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Sharing of Profits and Presumption of Partnership

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SHARING OF PROFITS AND PRESUMPTION OF PARTNERSHIP

This note attempts to consider a question as yet believed to be undecided by Pennsylvania Appellate Courts, namely, whether or not the plaintiff, in order to establish his prima facie case in a controversy relative to the existence of partnership between the parties, is required to submit not only evidence of a participation of profits but also that such participation has not been in lieu of debt, wages, rent, annuity or interest.

For a great many years, dating from decisions by Lord Mansfield in 1775 and De Grey, C. J., in *Grace vs. Smith,* 2 W.B. 998 in the same year, down through that precedent making decision in *Waugh vs. Carver,* 2 W. Bl. 235 in 1793 and continuing with some modifications until *Cox vs. Hickman* by Lord Cranworth in 1860, the rule of law in England had been,

> "A participation in the profits of a business does, of itself, by operation of law, constitute a partnership."

In *Cox vs. Hickman,* 8 H.L. Cas, 268, the present English rule that "the true test of the existence of a partnership is whether the trade or business has been carried on in behalf of the person sought to be charged," repudiated the century old basis of English decisions.

Fundamentally it is on this case and those subsequent to its pronouncement that a portion of the Uniform Partnership Act of 1915 is premised, viz., "partnership liability is restricted to cases of actual partnership, except estoppel and that the fact of sharing profits is *but one situation, not in itself conclusive,* to be considered *along with other* facts of the case, in determining the existence of a real partnership relation." (Crane and MaGruder on Partnership p. 59)

This ultimate adoption of the later English attitude on this question in the Uniform Partnership Act of 1915, despite decisions by the courts of Pennsylvania in *Purvince vs. McClintee,* 6 S & R 259, and *Edwards vs. Tracy,* 62 Pa. 374—obsequiously and consistently adhering to the *Waugh vs. Carver* doctrine, is a result of a gradual recognition by the Pennsylvania courts of the fundamental fallacy basic in that doctrine.

An awareness of that fallacy—"that he who takes part of the profits of trade is taking part of that fund upon which the creditor of the business relies for his payment"—was indicated in *Miller vs. Bartlett,* 15 S & R 137, *Dunham vs. Rogers,* 1 Pa. 255, *Ryder vs. Jacobs,* 182 Pa. 624, and *Kaufman vs. Kaufman,* 222 Pa. 58. It was strongly evidenced in the exceptions enacted in the Statutes of April 6, 1870 and June 15, 1871 in which profits taken as interest and wages respectively were determined upon proof presented to rebut such sharing as conclusive evidence of a co-partnership.

The ground work was laid therefore and the Pennsylvania Legislature in the Uniform Partnership Act of 1915, Mar. 26, P.L. 18 adopted the rules recommended by the codifiers.

Paragraph (1) of Sec. 6 provides—"A partnership is an association of two or more persons to carry on as co-owners a business for profit."

Sec. 7 is the provision relative to the issue herein under consideration. It provides that, "In determining whether a partnership exists, these rules shall apply: (1) except as provided by Sec. 16, persons who are not partners as to each other are not partners as to third persons." (Sec. 16 provides that as to relying third parties, a partnership relation may be held to exist on grounds of estoppel or holding out.)

In Sec. 7 paragraph (4) we find these words: "The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business *but no such inference* shall be drawn if such profits were received in payment (b) as wages of an employee. . ."

This brief review of the vicissitudes of a phase of partnership law in English and American Courts may assist us in determining the basic query. We can arrive at the following conclusions. *At one time,* (1) as to 3rd parties and creditors a sharing of profits was conclusive evidence of partnership, *without more;* (2) As between the parties a sharing of profits was prima facie evidence of a partnership rebuttable by proof of express pacts or agreements to the contrary or evidence of acts and conduct by the parties to the contrary. *At the present time,* as between the parties and as to creditors, exclusive of Estoppel, there is no distinction in the degree of proof required to establish a partnership relation. The test is "the real intention of the parties, and courts will look to the substance of the relationship and not the form of the agreement." *Thillman vs. Benton,* 82 Md. 64.

The history of this law therefore illustrates convincingly that as between the parties, when the plaintiff produced evidence of participation of profits he established a rebuttable presumption of a partnership; that the burden of going forward with the evidence then shifted to the defendant upon whom there devolved the necessity of producing evidence to establish (a) that there was no sharing of profits, or (b) that such sharing of profits was in lieu of wages, debts, interest, rent, annuities, etc.

Did the codifiers in the language of Sec. 7 intend that the plaintiff must produce evidence not only of *profit participation* but also that such sharing of profit was not in lieu of other purposes and agreements? Or was their purpose the restatement of the procedures to which heretofore the legal profession had adhered? The question can be a matter of some moment in a contested business relationship. It is very possible that there may be little or no actual evidence of any agreements or from the conduct of the parties of a partnership relation except the sharing of profits.

Suppose plaintiff A in his bill of complaint avers a partnership on the grounds of a sharing of profits and defendant B in his answer denies the alleged partnership claiming that A received a share of the profits as compensation for services rendered in the capacity of an employee. If, in order to establish his prima facie case, the plaintiff's burden of proof includes (1) a sharing of profits and (2) evidence of no employer-employee relation, then under the meagerly available evidence from the conduct of the parties the plaintiff's case falls. But if the plaintiff need show *only* a sharing of profits to establish a prima facie case, then the burden *not of proof* but of going forward with the evidence shifts to the defendant who must rebut the presumption of partnership with proof to the effect that the sharing of the profits of the business was in lieu of wages. Obviously under such a set of facts, if the latter is the interpretation of the statute, the advantage is clearly with the plaintiff or at least his burden is not so onerous.

In its ultimate analysis the question really is: *In the absence of proof to the contrary,* is the sharing of profits conclusive evidence of a partnership?

By the weight of authority the accepted view today is that the sharing of profits is not per se conclusive evidence of a partnership (20 Ruling Case Law 824) but that the real relationship may be shown from the agreements and the circumstances and all the facts involved. *Southern Can Co. vs. Sayler,* 152 Md. 303. A mere sharing of profits will not make the parties partners inter sese, whatever it may do as to third persons, *unless they so intend it.*

Whether or not a partnership exists is a question of fact and written articles of agreement are not necessary to prove a partnership; such a relation may exist under a verbal contract. *Mattei et al, vs. Masci Appellant,* 351 Pa. 93. However, the equity court will not enforce an alleged contract of partnership unless it is complete and certain in all its essential elements. *Beaver, Appellant vs. Slane,* 271 Pa. 317. The receipt of a share of profits of a business as compensation for services does not make the recipient a partner. *Frazier, Appellant vs. Mansfield et al.,* 305 Pa. 359.

While no one fact or circumstances can be taken as an unfailing criterion as to the existence of a partnership, still it does not appear that the courts will go so far away from their traditions on this question as to rule that in absence of proof to the contrary, a sharing of profits in itself does not establish a prima facie case, and if unsuccessfully assailed will not stand as conclusive evidence of a partnerhip.

In the case of *Gibbs Estate,* 157 Pa. 59, the Court said:

> "The best evidence of the existence of a partnership is the contract creating it. If proof of the contract is not within reach, its existence may be inferred from proof of contributions to the partnership stock. If direct proof of contributions cannot be had *it may be inferred from participation* in profits. Participation in profits is not conclusive proof of the existence of the partnership relations, Edwards vs. Tracy, 62 Pa. 374; but both in England and in this country it is cogent evidence

> upon the question. *It puts the defendant upon his proofs explanatory.* If he is able to show that such participation was referable to some other reason such as compensation for services rendered by him as agent, broker, salesman or otherwise, the *prima facie case is overcome.*"

We should be able to conclude therefore, at least from the historical aspect of the question, that the introduction by the plaintiff of evidence of a sharing of profits establishes his prima facie case and that the defendant must come forward with proof of participation in profits for purposes other than those of a partnership relation.

Aside from the historical view of this question there is considerable authority which lends itself favorably to the contention that the provision of Sec. 7, para. 4 of the Uniform Partnership Act raises a presumption of a partnership upon presentation of evidence of profit participation. However, in accordance with prevailing rules, the probative force of the circumstance is the not conclusive on the question and may be rebutted by a showing of fact to the contrary.[1] And if it is not so rebutted it is deemed sufficient to establish the fact of partnership.[2]

The Court in *Zenner vs. Goetz,* 324 Pa. 432, said:

> "It is seldom if ever, the duty of a litigant to prove a negative until his opponent has come forward to prove the opposing positive."

It is extremely doubtful therefore that Pennsylvania courts will hold that the words in para. 4, "and no such inference shall be drawn if such profits were received in payment: as wages to an employee . . ." — throw the burden of showing the fact of employment on the plaintiff. From the language context alone it seems logical that the codifiers intended a sharing of profits to be an inference of partnership rebuttable by evidence to the contrary.

The court in *Kruss vs. Guzy,* 36 Luz. Leg. Reg. Rep. 278 said:

> "The statute provides that receipt of a share of the profits of a business is prima facie evidence of a partnership. The allegations of the statement therefore *shift* the burden of proof to the defendant."

What this court meant was that the burden of going forward with the evidence shifted to the defendant. For Chief Justice Maxey said in *Zenner vs. Goetz,* supra:

> "A defendant's duty of coming forward with the evidence at certain stages of the trial is sometimes loosely referred to as the burden of proof. The burden of proof throughout the trial rests on the party affirming facts in support of his case against a defendant, while the burden of coming forward with the evidence may shift from side to side during the pro-

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[1] 47 Corpus Juris, Partnership, Sec. 63; In re Hayne, 277 Fed. 668; Martin vs. Peyton, 246 N. Y. 213; Lefeore vs. Silo, 96 N. Y. 321; Neserve vs. Andrew, 104 Mass. 360; Walker vs. Tupper, 152 Pa. 1.

[2] Fletcher vs. Palm, 133 Fed. 462; Martin vs. Peyton, 246 N. Y. 213; Towland vs. Long, 45 Md. 439.

> gress of the trial. It is well recognized principal of evidence that *he who has the positive of any proposition is the party called upon to offer proof of it.*"

Chief Justice Maxey also wrote the opinion in *Renes vs. McGoven,* 317 Pa. 302. In this case he cites the case of *Abrath vs. N. E. Ry. Co.,* 32 W.R. 50, 53 as standing for this proposition:

> "In every law suit somebody must go on with it; the plaintiff is the first to begin, and if he does nothing he fails. If he makes a prima facie case and nothing is done by the other side to answer it, the defendant fails. The test, therefore, as to burden of proof is simply to consider which party would be successful if no evidence at all was given, or if no more evidence was given than is given at this particular point of the case; because it is obvious that during the controversy in the litigation there are points at which the onus of proof shifts, and at which the tribunal must say, if the case stopped there, that it must be decided in a particular way. Such being the test, it is not a burden which rests forever on the person on whom it is first cast, but as soon as he, in his turn, finds evidence which, prima facie, rebuts the evidence against which he is contending, the burden shifts until again there is evidence which satisfies the demand. Now, that being so, the question as to onus of proof is only a rule for deciding on whom the obligation rests, of going forward further, if he wishes to win."

If a court should hold that the receipt by a plaintiff of a share of profits does not shift the burden of going forward with evidence to defendant upon evidence produced of such participation by the plaintiff, such decision would depend entirely upon a determination of the extent of proof necessary to set up a prima facie case:

> 1. If the act is to be so interpreted as to require the plaintiff to establish (1) sharing of profits, (2) no employee relation and (3) other circumstances of partnership relation, in order to set up his prima facie case then of course the burden of coming forward with the evidence will not shift to the defendant until such facts are amply shown.
> 2. If the act requires the plaintiff to show a sharing of profits only to set up his prima facie case then the burden shifts to the defendant to prove that the plaintiff was an employee and received a division of profits as wages.

The writer is inclined to the opinion, with some reservation, that from the historical development of this phase of partnership law, from the weight of authority by dicta in various cited cases, from the seemingly obvious intent of the codifiers in their language usage, and from the rules of evidence, that the plaintiff need but show a sharing of profits to establish his prima facie case and the burden then shifts to the defendant to bring forth evidence that such sharing was in lieu of wages, debt, interest or rent as the case may be.

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