

E 14-1

Facts

Capital	BV	Share	Tax Base
Riley	500000	60%	425000
Smith	400000	40%	330000
Total	900000		755000

Assets	Book	FMV
Land	15000	55000
Other	885000	885000
Total	900000	940000

Tyler's contribution		FMV	Basis
Cash	170000	170000	
Equipment	80000	42000	
Total	250000	212000	

Key trick is to recall identities:

OE = Net Assets = Assets - Liabilities.

Also

To solve the problem, what info do we need?

Thus for instance,

For Bonus method: Have any assets lost value?

Why? Because rest follows mechanically from the shares.

Look at it this way: once we know the asset base and the new partner's share we can compute the bonus.

How? Bonus = New partner payment - new partner share * new asset base

Here Tyler pays \$250,000 for 20% of a partnership with assets of BV \$1,150,000. What is the bonus?

His share is 20% of \$1,150,000 = \$230,000. He pays in \$250,000. What is the bonus to Riley and Smith?

Basically Tyler has to pay part of the \$250,000 for assets not in the books and that is what is taken off the top from his payment and credited to Riley and Smith. Accounting reflects the economics.

Bonus method (historical cost, no revaluation)

Step 1	New Partnership Assets		1150000	
Step 2	Total Partner Capital		1150000	<==
			!!	
			!!	
			!!	
			!!	
			!!	
Step 3	* Computation of Bonus			!!
	Tyler's share of capital	20%		!!
Step 4	Partnership asset base		1150000	<==
	Tyler's imputed capital		230000	<=== 20% of Partnership asset base
Step 5	Bonus to old partners		20000	<=== Difference between Tyler's imputed
Step 6	New Capitalization			capital and the amount he paid in
		Original	Bonus*	Net
	Riley	500000	12000	512000 <=== 60% of \$20,000
	Smith	400000	8000	408000 <=== 40% of \$20,000
	Tyler	250000	-20000	230000
	Total Partner Capital			1150000

Entry

Dr.	Cash	170000	
	Equipment	80000	
Cr.	Riley		12000
	Smith		8000
	Tyler		230000

Balances

Riley	512000
Smith	408000
Tyler	230000

Goodwill method (with revaluation)

Step 1	Tyler pays 250000 for a	20% interest		
	Imputed value of entire firm	1250000		
Step 2	FMV of old assets	1000000		
	BV of old assets	900000		
	Gain	100000		
	Of which Land	40000		
	Hence Goodwill	60000		
Step 3	Riley's share of appreciation	60000		
	Smith's share of appreciation	40000		
Step 4	New Capitalization			
		Original	Bonus*	Net
	Riley	500000	60000	560000
	Smith	400000	40000	440000
	Tyler	250000	0	250000
	Total Partner Capital			1250000

Entry

Dr.	Land	40000	
	Goodwill	60000	
	Cash	170000	
	Equipment	80000	
Cr.	Riley		60000
	Smith		40000
	Tyler		250000

Balances

Riley	560000
Smith	440000
Tyler	250000