Partnership Accounting

- Partner Capital Accounts -

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Capital Accounts

• A partnership keeps track of each partner’s economic investment in the partnership through a financial record called a capital account.
Capital Accounts

• A partner’s opening capital account balance generally equals the value of his contribution to the partnership – (i.e. cash plus the net value of any contributed property).
Capital Accounts

• Example: Partner A contributes $100 and a truck with a FMV of $50 to form the AB partnership.

• Therefore, Partner A’s capital account balance will be $150. ($100 Cash + $50 Truck (FMV))
Capital Accounts

• As the partnership continues in existence, the capital account increases or decreases to reflect a partner’s share of partnership income or loss and withdrawals.
Capital Accounts

• **Increase in Capital Account**

  Generally,
  
  1. Income
  2. Gains
  3. Capital Contributions

  increase a partner’s capital account.
Capital Accounts

• Decrease in Capital Account
  
  Generally,
  
  1. Losses
  2. Capital Distributions

  decrease a partner’s capital account.

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Capital Accounts

• Example 1:

A and B form the AB partnership.
A contributes: $100 cash (+)
    $ 50 truck (+)
$100 cash to purchase inventory for partnership.

B contributes: $200 cash (+)
    $ 50 equipment.
## Capital Accounts

- Upon Formation, the AB Balance Sheet is as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 400</td>
</tr>
<tr>
<td>Equipment</td>
<td>$ 50</td>
</tr>
<tr>
<td>Truck</td>
<td>$ 50</td>
</tr>
</tbody>
</table>

**Total Assets** $ 500  
**Total L & E** $ 500
# Capital Accounts

- A & B’s Capital Accounts are as follows:

<table>
<thead>
<tr>
<th>Partner A</th>
<th>Partner B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Cash</td>
</tr>
<tr>
<td>$ 200</td>
<td>$ 200</td>
</tr>
<tr>
<td>Truck</td>
<td>Equipment</td>
</tr>
<tr>
<td>$ 50</td>
<td>$ 50</td>
</tr>
<tr>
<td>Balance</td>
<td>Balance</td>
</tr>
<tr>
<td>$ 250</td>
<td>$ 250</td>
</tr>
</tbody>
</table>

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Capital Accounts

- Both Partners A and B’s capital account balances are $250 each respectively.

- Upon formation each partner owns a 50% interest in the partnership.

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Capital Accounts

Partnership Ownership % - Year 1

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Capital Accounts

Example 2:

- Assume in Year 2 that the AB Partnership has $100 of income, and makes a $60 cash distribution to Partner A.
## Capital Accounts

- A & B’s Capital Accounts are shown as follows:

<table>
<thead>
<tr>
<th>Partner A</th>
<th>Partner B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Balance</td>
<td>Beginning Balance</td>
</tr>
<tr>
<td>$ 250</td>
<td>$ 250</td>
</tr>
<tr>
<td>Income (+)</td>
<td>Income (+)</td>
</tr>
<tr>
<td>$ 50</td>
<td>$ 50</td>
</tr>
<tr>
<td>Distribution (-)</td>
<td></td>
</tr>
<tr>
<td>$ 60</td>
<td></td>
</tr>
<tr>
<td>Ending Balance</td>
<td>Ending Balance</td>
</tr>
<tr>
<td>$ 240</td>
<td>$ 300</td>
</tr>
</tbody>
</table>

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Capital Accounts

- Partners A and B have different ending capital account balances.

- Upon formation, each partner owned a 50% interest in the partnership.

- At the end of Year 2, Partners A and B’s ending capital account balances are $240 and $300 respectively.

- Partner A’s ownership percentage in the AB partnership decreased as a direct result of her distribution from the partnership.
Capital Accounts

Partnership Ownership % - Year 2

55.6%  
44.4%

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Capital Accounts

Example 3:

• Assume in Year 3 that the AB Partnership has a $100 loss and Partner B makes a $100 cash contribution to the AB Partnership.

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Capital Accounts

• A & B’s Capital Accounts are shown as follows:

<table>
<thead>
<tr>
<th></th>
<th>Partner A</th>
<th>Partner B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Balance</td>
<td>$ 240</td>
<td>$ 300</td>
</tr>
<tr>
<td>Loss (-)</td>
<td>$ 44</td>
<td>$ 56</td>
</tr>
<tr>
<td>Contribution (+)</td>
<td>$ 100</td>
<td>$ 100</td>
</tr>
<tr>
<td>Ending Balance</td>
<td>$ 196</td>
<td>$ 344</td>
</tr>
</tbody>
</table>

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Capital Accounts

- At the end of Year 3, Partner A owns a 36.3% interest and Partner B owns a 63.7% interest in the AB Partnership.

- Both Partners A and B’s ending capital account balances are $194 and $344 respectively.

- Both partners’ ownership percentage in the AB partnership changes as a direct result of Partner B’s cash contribution to the partnership.
Capital Accounts

Partnership Ownership % - Year 3

- Partner A: 36.3%
- Partner B: 63.7%

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Ownership % as reflected on Partner's tax returns, Form K-1.
Capital Accounts

• Summary

• Partnership capital accounts reflect a partner’s economic investment

• The value of a partnership interest can be determined assuming a hypothetical sale of the partnership assets at their fair-market value

• A partner who contributes more, generally owns more of the partnership interest than the partner who contributes less.