

**IS THE ELEMENT OF SHARING PROFITS AMONG THE PARTNERS  
NECESSARY TO ESTABLISH A PARTNERSHIP? - A COMPARATIVE ANALYSIS  
BETWEEN COMMON LAW PARTNERSHIP AND THE SHARI'AH LAW**

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**ABSTRACT**

*Certain contemporary Shari'ah scholars claim that the British Partnership Act 1890, that is the governing law of Sri Lanka as well, resembles the rulings that administer shirkah (partnership) format under the Shari'a. It is therefore, the objective of the study is to explore the above claim by undertaking a comparative study between the Act and the relevant Shari'ah principles. Adopting library and online research methodology, the study in respect of the subject has revealed that, whereas there are parallels between two diverse laws, certain conflicts that are incompatible with the teachings of Shari'ah have been identified more specifically in terms of the definition of partnership. The conflicts identified to be incompatible with the principles of Shari'ah can be reconciled by introducing similar provision as arranged in section 246 of Sudanese Civil Transactions Act 1984.*

**Keywords:** Partnership, Shirkah, Shari'ah, Common Law

**1. Introduction**

Within Sri Lanka all matters, in respect of law of partnership, shall be administered in accordance with the law that would be administered in England in the like case".<sup>1</sup>

Thus the UK Partnership Act of 1890 is applied as the governing law of Sri Lanka in matters of partnership. While adopting the rules contemplated in the Act, Sri Lankan jurisdiction has

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<sup>1</sup> Section 3 of the Civil Law Ordinance No.5 of 1852 as quoted by Maheshwaran Pragash (2018), Partnership Law of Sri Lanka at <https://theshapeoflaw.wordpress.com/2018/07/16/partnership-law-of-sri-lanka/>

recognized the application of common law and equity principles relating to partnerships by substantiating the judgment delivered in the case of *Soosaipillai v Vaithilingam*<sup>2</sup>.

Whereas scholars claim that the provisions of British Partnership Act resembles the rulings that govern *shirkah* form of joint venture as described in the *Hedaya*<sup>3</sup>, judicial interpretations, related to certain provisions of the Act, portray that there are elements that do not in consonance with the Shari'ah.

This study would shed its light on the provision of the Act that defines the partnership with the opinions of relevant courts of common law jurisdictions in order to get familiarized with the stance of this law and then move on to Shari'ah perspective for its arrangements on the subject matter. This effort primarily aims at carrying on a comparative analysis between two diverse laws in order identify the status of the claim of scholars that the common law definition given to the partnership resembles the definition given to partnership in the *Hedaya*. The research would not extend its wings towards limited liability company as that is governed by different Act enacted for the purpose.

## 2. Partnership Defined

Section 1 (1) of the British Partnership Act 1890 provides for the definition of a partnership:

"Partnership is the relation which subsists between partners carrying on business in common with a view of profit." Section 3 (1) of Malaysian Partnership Act 1961 is the identical provision that defines partnership with similar set of wordings as in British Partnership Act. The definition has integrated three elements that have to be fulfilled by persons involved in such kinds of business activities if they want to be governed in accordance with this definition. Those are as follows;

- I. Business of the firm should be carried on by two or more persons.
- II. Business of the firm should be common to all partners of it.
- III. Business carried on by partners should be with a view of profit.

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<sup>2</sup> 37 NLR 381

<sup>3</sup> Afzal-Ur-Rahman 1982), *Economic Doctrines of Islam* Vol.iv (Banking and Insurance) Islamic Publication Ltd. p-302 He describes as "the similarity between British Partnership and *shirkat* is very real: the types of partners, their rights, duties and functions and obligations to third parties in respect of debts, etc., as laid down in the British Partnership Act of 1890 are more or less the same as described under *shirkat* in the *Hedaya*"

For a business partnership to be established under the Act, all these three elements have to be satisfied by the persons involved in such initiative.

### ***2.1 Carrying on a Business***

Section 45 of the British Partnership Act defines the "business" as virtually any activity of a commercial or professional nature is comprehended in this term. The activity need not be of a continuing nature since a single commercial adventure is clearly regarded by the Act as falling within its ambit<sup>4</sup>. The same view has been adopted by Malaysian courts as well; *Gulazam V Noorazman and Sobath*<sup>5</sup>. Plaintiff contributed necessary funds to purchase a cattle that was looked after by the defendant for the purpose of selling it for a profit to be shared among them. The plaintiff sought the assistance of the court, to recover his share of profit that was refused by defendant arguing the venture was not a partnership. Court held that the nature of relationship between the parties had the business character of a partnership. However, mere ownership of property in common from which profits are drawn is neither a partnership nor a joint adventure, since "property owning is not a trade"<sup>6</sup>. Section 3 (2) of Malaysian Partnership Act as well as section 2 (1) of British Partnership Act specifically excludes all types of limited liability company from the partnership genus. An investment carried on solely by trustees on behalf of investors do not fall under the definition "business"<sup>7</sup>

A single snap act, even if done by certain persons together, unless it involves some continuity, cannot be regarded as their business. Thus the act of two persons in joining their money together for effecting the purchase of a shipload of wheat was held to be not a business.<sup>8</sup> In the case of *Alexander v Long*<sup>9</sup> Lord Ellenborough CJ said: "If the parties be jointly concerned in the purchase, they must also be jointly concerned in the future sale, otherwise they are not partners." In the case of *Smith v Anderson*<sup>10</sup> Brett LJ said that:

“The expression ‘carrying on’ implies a repetition of acts, and excludes the case of an association formed for doing one particular act which is never to be repeated. That series of acts is to be a series of acts which constitute a business”.

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<sup>4</sup> Re Abenheim (1993) 109 L.T. 219.

<sup>5</sup> (1965) MLJ 65, High Court

<sup>6</sup> *Glasgow Heritable Trust V Inland Revenue*, 1954 S.C. 266 per Lord President Cooper at p 284

<sup>7</sup> *Smith V Anderson* (1880) 15 Ch D 247

<sup>8</sup> *Gibson V Lupton*, (1832) 9 Bing 297; 2 LJCP 4: 131 ER 626

<sup>9</sup> (1884) 1 TLR 145

<sup>10</sup> (1880) 15 Ch D 247; (1874-1880) All ER Rep 1121

Capital contribution is not necessary for the creation of a partnership. A person sharing profits for his labour without contributing to the capital can also be a partner.<sup>11</sup> So also is the contributor of tenanted premises for business purposes. He too becomes a partner. Such use of premises does not by itself amount to sub-letting.<sup>12</sup>

## ***2.2 Carrying on a Business in Common***

The final part of the definition in section 1 (1) of the British Partnership Act emphasizes that the business should be carried on in common meaning to state that the business of the partnership firm may be carried on by all of them or any of them acting for all. The requirement for a business to be carried on in common does not mean that all partners must participate in the conduct of the business, as some partners may be inactive. These inactive partners are commonly known as "silent" or "sleeping" partners.<sup>13</sup>

Thus, each partner is entitled to participate in managing the partnership business; a business may be carried on 'in common' even if not all partners take an active part in the business.

## ***2.3 With a view of Profit***

The element that is incorporated in the provision is that; the partnership business shall be carried on with a view of profit. So, for the existence of a partnership business, it is vital to establish that activities of the firm were with the intention of making profit and if the business is carried on without this intention no partnership would exist.

Does the above definition recognize a partnership that never resulted in making actual profit? The expression "with a view of profit" does not require the occurrence of a trading profit over any period a necessary requirement for the existence of a partnership. The definition refers to the point at which the parties first enter the association and at that stage no actual profit can have been made and profits can only be in the form of intention.<sup>14</sup> Consequently, an intention to gain profit is adequate to satisfy the requirements laid down in the definition to establish a partnership.

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<sup>11</sup> Avtar Singh 2003, Law of Partnership Commentaries on the Partnership Act with Practice Notes and Assessment of firms for Income Tax Purposes, Eastern Book Company, Lucknow, p-19

<sup>12</sup> Parkash Chand v Bhan Chand, (1995) 2 Punj LR 147

<sup>13</sup> Chia Sau Yin V Liew Kwee Sam (1960) 26 MLJ 122

<sup>14</sup> J.B. Miller p-6

The view adopted by the Malaysian Court in the case of Chooi Siew Cheong V Lucky Height Development Sdn Bhd<sup>15</sup> that an agreement to divide certain sub-lots of the land among parties involved in lieu of profits was held that there was no "with a view of profit".

The partners must intend that the outcome of the business association be profit, rather than just a sharing in the product of the enterprise. This requirement was referred to by Dawson J in United Dominion Corp Ltd.<sup>16</sup>

### 3. Sharing of Profits

There has been some academic debate on whether the division of profit is an essential component that has been envisaged in the definition of the Act. Different views of scholars in this regard have been discussed and the distinct views adopted by courts also have been focused for better understanding of the legal position. The section of the Act neither makes any express claim that the profits should be shared among the partners nor indicates any particular mode to distribute the profits derived from joint venture.<sup>17</sup> It has been suggested that the statutory definition implies a fourth element, namely, the element, "with a view of profit" only would not establish a partnership but the division of profit among themselves also is a necessary implied condition of the provision of the Act.<sup>18</sup> This opinion is rendered significant when profit sharing was supposed to be a vital factor as final test in determining the creation of partnership.<sup>19</sup> On the other hand the Act further specifies that sharing of gross returns does not of itself create a partnership.<sup>20</sup>

There are instances where, above claim of sharing of profit, to be a component of the definition, has been overlooked by certain jurisdictions. In *Stkel V Ellice*<sup>21</sup>, even where the condition to share the profits was absent it was held that there is a partnership as the partnership was formed with a view of profit. In this case one partner was a salaried partner and he was not entitled to share the profit.

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<sup>15</sup> (1995) 1 AMR 929

<sup>16</sup> (1985) 157 LLR 1, 60 ALR 741

<sup>17</sup> This view is further strengthened by sec 4 (c) of the Act, providing that sharing profits creates a prima facie evidence that they are partners.

<sup>18</sup> Pollock, *Digest of the Law of Partnership* (15th ed.) pp-et seq; as quoted by Miller J.B. (1994), *The Law of Partnership in Scotland*, (2nd ed.) Edinburgh: N. Green p.8

<sup>19</sup> *Grace v Smith* (1775) 2 Win blacks 997

<sup>20</sup> sec.4 (b), Malaysian Partnership Act 1961: sec 2(1) English Partnership Act 1890

<sup>21</sup> (1973) 1 All ER 465

Avoiding such ambiguity section 4 of Indian Partnership Act defines the partnership as "an agreement to share the profits" of a business. It has included two more points that are omitted in the English definition as well as the definition given by the Malaysian Partnership Act. The Indian definition makes it quite clear that persons interested in a partnership must agree to share its profits. The partners are required here to agree to distribute the profits among themselves in order to satisfy the requirement of the Act.<sup>22</sup> It is therefore, Indian courts considered that the element of sharing profits is an essential part of the partnership. However, they are not restricted from dividing the share either in proportion or to receive a fixed sum.<sup>23</sup>

Though the claim by scholars for the sharing of profits under partnership is to be inherent in the provision, the decisions of the courts had been contrary to the above notion. This very important element of the partnership has been omitted by the draughtsman of the Act either purposefully or unintentionally. This is because; there is authority for the proposition that at common law, participation in the profits earned by the association was regarded as of the essence of partnership before the passing of current partnership Act<sup>24</sup>. Since the provision that is subjected here projects obscurity in deciding the meaning of expression in terms of sharing profits, the judiciary would have to take charge of the duty to absolve the ambiguity as common law in general lies upon just decisions of the courts.

The contention that the sharing of profits is an implied element under the Act which does not apparently provide for was analytically examined by the courts when the issue arose with a view to reduce the ambiguity. The matter was clarified to some extent by the Court of Appeal in *M Young Associated Limited V Zahid*<sup>25</sup>. In this case the court held that a person receiving a fixed sum from a firm unrelated to the firm's profits could nevertheless be a partner. But only Hughes L.J. expressly addressed the issue as to whether a person receiving in the form of return from a firm could still be a partner. In his opinion, if the other essentials of a partnership were present,

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<sup>22</sup> *CST V K. Kelukutty* (1985) 4 SCC 35 The Supreme Court of India listed the components that have been integrated in section 4 of Indian Partnership Act that sets out the definition as follows "The components of the definition of partnership, and, therefore, of "a firm" consist of (a) persons (b) a business carried on by all of them or any of them acting for all, and (c) to share its profits."

<sup>23</sup> *Kundamal v Madan Gopal* AIR 1956 Hyd 27

<sup>24</sup> *Pooley V Driver* (1876) LR 5 Ch. D. 458 as quoted by J.B. Miller (1994), *The Law of Partnership in Scotland*, (2nd ed.) N. Green, Edinburgh p 08

<sup>25</sup> (2006) EWCA Civ 613, (2006) 1 WLR 2562

"the partners are free under the Act to arrange for remuneration of themselves in any manner they choose, including by agreement that one or more shall receive specific sums or that one or more receive nothing, in either case irrespective of profits"

The Court of Appeal in *Rowlands V Hudson*<sup>26</sup> however, took the view that the decision in *M Young Legal Associates* was that the receipt of a share of profits was not a pre-requisite of a claim to partnership because the Partnership Act 1890 has not integrated this element of sharing profits among the partners themselves. This was a requirement to be established previously; 'but the Act, while it speaks of "view of profit" says nothing about the profits being shared between the partners at all; and it has accordingly been suggested that under the Act persons who jointly carry on a business resulting in profit, though without any intention of dividing that profit among themselves'.<sup>27</sup>

Prior to the introduction of British Partnership Act 1890, sharing profit was a requirement for the existence of a partnership as the partnership was defined as "an agreement that something shall be attempted with a view to gain, and that the gain shall be shared by the parties to the agreement is the grand characteristic of every partnership."<sup>28</sup>

#### **4. Shirkah (Partnership) under Shari'ah**

Partnership contracts in Islamic law classically refer to contracts of shirkah and mudarabah. According to Islamic law both forms of partnership in fact constitute equity partnership and unlike common law partnership, both the modes have their own different sets of rulings according to their intrinsic characteristics. Additionally, contractual partnership (shirkah al-aqd) itself has more types such as shirkah al-mufawadha (unlimited partnership), shirkah al-wujuh (Credit partnership), shirkah al-a'mal (labour partnership) and shirkah al-inan (limited partnership). The research limits its scope of study to the mode of shirkah al-inan due to its suitability with the conventional partnership under common law.

##### **4.1 Definition**

Partnership in Islamic law is denoted by the word "sharikah" whereas the terminology "shirkah" is also used by jurists to signify the partnership. Countries where common law is applied as governing law of partnership have different sets of rulings for the partnership and

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<sup>26</sup> (2009) EWCA Civ 1025 (see Morse p. 26)

<sup>27</sup> Pollock (1920) Pollock's Digest (11<sup>th</sup> ed.) P.8; he was the great draftsman of the bill which became the Act of 1890.

<sup>28</sup> Lindley (1888), Lindley's Treatise on the Law of Partnership (5<sup>th</sup> ed.) p.1 and 2

companies while under Shari'ah both these forms are identified with the same terminology of sharikah. Despite of the fact that the Opinions of Muslim scholars never split in approving the legality of the partnership, they had different views on certain matters of this particular law.<sup>29</sup> Interpretation given to the terminology "sharikah" varies among the jurists of Islamic jurisprudence.

The nomenclature for partnership (sharikah) linguistically denotes the intermingling of capitals contributed by the parties that cannot be distinguished them separately. The very term was used as a common term by majority of jurists for every mode of partnership contracts even when the capital contributed can be distinguished individually. Therefore, the recognition of the capital without distinguishing one from the other is no more a requirement unless the contract so requires.<sup>30</sup>

The Hidayah stipulates that "Shirkah, in its primitive sense signifies the conjunction of two or more estates, in such manner, that one of them is not distinguishable from the other. The term shirkah, however is extended to contracts, although here be no actual conjunction of estates, because contract is the cause of the law it signifies the union of two or more persons in one concern."<sup>31</sup>

#### ***4.2 Sharing of Profits under Shirkah***

Wealth itself qualifies for entitlement to sharing profit realized from a business because the same wealth would bear the losses of the business if incurred. Therefore, the wealth alone does not make a partner entitled to share the profit but the liability tied with the wealth to share loss is also the reason that entitles him for profit. The risk in sharing loss is a main element for partners to form a partnership by employing their funds as their investment towards the partnership.

Profit sharing is a significant factor of a partnership business. Therefore, the contract must include the stipulations without any ambiguity in this regard. Otherwise, the contract would be rendered defective on the basis of following juristic views in this effect. The Hanafi School states that "the specific ratio of profits must be stated clearly. If this is left ambiguous, it leads to vitiation of legal effect of the partnership. The reason is that the primary object of the

<sup>29</sup> Ala Eddin Kharufa (2004), Transaction in Islamic Law, Published by A.S. Noordeen, p.169

<sup>30</sup> Ibn Al-Humam al Siwasi al Iskandari, Kamal al-Din Muhammad (1970), Fath al-Qadir ala al-Hidayah Sharh Bidayat al-Mubtadi, Vol.5, Cairo: Mustafa al-Babi al-Halabi p-2,

<sup>31</sup> Marghinani Ali Ibn Abi Bakr (1994), Translated by Charles Hamilton The Hedaya Vol. II, Commentary on the Islamic Laws, Darul Ishaat, Karachi-1, Pakistan . p. 540



contract is sharing of profits, and if this is not specifically stated, the legal effect of the contract is vitiated.”<sup>32</sup> Though there is no significance deviation from the above view in the work of Maliki school, Shafii jurists have different rulings in the division of profits. Accordingly, The Shafiis stipulate that “profit and loss must be strictly tied up with the ratio of investment, and not on the basis of the work carried on by the members of the joint venture. It does not matter, as far as the sharing profits is concerned, whether or not the partners contribute equal amounts of work. If this condition is violated, the partnership is void”.<sup>33</sup>

The distribution of profits should be set out as agreed by the partners at the time of effecting the contract, thereby they become entitled to share the profits in proportion as they settled. In the event of any defect in the contract, or in the absence of proper provision, the profits should be divided strictly in proportion to the capital arrangement and remuneration for work done should be paid.<sup>34</sup> This rule was formulated based on a Hadith: "Profits are shared as stipulated in the contract, while losses are shared in proportion to the capital shared."<sup>35</sup>

The matters discussed above have proved that there are different approaches among the jurists with regard to the sharing of profits. The Hanafis disallowed a contract that permits a partner either to collect entire profits or draw a major share in the profit by working less.<sup>36</sup> Though the rationale behind this is not discussed in detail, the ruling seems to circumscribe any exploitation that may be thrust upon the weaker party. Likewise, shafi-i jurists ruled that any condition that provides for a partner to collect total profits accrued and bears the entire loss incurred would render a partnership invalid. They contemplate that both profits and losses should be apportioned in the share of capital and any deviation from this principle i.e. failing to share the profits and loss in proportion to the capital then the partnership would be considered invalid.<sup>37</sup> Shafi-i view is more rigid in this regard whereas a flexible opinion has been expressed by Hanafi jurists.

Partnership law that governs partnership in Sudan (previously English law) defines a partnership as “a contract by which each of two or more persons, being the parties to such

<sup>32</sup> Al-Kasani, *Bada'i al-Sana'i*, vol.7, p. 3541 as quoted by Imran Ahsan Khan Nyazee, (2006). *Islamic Law of Business Organization- Partnership*, Kuala Lumpur: The Other Press, p. 136

<sup>33</sup> Al-Sarakhsi, *al-Mabsut*, vol.11, p. 152, *ibid*, Imran Ahsan Khan Nyazee p. 208

<sup>34</sup> Shamsuddin Muhammad bin Ahmad Al-Khatib Al-Shirbini (Shafi i), *Mughni al Muhthaj ila Ma'rifati Ma'ani al Fal il-Minhaj Dharul Qutub al-Ilmiyyah*, Beirut 1994 (1<sup>st</sup> ed.) vol.3, pp. 228-229

<sup>35</sup> Al-Hafiz Al Zaylai, (1st ed.), *hadith*, vol. 3. p. 475

<sup>36</sup> Wahbah Zahayli, p. 466.

<sup>37</sup> Al-Khatib Al-Shirbini (Shafi-i), vol. 3, pp. 228-229.

contract, obliges himself to provide his share of capital or labour in an investment business, (Mashru' mali), in order to take part that investment and to share with his co-partners its profits and losses.”<sup>38</sup> It is clear that the definition adopts that of the Hanafi school.<sup>39</sup> This arrangement is clear manifest that, sharing profits, among the partners, is an integral part of the definition of the partnership.

## 5. CONCLUSION

It is evident that, prior to legislating the current British Partnership Act 1890, sharing profits, among the partners, was an integral part of the definition of the partnership and when the latest enactment was legislated, this very element was purposely not included to the definition of the partnership. Therefore, a joint venture established with a view of profits, under common law principles, would be sufficient to prove a valid partnership even when the profits are not shared among the partners. This arrangement does not in conformity with the Shari'ah rulings in relation to the definition of partnership as Shari'ah requires the profits to be shared among the partners. To avoid the ambiguity, the definition given in Sudanese partnership law is recommended.

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<sup>38</sup> Section 246 of the Civil Transactions Act 1984, under section 3 of the Act further states that the court must in the application and interpretation of that Act apply principles of Islamic law. The Court must also do so in the absence of a provision as well.

<sup>39</sup> Al Mejella Article (1329) as stated by El Gaily Ahmed El Tayeb, Principles of Partnership Law in Malaysia, International Law book Services, KL, p. 72

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