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IMPLICATIONS OF TRANSFER OF A PROPRIETORSHIP CONCERN

Proprietorship Firm- Definition

1. A proprietorship firm is an unincorporated business run by a single individual, i.e., sole proprietor. The sole proprietor is the owner of the business andthe management and control lie with the firm.The sole proprietor is entitled to all profits and liable for all losses in the business and pays personal tax on the profits earned.

2. The assets and liabilities of a proprietorship firm lie with the sole proprietor. Unlike a company, a proprietorship firm is not a separate legal entity. Sole proprietorship is not registered. This means that all liabilities extend from the business to the owner.

3. It is stated that registration under Shop and Establishment Act of the state is required in which business is located.

Transfer of proprietorship firm

1. The sole proprietorship itself cannot be transferred; however the proprietorship firm can be transferred by transfer of ownership of assets of the firm. The method for same is either through execution of a gift deed, transfer by sale or inheritance.

2. By reason of the fact that the proprietorship firm and the proprietor are not distinct entities, and that sole proprietor is personally responsible for all aspects of the business, including its finances, debts, and liabilities, the legacy of the sole proprietor ends at the termination of the proprietorship. Legacy like IT record, or any Bank OD granted cannot be carried on in the name of the transferee. However, the assets and liability can be transferred. The transferee is thus deemed to be carrying on its own separate business with the assets of the transferor.

3. In case of transfer by agreement, the agreement should specify the purchase price, payment terms, the scope of assets being transferred, any liabilities being assumed, and any non-compete clauses if applicable.

4. The transfer may also assume the legal requirements of business licenses, permits, or registrations as the same do not stand transferred automatically. It may also include updating titles, registrations, or contracts as needed. The necessity of the same can be understood by a comparison with a One Person Company where the licenses are in the name of the company.Hence acquiring new licenses in case of transfer is not required while the license in case of proprietorship concern is in name of transferor and hence transferee has to register/obtain all permissions afresh in his/her name.

5. Even after the transfer, the original owner may have ongoing obligations, such as warranties or indemnities since the proprietor is personally liable for such acts.

Transfer of credentials of a sole proprietorship firm

1. Considering that the procedure for transfer of ownership is not statutorily defined, the terms of the transfer are guided by the terms and conditions agreed upon in the agreement/deed evidencing the transfer. Similarly, the credentials of the firm and the limit for such transfer may be dictated in the agreement.

2. However, whether such credentials will be accepted/considered to be valid by a third party will entirely depend on the nature of the credential in question.

3. The general opinion that the goodwill of a business, being an asset, may be transferred by a sole proprietor holds true since the assets of the firm are transferrable.

Conversion of sole proprietorship into partnership

1. A sole proprietorship may be converted into a partnership firm by addition of one or more partners for carrying on the business.

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2. In *Sitaram Motiram Jain vs Commissioner of Income-Tax, 1961 43 ITR 405 Guj*, the sole proprietorship was converted into a partnership and the sole proprietor assumed the role as one of the partners of the partnership firm. The Gujarat High Court relied on the deed of partnership to determine the rights and liabilities of the sole proprietor after the firm was converted into the partnership concern. The Court held that it appears that it was the intention of the parties to maintain the continuity of the business. In this respect, the Court also observed that what is to be considered is whether the business that had been originally carried on had been continued. In the present case, the same business was continued with only the change in persons carrying on that business. Thus, the identity of the business would not change merely by reason of the change in the persons who carry on that business.

3. In *Hassan Kassam v. Commissioner of Income-tax*, 1948 16 ITR 19 Patna, Division Bench of the Patna High Court took the view that where a business was carried on by an individual and thereafter, the same business was carried on at the same place by the same person in partnership with his sons, the same business is deemed to have continued, and that the identity of the business did not change.

4. However, the above-mentioned decisions are subject to the premise that proprietor should have continued the business as one of the partners in the partnership firm after conversion and the continuation should have been of the same business after conversion.

Conclusion

1. The legal premise on the limits of transfer of a sole proprietorship is not very clear because of absence of a legislative backing in this aspect.

2. Where a sole proprietorship has carried on business which is to be transferred to the son, the determination of the assets and liabilities is to be adjudged subject to the agreement between the parties.

3. For the specific purpose of carry forwarding the credentials earned by the proprietor by performance of tenders, the terms of the tender have to be relied upon. If the tender terms authorise the use of past credentials of the sole proprietor by a transferee, such credentials may be used for the purpose of qualifications of tender and if not, the transferee may have to establish the basis for claiming such right over the credentials.

4. Where the pre-qualification criterion is silent on the authority for use of such credentials, some of such basis for claiming continuation of credentials could be:

   - the involvement of the transferee in the business while it was being continued by the transferor,
   - the transferee/partnership firm carrying on the same business,
   - the nature of the tender does not refrain the use of credentials of transferor by the transferee, etc.

5. The logical conclusion, in the absence of statutory or judicial interpretations, also rests in favour of the fact that the tendering authority would be the decision maker on the question of allowing or disallowing the credentials of sole proprietor to flow to the subsequent owner of the business.

6. The decision must reasonably be dependent on the nature of the business. For instance, a business subsisting on an artistry of a particular person would not permit transfer of credentials to the transferee of the business while a business providing management services could restrictively permit the transfer of credentials because the nature of business is distinct and capable of being performed in the same manner by a different person sufficiently qualified or fit for the same.

7. The decision may however be amenable to challenge and subject to the interpretations of the courts where the challenge may have to be made directly to the tender terms.