication

A person may, by his words or conduct, represent himself or permit another person to represent him to the public in such a way as to justify those dealing with the firm to believe he is a partner. In such an event, he will be held liable for the debts of the firm to those who have extended credit to the firm upon this representation. This situation may commonly arise when a partner retires from the firm without making his retirement known to those who have been dealing with the partnership.

Tests of the Existence of a Partnership

Persons may sometimes be held liable to third persons as partners, even though they have no partnership agreement or any intention of creating such a relationship. At one time it was held that sharing in the profits of a business made one a partner but this is no longer held to be conclusive evidence of a partnership. Profits may be received in payment of a debt, wages, rent, interest, or goodwill in the sale of a business. The law is now well settled in Kansas that where a person loans or advances money or goods to another person to be invested in some business enterprise, the lender to share in the profits in lieu of interest on the loans, the arrangement does not constitute a partnership. It will not constitute a partnership to third persons unless the acts of the parties in the furtherance of this agreement between themselves are such that third persons are misled into a reasonable belief that a partnership exists.¹

Where several parties unite in the purchase of real estate, not as a

¹ Rider v. Hammell, 63 Kas. 733

permanent investment but as a speculation with a view of selling it for profit, and there is a community of ownership of the property, community of power in carrying on the enterprise, and community of interest in the profits and losses, it will ordinarily be treated as a partnership in Kansas.¹

Partnership Property

Partnership property includes everything owned by the firm. The property may have been brought into the partnership at its formation, or it may have been acquired later by purchase or in some other manner. Although it may have been bought with the firm's money in the name of one of the partners, it is nevertheless partnership property. The mere use of property by the firm is not sufficient to justify the belief that it is partnership property. If one of the partners permits the use of his private property, this property does not become partnership property. Upon the dissolution of the firm, the use of this property reverts to the person holding title to it.

In Kansas, the property of the partnership is the joint property of the partners and unless all the partners consent to do so, one partner cannot dispose of the property of the partnership to satisfy his individual debts.² In like manner, one partner has no authority to make a general assignment of the firm property for the benefit of the creditors of the partnership without the assent of the copartners.³

After a partnership has been dissolved, in Kansas, the partners become tenants in common as to the partnership property, and none of them have the right to sell the interest of any of the other partners in this property, unless by special agreement, except so far as may be necessary to settle the partner-

1 Jones v. Davies, 60 Kas. 309

2 Tootle v. Rice, 53 Kas. 576

3 Shattuck v. Chandler, 40 Kas. 516

ship affairs and pay the partnership debts.¹

Partnership Capital

The capital of a partnership consists of the total contributions made by the partners. It may consist of money, patents, securities, trade secrets, goodwill, or anything of value. The contributions may not be equal; one person may furnish money or other property, whereas another may give of his time, skill, or experience. The proportion of capital to be contributed by each member is a matter of agreement.

Upon the dissolution of the partnership, the property is returned to the members in the same proportions as their capital ratio, unless an agreement to the contrary exists. If one person invests only his skill or services, he will not be entitled to share in the distribution of the capital upon the dissolution of the partnership.

In Kansas, during the continuance of the partnership, no part of the capital stock can be withdrawn nor can any division of interest or profits be made so as to reduce the capital stock below the sum stated in the certificate. If at any time during the continuance or at the termination of the partnership, the property or assets are not sufficient to pay the partnership debts, then the special partners are held responsible for all sums received, withdrawn, or divided by them, with interest from the time the sums were withdrawn or divided.²

¹ Hogendoblen v. Lyon, 12 Kas. 276

² Corrick, General Statutes of Kansas, 1935, Sec. 56-115

Good Faith

The relations of the partners to one another are that of trust and confidence. Each partner owes to his other partners, the highest integrity and good faith. Kansas law states that it is the duty of the partners to devote their time and best endeavors to carry on the partnership business and promote the prosperity of the firm. In the absence of any special agreement between them as to the division of labor, each should give time and attention to the conduct of the business without compensation, and without regard to the relative value of the services of the several partners.¹

Each one must comply with the terms of the partnership agreement, whether it is written or oral. A partner cannot engage in another business with a purpose which is adverse to that of the partnership. He cannot use the partnership property for the payment of his personal debts.

Kansas courts have decided that the obligation of one partner to another in the management of the partnership business is the exercise of good faith and of ordinary care and prudence, and if loss happens through the ordinary negligence of a partner, he must bear the loss.²

Compensation

A partner is not entitled to extra compensation for the performance of his duties, unless an agreement provides for such compensation. Even though one member of the firm may be more active than his copartners in promoting the best interests of the business, he cannot obtain extra compensation. The partners may, however, make an agreement that wages or

1 *Insley v. Shire*, 54 Kas. 793

2 *Carlin v. Donegan*, 15 Kas. 495

salaries will be paid them for their services. When the partnership is dissolved, the partner who winds up the affairs of the partnership is entitled to reasonable pay for this service.

Personal Management

Unless the partners have made an agreement to the contrary, all of them have an equal right in the management of the business. A partner's share in the management is not governed by the amount of his contribution; it is equal to that of any one of the other partners. On the other hand, they may agree that one or more of them may have the entire management and control of the business. In ordinary matters affecting the partnership, the opinion of the majority of the partners will govern, unless there is an agreement to the contrary. The majority have no power against the minority, however, to change the nature of the business, to increase or reduce the capital, to engage in a new undertaking, or to admit new members.

Powers of a Partner

In the absence of an agreement to the contrary, each partner has the implied authority to bind the firm, and with it, the individual members and the property of the firm, by any act committed within the scope of the partnership business in a transaction with a third party. A Kansas court decision states that every partner is a general agent of the firm to carry out and transact its business in the usual and ordinary way. It is a general principle relating to commercial or trading partnerships that each partner is the lawful agent of the partnership in all matters within the apparent scope of the business. The knowledge of one partner concerning

partnership matters is constructively the knowledge of all the members of the partnership, although the other members are actually ignorant of it.¹

Where an indorsement is made in the name of a firm, Kansas law will presume, in the absence of proof to the contrary, that the indorsement was made in the firm business.² If the authority of a partner is restricted by an agreement, notice of that restriction must be given to third parties. If that is not done, a third party may hold the partners liable on a contract made with this person. Kansas law states that a special partner has no authority to transact any business on account of the partnership, nor to make the partnership liable for his contracts.³ Among the implied powers of a partner are the following:

- (a) To compromise and release a claim against a third party.
- (b) To receive payments and give receipts in the name of the firm.
- (c) To employ agents and servants whose services are needed in the transaction of the partnership business, or to discharge them.
- (d) To draw and indorse checks, to make notes, and to accept drafts.
- (e) To insure the property of the partnership, to cancel insurance policies, or to give proof of loss and collect the proceeds.
- (f) To buy goods on credit or to sell part or all of the stock of the partnership, provided he does so in the regular course of business.

A Kansas court decision states that where money is borrowed by the partner of a trading firm in the name of the firm and a note is given therefor, this note is evidence of the obligation of the partnership; and if the other partners seek to avoid its payment, the burden of proof lies with them to show that the note was given in a matter not relating to the partnership business and that this was done with the knowledge of the holder of the note.⁴

1 Barber v. Van Horn, 54 Kas. 33

2 Fuller v. Scott, 8 Kas. 25

3 Land, etc. Co. v. Daley, 46 Kas. 504

4 Deity v. Regnier, 27 Kas. 94

The partners in a trading firm have a greater diversity of powers than those in a nontrading firm. A trading firm is one in which the members are engaged in buying and selling or in manufacturing. A nontrading firm, on the other hand, is one in which the members are engaged in an occupation, such as printing, or a profession, such as the practice of law.

The Kansas statutes states that the general partners only are authorized to transact business, to sign for the partnership, and to bind the partnership. A special partner may from time to time examine into the state and progress of the partnership concern, and may advise as to the management but he cannot transact any business of the partnership nor be employed for that purpose as agent, attorney, or otherwise. If he interferes contrary to these provisions, he shall be considered a general partner. The general partners are liable to account to each other and to the special partners for their management of the concern.¹

Prohibitions

Among the acts which a partner does not have the implied power to do and for which he must obtain the unanimous consent of all the partners in order to bind the firm are the following:

- (a) To assign the assets of the firm for the benefit of creditors.
- (b) To indorse a negotiable instrument as an accommodation. Such an indorsement would bind merely the indorser individually.
- (c) To submit a partnership controversy for arbitration.
- (d) To dispose of the goodwill of the business, or to do any other act which would make impossible the continuance of the business.
- (e) To discharge a personal debt by agreeing that it will be set-off against one due the firm.

A Kansas court decision states that a partner in a nontrading firm has no implied power to bind the firm by the execution of commercial paper in the name of the firm.¹

Liabilities

In Kansas, an agreement to form a partnership is essential before a party can be made liable for an alleged partnership contract.² Each member of the firm is individually liable for all the debts of the firm. If one partner is compelled to pay a firm debt out of his own estate, he is entitled to a proportionate refund from the other partners. To be entitled, however, is one thing; to collect is another. Where a partner claims that his liability to creditors of the firm is restricted by a special contract between the partners, and no proceedings have been had under the limited partnership act, in Kansas, it is incumbent on him to prove notice to or knowledge by the creditors of such contract limitation, or he will be liable equally with the other partners for the entire debts of the firm.³

A partnership is liable for any tort, or wrongful act, committed by a partner while acting in the ordinary course of the business of the partnership. Hence, if one of the partners causes an injury to the person or property of a third party, the partnership is liable therefor. The partnership is not liable, however, for illegal contracts made by individual members because third persons are presumed to know the law, and contracts contrary to law are unenforceable.

The Kansas statutes state that every partner who is guilty of any fraud in the affairs of the partnership is liable civilly to the party injured, to the extent of his damage. He is also liable to an indictment for a

1 Lee v. National Bank, 45 Kas. 8

2 Gauss v. Hobbs, 18 Kas. 500

3 Medberry v. Soper 17 Kas. 369

misdeameanor, which is punishable by a fine or imprisonment or both in the discretion of the court by which he is tried. Actions respecting the business of a limited partnership may be prosecuted by and against the general partners only, as if there were no special partners. The members of a limited partnership are subject to all of the liabilities and entitled to all of the rights of general partners except as provided above.¹

Sharing of Profits and Losses

The articles of copartnership usually specify the basis upon which the profits and losses are to be shared and this proportion cannot be changed by a majority of the members of the firm. The majority of the members of the partnership may order a division of the profits at any time unless there is an agreement to the contrary.

The profits of the partnership may be shared in any manner which is agreeable to the partners and a full statement covering this matter should form a part of the articles of copartnership. If the agreement is silent on this point, the law assumes it was the intention of the partners to share profits and losses equally. In some cases, the division of the profits is based upon the relative capitals of the partners, while in other cases, the profits are divided according to specified percentages which bear little or no relationship to the respective capital investments of the partners or to the time and effort which each devotes to the business. If it is the intention of the partners to share profits and losses in proportion to capital contributions, the articles of copartnership should state exactly how the respective equities are to be computed. The fairest method of sharing profits under ordinary conditions is by using relative average capitals for the period under

¹ Corriek, General Statutes of Kansas, 1935, Sec. 56-118

consideration, provided that inequalities of service to the partnership are taken care of through salary adjustments.

Some of the most common methods of dividing profits are:

(a) Equally, either because of an agreement to that effect or because of a failure to make any agreement.

(b) In an agreed upon ration or a series of ratios which may bear little resemblance to capital investments or time contributed to the business of the partnership.

(c) The division of profits according to capital ratios is most commonly used when profits are realized chiefly through capital. There should be a definite agreement in the articles of copartnership whether profits are to be divided according to the ratios of the original capital investments, capital at the beginning of the accounting period, capital at the end of the accounting period, or the average capital invested during the accounting period. This is very important to prevent disputes from arising if investments and drawings during the period change the capital ratio.

The division of profits according to the average capital invested during the accounting period is perhaps the most equitable method of distributing profits as the average investment represents the amounts of capital contributed by each partner for the use of the business during the year. When this method is used, there should be an agreement in the articles of copartnership as to the amount of drawings which each partner is allowed. Drawings within this agreed amount are charged to the partners' drawing accounts and any excess drawings are charged to the partners' capital accounts as a withdrawal of capital. The following are two common methods of computing average capital ratios:

<u>A Capital</u>		<u>B Capital</u>	
Withdrawals	Contributions	Withdrawals	Contributions
\$300 x 6 mon.	\$1000 x 9 mon.	\$500 x 8 mon.	\$2000 x 6 mon.
500 x 3 mon.	2000 x 12 mon.	200 x 5 mon.	2000 x 12 mon.
Total <u>\$3300</u>	Total <u>\$33,000</u>	Total <u>\$5,000</u>	Total <u>\$36,000</u>
	Bal. <u>\$29,700</u>		Bal. <u>\$31,000</u>

Ratio of division of profits, \$29,700 ÷ \$31,000

<u>A Capital</u>		<u>B Capital</u>	
Withdrawals	Contributions	Withdrawals	Contributions
Bal. Jan. 1,	\$1,000	Bal. Jan. 1,	\$2000
Mar. 1, \$500	Oct. 1, \$1,000	Feb. 1, \$300	May 1, \$500
May 1, 200	Dec. 1, 2,000	Mar. 1, 400	Oct. 1, 500
\$1,000 x 2 mon. =	\$2,000	\$2,000 x 1 mon. =	\$2,000
500 x 2 mon. =	1,000	1,700 x 1 mon. =	1,700
300 x 5 mon. =	1,500	1,300 x 2 mon. =	2,600
1,300 x 2 mon. =	2,600	1,800 x 5 mon. =	9,000
3,300 x 1 mon. =	3,300	2,500 x 3 mon. =	6,900
Total <u>\$10,400</u>		Total <u>\$22,200</u>	

Ratio of division of profits, \$10,400 ÷ \$22,200

(d) By allowing interest on capitals and dividing the remaining profit in an agreed ratio. The partners may decide to distribute only a portion of the profits in the capital ratio and the remainder of the profits in some other ratio because of other factors in the production of profits besides capitals and dividing the remaining profit in some other ratio. A partner cannot claim interest on his capital unless there has been an agreement to that effect, for the law assumes that the investment was made for the purpose of earning profits and not interest.¹ Interest on capital should be considered a division of profits and not a current expense.

The articles of copartnership should cover the following points in allowing interest on invested capital:

(1) The rate of interest may be stated specifically or it may be

¹ Finney, Principles of Accounting, Intermediate, p. 82

determined by reference to the call money market, the yield of certain governmental obligations, the charge made by local banks for commercial loans, or to some other available measure.

(2) If the articles of copartnership provide for a regular interest allowance, there should be included a statement of how to deal with the cases in which the firm operates at a loss or has a net profit of less than the interest. It is preferable that the full amount of the interest be allowed and the resulting debit balance in the profit and loss account should be apportioned to the capital accounts in the profit-sharing ratio.

(3) The capital balance on which interest is to be allowed should be stated and if an average balance is agreed upon, the method by which the average is to be determined should be stated.

(e) By allowing salaries to the partners and dividing the remaining profit in an agreed ratio. This method of allowing salaries to the partners is to apportion at least a part of the profits according to the relative value of the partners' services. The salaries may be paid monthly or at other intervals during the year. They may be credited at intervals to the partners' drawing accounts as an offset against drawings taken from time to time; or they may be credited in total at the end of the period. If the salaries are paid at intervals throughout the period, they should be charged to the partners' salary accounts; if they are paid in total at the end of the period, they may be charged to the partners' salary accounts or direct to the profit and loss account. Finney has this comment to make on the treatment of interest on capital and salaries to partners:

There is some difference of opinion among accountants as to whether interest on capital and salaries to partners should be shown in the profit and loss statement as expenses or as divisions of profit. From a purely theoretical standpoint, it seems that partners' salaries and interest on partners' capitals are both divisions of profits. Partners are supposed to contribute capital and services for the purpose of producing partner-profits; and the interest and salaries are merely devices for distributing

profits in proportion to the amount of the capital and the value of the services contributed. But in practice it is not unusual to show the partners' salaries as an expense, and the interest on capital as a division of profits. The treatment of partners' salaries as an expense may be desirable if the partners are assigned departmental duties and statements are prepared showing the results of operations departmentally, or if it is desired to compare the results of a partnership's operations with those of a corporation.¹

If the articles of copartnership provide for a regular salary allowance, there should be included a statement of how to deal with the cases in which the firm operates at a loss or has a net profit of less than the salaries. It is preferable that the full amount of the salaries be allowed and the resulting debit balance in the profit and loss account should be apportioned to the capital accounts in the profit-sharing ratio. This may result in giving one partner a net credit although the business operated at a loss for the current period. To prevent this, the articles of copartnership should state that interest on capital and salaries will be allowed partners only if the profits exceed the interest and salary allowed. If the profits are less than interest on capital and salaries, they may be divided in the capital ratio. If the business operated at a loss, the loss could be divided equally. Johnson makes these remarks concerning partners' salaries:

Partners are not entitled to salaries unless salaries are specifically provided for by the articles of partnership, even though one partner may devote all of his time to the business and the other may devote little or none. Partners may expressly agree that salaries may be allowed without indicating their purpose or their accounting, or that salaries shall be allowed for the purpose of dividing profits. In either event, salaries are purely a device of profit apportionment. Partners' salaries are not true business expenses. They do not affect the net income of a partnership. True economic gain or loss cannot be the result of transactions between proprietary interests.²

Each working partner should be entitled to a stated salary as compensation for his services just as each investing partner should receive interest on his capital investment. The general rule from a legal standpoint is that a partner

1 Finney, Principles of Accounting, Intermediate, p. 83

2 Johnson, Elementary Accounting, p. 360

is not entitled to compensation for services in carrying on the business, other than his share of the profits, unless such compensation is specifically authorized in the partnership agreement. However, this rule need not prevent recognition of an implied agreement to compensate an active partner for his services where profits are shared in the capital ratio and one or more partners are inactive.¹

Where a particular partner furnishes especially important services, the device of a bonus, usually expressed as a percentage of net profit, may be used as a means of providing additional compensation. It must be decided whether the bonus is to be considered as a current expense or a division of profits.

Perhaps the most equitable method of dividing profits is to fix each salary at a level commensurate with the worth of each partner's services to the business, to allow a reasonable rate of interest on the partners' capitals to compensate for unequal investments and divide all remaining profits equally.

Partners' Personal Accounts

A separate Partner's Loan Receivable and Partner's Loan Payable account should be set up on the ledger so as to keep transactions between the firm and its partners entirely separate from transactions between the firm and outside creditors and debtors. If a Partner's Loan Receivable account remains on the books for a considerable length of time and especially if it amounts to a considerable sum, it is best to remove it from the books by deducting it from the partner's capital and to consider it as a withdrawal of capital. This is advisable so that creditors are not given a false impression that the firm is operating with a certain capital when a substantial portion of it has been withdrawn.

¹ Rains v. Weiler, 101 Kan. 294

The personal accounts of the partners are debited with: withdrawals of cash, merchandise, or other assets, partners' salaries paid, payment by the partnership of the partners' personal obligations, and partnership funds collected and retained by the partners. They are credited with: partners' salaries owed, partnership obligations assumed or paid by the partners, and partners' personal funds collected and retained by the partnership. At the end of each accounting period, the balance of the partners' drawing accounts should be transferred to their related capital accounts.¹

The partnership cannot charge interest on drawings in excess of the agreed amounts unless there is an agreement to this effect. A partner can expect interest on a loan he has made to the partnership even though there is no provision for this matter as the law presumes that he made the loan with the expectation of receiving interest on it. This interest should be shown as a financial expense on the balance sheet as a matter of expediency.

¹ Johnson, Elementary Accounting, p. 358

PARTNERSHIP DISSOLUTION

General Considerations (Minor)

The words "dissolution" and "termination" are often used interchangeably in relation to a partnership. A dissolution of a partnership is a change in the relationship which results when one of the members ceases to be associated with the others in the operation of the business; Whereas a termination of a partnership includes the winding up of the affairs of the business.

Dissolution does not mean that the partnership is terminated immediately; the relationship continues until the winding up of the affairs of the firm is completed. No new contracts may be made and no new business undertaken other than that necessary to wind up the business. The liabilities of the partners continue until the final settlement.¹

In Kansas, whenever a partnership is dissolved, it is lawful for any of the partners to make a separate compromise with any or all of the creditors of the partnership. This compromise is a full discharge to the debtor only, of every liability to the creditor or creditors with whom the compromise is made. The partner making the compromise must obtain from the creditor or creditors with whom he is making the compromise, a written note or memorandum releasing him from all liability incurred by reason of his connection with the partnership. This written note or memorandum may be given in evidence by the partner to deny the creditor's right of recovery against him. If such a liability is in any court of record in Kansas, then the written note or memorandum, duly acknowledged by the parties making it before any officer authorized to take the acknowledgment of deeds, should be filed with the clerk

¹ Peters, Principles of Business Law, p. 216

of the court, and the clerk will discharge the judgment of record so far as the compromising partner is concerned.

Such a compromise with any individual member of a partnership firm must not be so construed as to discharge the other partners, nor shall it impair the right of the creditor to proceed at law or in equity against the members of the partnership firm who have not been discharged. The members of the partnership firm so proceeded against shall be permitted to set off any demand against the creditor or creditors which could have been set off had the suit been brought against all of the individuals composing the partnership firm. The discharge of an individual of a partnership firm does not prevent the other members of the firm from availing themselves of any defense at law or equity that would have been available had not the above act been passed, except that they cannot set up the discharge of one individual as a discharge of the other partners unless it appears that all were intended to be discharged. Such a compromise of an individual of a partnership firm with a creditor of the firm in no wise affects the right of the other partners to call on the individual making the compromise for his ratable portion of the partnership debts, the same as if the above law had not been passed.¹

From a legal point of view, the withdrawal of one or more partners or the admission of one or more new members has the effect of dissolving the original partnership and bringing into being a new firm. This means that the terms of the original agreement are not binding upon the successor partnership. As far as the continuity of the business enterprise is concerned, a change in the firm membership may be of only nominal importance. There may be no substantial difference between the new firm and its predecessor with respect to the character of the business, operating policies, relations with customers, etc.

To determine the value of the equity of a retiring partner, or the amount

¹ Corriek, General Statutes of Kansas, 1935, Sec. 56-201

to be paid for a specified share by an incoming partner, a complete inventory and valuation of firm resources may be required. There should be a careful adjustment of the partners' equities in accordance with the new relationships established.

A withdrawing partner may continue to be liable for firm obligations incurred prior to his withdrawal unless the settlement includes specific release therefrom. In Kansas, the dissolution of a partnership in on respect changes the liability of the partners to the creditors. Each is liable for the entire debt after the dissolution as fully as before the dissolution.¹

An incoming partner generally is liable only for the debts incurred by the firm of which he becomes a member. In Kansas, an incoming partner of a trading firm is not liable for the prior debts of the firm without a special promise, founded on a sufficient consideration; but such consideration may be the interest in the property of the firm received by him at the time he becomes a member.²

Changes in the personnel of a partnership may be caused by the retirement of a partner, the death of a partner, or by the admission of a new partner. Before the change in personnel is recorded, they close the books, credit each old partner with his share of the profits and transfer the balance of his Drawing account to his Capital account. Then, make entries to adjust the asset valuations in accordance with any agreements made in this respect. Gains or losses reflected by such adjustments should be divided among the old partners in their profit and loss ratio. The partnership may have developed a goodwill because of its successful operation. Goodwill is an asset, and, if a value is agreed upon, it may be recorded by an entry debiting Goodwill and crediting the old partners in their profit and loss ratio. Instead of crediting the

1 Medberry v. Soper, 17 Kas. 375

2 Rohlfing v. Carper, 53 Kas. 251

partners' Capital accounts in the entries adjusting the asset values and placing the goodwill on the books, the bookkeeper may credit the Capital Adjustments account which will then be closed by an entry dividing the net amount of all the adjustments among the partners.

Methods of Dissolution

In Kansas, every alteration which is made in the name of the partnership, the nature of the business, in the capital, or in its shares, or in any other matter specified in the original certificate, is considered a dissolution of the limited partnership. A limited partnership which is in any way carried on after the alteration is made, is considered a general partnership unless it is renewed as a limited partnership.¹

There are three general ways in which a partnership may be dissolved. They are:

(1) Act of the parties - The dissolution of a partnership may be effected by:

(a) Agreement - A partnership may be terminated in the same manner in which it was formed, that is, by an agreement. The partners have a right to agree to discontinue their relationship. The date of termination may be fixed at the time of the formation of the partnership or later. If no time limit is agreed upon, the relationship may be terminated at will without liability between the partners. In Kansas, when there is no contract for the continuation of the partnership for a certain time, it is always in the power of any one partner to dissolve the partnership at his own pleasure and for no other cause than that pleasure.²

¹ Corriek, General Statutes of Kansas, 1935, Sec. 56-113
² Blaker V. Sands, 29 Kas. 551

Upon the renewal or continuation of a limited partnership beyond the time originally agreed upon for its duration, a certificate must be made, acknowledged, recorded, and published in the same manner as for the formation of a limited partnership. The affidavit of one or more of the general partners must be filed with the proper county clerk as in the formation of a limited partnership. Every limited partnership which is not renewed or continued in conformity with the above provision, is considered to be a general partnership.¹

(b) Withdrawal - Although a partnership may be formed to do business for a definite time, a partner may withdraw before the expiration of that time and thus cause a dissolution. A partner has the power to dissolve the partnership in this way, but he may not have the right to do so. A partner has the power to break the contract; but if its breach is not justified, he will be liable for damages. No one can be compelled to be a partner against his will, but he must assume responsibility for his acts. In Kansas, any special partner may sell and transfer his share or any part of it in good faith to any person, with the written consent of all of the members of the partnership. The consent must be filed with the books and papers of the partnership and entered on a book of the partnership which is kept for this purpose. No transfer is valid until an endorsement is made of the transfer upon the certificate of the partnership and notice of the transfer entered on the margin of the page where the certificate is recorded.²

(c) The sale of the partnership business - If the business is sold for a lump sum, any profit or loss on the sale should be distributed to the partners in their normal profit and loss ratios. If the assets of the partnership have been appraised individually, the new valuations may be placed on the books through adjusting entries. This is not general practice, however. Instead,

1 Corrick, General Statutes of Kansas, 1935, Sec. 56-112

2 Corrick, General Statutes of Kansas, 1935, Sec. 56-113

the individual appraisals are incorporated into the explanatory data supporting the entry of sale. The difference, if any, between the price charged the purchaser and the book value of the net assets sold, is a profit or loss on the sale. It should be distributed to the partners in their profit and loss ratios. Any profit or loss on the disposal of the assets should always be divided between the partners before any cash distribution is made to them because the amounts of cash to which they are entitled cannot be determined until their shares of the profit or loss have been credited or charged to them. The profit or loss should be divided between the partners in their profit and loss ratio.

A partnership may be disposed of either by transferring the business as a unit or by the sale of the specific assets, followed by liquidation of the liabilities, and the dissolution of the firm. Such transactions may be based on book value or may be above or below the book value. If the assets are specifically revalued, preliminary entries to reflect the revaluation may be used, or the gain or loss may be recognized in connection with the closing out of the several items at book value. The entry to record the final distribution to the partners does not indicate the share of each partner in each of the assets distributed; by agreement among themselves, the partners may share these assets in whatever ratio they elect. The accountant should keep uppermost in mind the fact that partners are in business primarily to share the available assets in a manner calculated to give each partner, within the limits of his capital credit, his proper share of such loss or gain as is inherent in the assets distributed.

Partners wishing to wind up their business affairs, may prefer to sell the firm assets rather than to sell the business as a unit if a purchaser for the assets can be found. Under this procedure, the liabilities for which

the partners are personally responsible will be paid by the firm. Where a purchaser of the partnership assumes the firm liabilities, the partners are relieved of all responsibility only if written releases are secured from the creditors of the firm.¹

(d) Conversion of the partnership to a corporation - If a partnership is converted into a corporation, the conversion represents the sale of the net assets to the corporation. Instead of cash, the partnership generally receives stock in the corporation. The need to raise additional capital for a growing business is often a major explanation of the desire of a group of partners to incorporate their firm. Limited liability, continuity, and ready negotiability of interest are important features of the corporate form in this connection. For the corporation, new books may be opened or the books of the partnership may be continued after provision has been made for the new proprietorship structure and such additional adjustments as are necessary or desirable. A frequent fault in connection with the incorporating of partnerships, is the placing of unduly high values on the assets transferred, particularly on what is assumed to be the goodwill of the firm.

(e) Retirement or death of a partner - The capital account of the retiring partner, or the estate of the deceased partner, should be adjusted to record the present estimated valuation of the assets. Any gains or losses resulting from this revaluation, should be distributed to the partners' capital accounts in their profit and loss ratios. The balance of the retired or deceased partner's capital account is then transferred to a special accounts payable account.

(f) Liquidation of the partnership business - As a general rule, liabilities should be paid off first, then loans of partners, and finally, partners' capital accounts. Partners' unpaid salaries do not rank as preferred

claims, there being no bona fide employer-employee relationship. In no case, should any cash be paid to partners until all profits and losses have been distributed to the capital accounts and the right of offset has been applied.¹

When a partnership discontinues its business operations, the owner of the capital equity will normally be desirous of an early winding up of the firm's affairs in order that capital may be available for investment in new commercial undertakings or for other purposes. However, an immediate and final liquidation may not be possible or expedient. Winter, in his *Advanced Partnership and Corporation Accounting*, writes:

In many instances, as when the firm has been unprofitable over a period of years, when the firm is actually insolvent, when the purpose of the firm has become illegal because of legislative enactment, it may be wholly impossible to sell the business as a unit. In other cases, the partners may believe that a gradual winding up of the business will be less costly to them than the loss which they will experience if they accept the best bid which has been made for the business as it stands.

If gradual realization and liquidation is decided upon, one or more of the partners may be selected to carry out the process or the services of an outsider may be secured. It is the duty of this person to sell off the assets at the best prices obtainable and to distribute in lawful manner the proceeds of these sales. Cash should be distributed in the following order:

- (1) To creditors of the firm
- (2) To partners for loans or advances
- (3) To partners for capital investments
- (4) To partners in accordance with the profit and loss percentages for any balance remaining.

Creditors always take precedence over partners, but no partner should receive a cash payment from the liquidator unless that partner's capital and

¹ Johnson, *Elementary Accounting*, p. 394

other credits exceed that partner's share of the loss if no further distributions to partners are made. It is particularly important that the liquidator should pay all creditors' claims, or set aside funds from which to make such payments from the first receipts coming into his possession. A second important point is that he should not make any distribution to a partner whose claims are inferior to those of other partners. If he fails to observe these rules, the liquidator may be held personally responsible to creditors and to the offended partner.

(g) Consolidation of the partnership business - It sometimes happens that the members of two or more partnerships find it desirable to combine their enterprises into one business unit. Winters, in his *Advanced Partnership and Corporation Accounting*, makes the following comments:

The combination results legally in dissolution of the old firms and the formation of a new partnership. The agreement under which the new firm arises should set forth, among other things, the basis on which the assets of the old firms are to be valued for transfer to the new firm, the goodwill contribution, if any, of each old firm, disposition of cash balances, and the treatment to be accorded the liabilities and commitments of the old firms. The articles of partnership of the new firm will usually be similar to those of any firm of similar size and purpose and offer no special problem. A new set of books may be opened or the books of one of the old firms may be continued. The former procedure is usually favored. Old books which are not continued should be formally closed.

(h) Admission of a partner - When a new partner is admitted, a new partnership is created. The creation of the new partnership automatically dissolves the old one, since the agreement which bound the old partners is now superseded by a new agreement binding the new partner. Therefore, new articles of partnership should be drawn up, because the old articles cannot be assumed to bind the new partner, who was not a party to the old contract. A new partner may gain admission to the firm in either of two ways: by purchasing all or a portion of the interest of an old partner, or by making a contribution to the capital of the partnership.

No partner has a right to sell all or a portion of his interest in the capital of the firm without the consent of the other partners. The right to choose one's associates in a partnership is a fundamental right; if a partner attempts to sell his interest without the consent of the other partners, he dissolves the partnership and the purchaser does not become a partner. This is the rule under the common law which is somewhat modified by the Uniform Partnership Act. The purchaser obtains only the right to demand a settlement of the affairs of the firm and a payment of whatever interest may remain to him after the assets have been realized and the liabilities paid. Moreover, the partner who sells without consent is liable to his former partners for whatever loss they may sustain as a result of his action. Kansas law has decided that a partner may dispose of his interest in the partnership to a third person with the limitation that he cannot by such a transfer, introduce the purchaser into the firm without the consent of the other partners. In equity, the purchaser acquires the right to call for an accounting and settlement.¹ If the sale is made with mutual consent, a new partnership is formed. As the payment is made by the purchasing partner to the selling partner, the cash or other assets given in payment will not appear on the firm's books. The only entry required is one of transferring a capital credit from the account of the old partner to the account of the new one. Since the sale of one partner's interest dissolves the old partnership, new articles should be drawn up for the new partnership. It is particularly important that the new profit and loss sharing ratio be definitely agreed upon, because the dissolution of the old partnership cancels the old profit and loss sharing agreement. If an incoming partner purchases an interest in the business from more than one partner, there must be an agreement as to the portion of capital to be transferred by each partner.

¹ Jones v. Way, 78 Kas. 535

A new partner may gain admission to the firm by making a contribution to the partnership capital. The assets contributed are in this instance placed on the firm's books. It is essential that the assets thus contributed be properly valued, because any subsequent loss or gain on the sale of these assets becomes a partnership loss or gain and not a loss or gain of the contributing partner. As in the case of a withdrawal, the admission of a new member involves placing a value on a share of the firm capital, and this generally requires a complete valuation of the enterprise as a going concern. Under the common law, the assignment of a partner's interest dissolves the firm, but under the Uniform Partnership Act it gives the remaining partners a right to demand a dissolution. Thus, it is possible for a party to acquire the interest of a partner without becoming a partner. A member of a partnership may sell or assign his interest but unless this has received the unanimous approval of the other partners, the purchaser does not become a partner; one partner cannot force his copartners into partnership with an outsider. Under the Uniform Partnership Act, the buyer in such a case acquires only the seller's interest in the profits and losses of the firm. He has no voice in management nor may he obtain an accounting except in case of dissolution of the business; ordinarily he can make no withdrawal of capital without the consent of the partners. Under some statutes, however, the sale or attempted sale of an interest dissolves the partnership.

(2) Decree of court - There may be occasions when the partners deem it advisable to apply to a court to have the partnership dissolved. The court will act if there is a valid reason for its doing so. The reasons that generally give a partner the right to apply to a court for dissolution are:

(a) Misconduct of a partner - The gross misconduct of a partner affords justifiable ground for a dissolution. The misconduct must be of such a character

as to render his actions injurious to the business. Thus, habitual intoxication, conviction of a crime, or commission of fraud against the other members will be a valid reason for a court to interfere on behalf of the firm. A court will not interfere when the reason for the application is merely an error in judgment, or a minor violation of the partnership agreement.¹

(b) Inability of a partner to act or a breach of duty by him - If a partner becomes totally incapacitated and as a result cannot perform his duties, a court will issue a decree of dissolution. Likewise, long and continued absence from business, engaging in a rival business, and failure to furnish the agreed capital are other reasons.

(c) Impossibility of making the business successful - If success is impossible in the future conduct of the business, if the undertaking is impracticable or incapable of being put into operation, or if the operation of the business would result in serious financial loss or bankruptcy, a court will dissolve the partnership. If dissension among the partners becomes so serious that it is undesirable for them to continue the relationship, a legal dissolution can be secured.

(3) Operation of law - The chief causes that will dissolve a partnership by operation of law are:

(a) Death - The death of a partner dissolves the partnership. The remaining partners must settle the business affairs and distribute the assets to those entitled to receive them. In some states, if a partnership is formed for a definite time, the contract may fix a time during which the remaining partners are to wind up the affairs of the firm.²

1 Peters, Principles of Business Law, p. 217

2 Peters, Principles of Business Law, p. 218

(b) Bankruptcy - The bankruptcy of a partner or of the firm itself is cause for dissolution. Likewise, an assignment of the assets of the firm for the benefit of the creditors effects a dissolution. The inability of a partner to pay his debts as they become due is not in itself sufficient to dissolve the firm since his assets may exceed his liabilities.

(c) Illegality - If the purpose for which the partnership was formed, or if the association itself, is unlawful, the relationship will be dissolved.

Effect of Dissolution

Dissolution terminates the authority of any partner to act for the firm except that authority which may be necessary in winding up the affairs of the partnership or completing any unfinished business. It must be noted that, although dissolution terminates the authority of the partners to create new obligations, it does not discharge existing liabilities.

Notice of Dissolution

When a partnership is dissolved, a new firm is frequently established. Such a change may not become known to creditors or other third parties who have done business with the old firm. For the protection of these third parties, the law requires that in certain cases, they must be given actual notice of the dissolution.¹ If notice is not given, every member of the old firm will be held liable for the acts of the former partners which are committed within the scope of the new business.

¹ Peters, Principles of Business Law, pp 218-219

Notice of dissolution is usually given to former creditors by mail, and to other persons by publication. A Kansas court decision states that only those who are in the habit of dealing with a partnership are entitled to actual notice of its dissolution.¹ No particular form is required; the necessary information must, of course, be given. In some states the method of giving notice is regulated by law. In the following instances, notice is not considered necessary:

- (a) To those who were partners
- (b) When the partnership was dissolved by the operation of law.
- (c) When the partnership was dissolved by a judicial decree.
- (d) When a dormant or a secret partner retires.

In Kansas, no dissolution of a limited partnership can take place, except by operation of law, before the time specified in the certificate, unless a notice of the dissolution is filed and recorded in the office of the county clerk, in which the certificate was recorded and in the office of every other county clerk where a copy of the certificate was recorded. The notice must also be published four weeks successively in some newspaper printed in the county where the certificate of the formation of the partnership was recorded. If no newspaper is printed in the county at the time of dissolution, then the notice may be published in some newspaper of general circulation in the county.²

Change from Corporation to Partnership

During recent years there has been a growing feeling that the inherent advantages of the corporate form of organization are more than offset in many cases by the increasing disadvantages under which the corporation must operate,

1 Merritt v. Williams, 17 Kas. 287

2 Corrick, General Statutes of Kansas, 1935, Sec. 56-120

particularly with respect to the tax structure and other unfavorable legislative developments. As a result, there have been many instances where a tentative plan to incorporate has been abandoned and a considerable number of cases where small corporations have been converted into partnerships.¹

¹ Paton, Accountant's Handbook, p. 1262

ACKNOWLEDGMENT

The writer gratefully acknowledges his indebtedness to Professor T. D. Letbetter for his helpful suggestions and criticisms in the preparation of this thesis.

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Date Due

Date Due		
May 12 '58 X		
Apr 20 '59		
23 Apr '59 C		
May 27 '60 J		
Mar 3 '62 W		
Mr 15 '62 W		
FEB 28 1963		