PARTNERSHIP ACCOUNTS

Definition :

Section 4 of Indian Partnership Act defines the term "Partnership" as "the relation between the persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

From the above definition, the following points can be deduced :

1. The persons forming partnership are individually called '**partners**' and collectively a '**firm'.**
2. The name under which the business is carried on is called **'firm name'**.
3. Since partnership is relation between **persons**, it means that minimum two persons are required to form a partnership. Maximum no. of partners is 10 in case of banking business and 20 in case of general business (Section 11).
4. A partnership is formed by an agreement. It may be **oral or in writing**. It may be **express or implied**. However it is desirable to have it in writing so that in case of dispute, it may be readily referred to. A document containing terms of partnership agreed among the partners and **properly stamped** is called **"partnership deed"**.
5. Definition uses the term "to share the profits" which shows the **basic intention** behind running the partnership business i.e. profit motive. However, if there is a loss, it will be borne by all the partners in the **agreed ratio or equally** as the case may be.
6. There must be the existence of some business.
7. The partnership business may be carried on by all the partners or any of them acting for all. Perhaps, it is the most important characteristic of partnership. It is known as principle of **"Mutual Agency"**. As per this principle, every partner is an agent of the other partners in so far as he carries on the business on behalf of the other partners. Further, every partner is a principal in respect of other partners carrying on business in his behalf. Hence, every partner is a **principal as well as an agent** in relation to other partners.

Application of provisions of section 13 where there is no partnership deed or the Partnership deed is silent :

a)	Salary to partner	Not allowed u/s 13(a)
b)	Profit sharing	Equal u/s 13(b)

c)	Interest on capital	Interest not allowed u/s 13(c)
d)	Interest on drawings	No interest on drawings is to be charged
e)	Interest on advances	6% per annum simple interest u/s 13(d)

Methods of maintaining Capital Account :

There are two methods of maintaining Capital Account - Fixed Capital Method and Fluctuating Capital Method.

Fixed Capital Method :

Under this method, two accounts are maintained, viz, Capital account and current account. Fixed capital contribution is credited to capital account. Capital account **can never show a negative balance**. All the entries relating to interest on capital/drawings, commission, salary etc. to partner, share of profit are credited to a separate account called current account. Current account **may show positive or negative balance.**

Fluctuating Capital Method :

Under this method, only one account, partners' capital account is opened. All the entries relating to interest on capital/drawings, commission, salary etc. to partner, share of profit are credited to capital account. Capital account under this method **may show positive or negative balance**.

Interest on capital / Remuneration etc to partner :

It is expenditure for the firm but income for the concerned partner. Hence, it is shown on the debit side of Profit and Loss appropriation account and credit side of partners capital / current account. Normally interest on capital is allowed on the opening capital for the full year unless there is introduction of fresh capital during the year under fluctuating capital method. Under fixed capital method, interest on capital is allowed on fixed capital balances only ignoring current account balance. The following entries will be passed for interest on capital / remuneration etc. to partner :

Salary to partner / Interest on capital :

Interest on Capital / Salary to Partner A/c	Dr.	XX	
To Partner's Capital / Current A/c			XX
Profit and Loss Appropriation A/c	Dr.	XX	
To Interest on Capital / Salary to Partner A/c			XX

Net Loss and Interest on Capital :

Subject to contract between partners, interest on capital is provided out of profits only. In case of loss, no interest is provided. But in case of insufficient profits, amount of profit is distributed in the ratio of capital as partners get share of profit by way of interest on capital only.

Interest on Drawings :

(a) If withdrawals are made in the beginning of each month, interest on drawings will be calculated for 6½ months.

(b) If withdrawals are made in the end of each month, interest on drawings will be calculated for 5½ months.

(c) If withdrawals are made in the middle of each month or if the questions says that withdrawals are made evenly throughout the year, interest on drawings will be calculated for 6 months.

Guaranteed Partner :

Guaranteed partner is a person who enjoys the right to have atleast some minimum profit in a year as per the terms of partnership agreement. Exces of the minimum profit over his normal share of profit will be borne by the remaining partners giving the guarantee in the agreed ratio or PSR. If his share of profit is more than the minimum amount, he will take his share of profit and not the minimum amount of profit.

Effective capital :

It is calculated as amount of capital X period for which it remained into business

Goodwill Adjustment on admission :

Goodwill

Goodwill does not appear in books of account

(1) Goodwill brought in cash

(a) Goodwill bought in cash :

Cash / Bank A/c Dr. XX
To Goodwill A/c XX

(b) Amount of (a) above distributed among old partners in ROS :

Goodwill A/c Dr. XX
To old partners cap A/c XX

(c) If amount of goodwill withdrawn :

Old partners cap A/c Dr. XX
To Goodwill A/c XX

(2) Incoming partners share of goodwill raised

Incoming partners cap A/c Dr XX
To Goodwill A/c XX

Goodwill A/c Dr. XX
To old partners cap A/c XX

Old partners cap A/c Dr. XX
To Goodwill A/c XX

(3) Total Goodwill raised

(a) G/W raised in old PRS :

Goodwill A/c Dr. XX
To old partners cap A/c XX

(b) G/W written off in new PSR:

All partners Cap A/c Dr. XX
To Goodwill A/c XX

Goodwill appears in books of account

(a) Book value of G/w < market value
Difference = raised

Goodwill A/c Dr. XX
To old partners cap. A/c XX

(b) Book Value > Market value
Difference = written off

Old partners Cap A/c Dr XX
To Goodwill A/c XX

(c) Book Value = Market value
No adjustment Entry required

Notes :

(1) If the incoming partner pays amount of goodwill privately to the other partners, no entry will be passed in the books of the firm.

(2) If amount of goodwill appears into the balance sheet and new partner brings goodwill in cash Then take following two steps :

(a) Write off the book value of goodwill

(b) Pass entries for goodwill brought in cash

(3) Inferred goodwill / Hidden Goodwill :

When the question gives combined amount of capital and goodwill brought in by the incoming partner, the amount of goodwill brought is calculated as under :

Estimated capital of the firm (amount brought in by incoming partner X reciprocal of his share)	XX
Less : Existing capital of the partners including amount brought in by incoming partner	XX
Hidden Goodwill	XX