

§ 10:10. Another short form definition of “Capital Account”..., Draft. Partn. and LLC...

---

**Draft. Partn. and LLC Allocation Provisions § 10:10**

Drafting and Understanding Partnership and LLC Allocation and Distribution Provisions | May 2017 Update  
Terence Floyd Cuff

Chapter 10. Capital Accounts  
II. Drafting Capital Account Definition

§ 10:10. Another short form definition of “Capital Account” based on the Allocation Regulations

Clause 2 is another short definition of “Capital Account” that relies heavily on the Treasury Regulations:

*Clause 2. Section x.x. Capital Account.*

*(a) “Capital Account” of a Member means the capital account of that Member determined in accordance with the rules set forth in Section 1.704-1(b)(2)(iv) of the Treasury Regulations.*

*(b) The Company will adjust Capital Accounts upon an event described in Sections 1.704-1(b)(2)(iv)(e) and (f)(5) of the Treasury Regulations, in the manner described in Sections 1.704-1(b)(2)(iv)(e), (f) and (g) of the Treasury Regulations, if the Company determines that the adjustments are necessary or appropriate.*

*(c) A Membership Interest may be transferred pursuant to the terms of this Agreement. In that event, the transferee will succeed to the Capital Account and the respective Percentage of the Transferor to the extent that the Capital Account and Percentage is attributable to the Membership Interests so Transferred.*

Some advisors use considerably more detailed definitions of “capital account.” These longer definitions have the virtue of being longer, if that is a virtue. These longer definitions may not be more serviceable than the short definitions in Clause 1 or Clause 2. Long definitions also provide abundant opportunities to make errors. That can make using longer definitions considerably more exciting (and expensive) than using short definitions. Some drafters prefer a long, detailed definition of “Capital Account” because they consider these long, detailed definitions *muy macho*.

Westlaw. © 2017 Thomson Reuters. No Claim to Orig. U.S. Govt. Works.

End of Document

© 2018 Thomson Reuters. No claim to original U.S. Government Works.

§ 10:11. Longer form definition of “Capital Account” based..., Draft. Partn. and LLC...

**Draft. Partn. and LLC Allocation Provisions § 10:11**

Drafting and Understanding Partnership and LLC Allocation and Distribution Provisions | May 2017 Update  
Terence Floyd Cuff

Chapter 10. Capital Accounts  
II. Drafting Capital Account Definition

§ 10:11. Longer form definition of “Capital Account” based on the Allocation Regulations

The definition of Capital Account in Clause 3 incorporates principles of the Allocation Regulations concerning partnership allocations and provides a medium-length definition of “Capital Account”:

*Clause 3. Section x.x. Capital Account. “Capital Account” of a Member means the capital account of that Member determined strictly in accordance with the rules set forth in Section 1.704-1(b)(2)(iv) of the Treasury Regulations.*

*Subject to the foregoing, these rules will control Capital Accounts:*

*(a) The Company will increase each Member's Capital Account by all items that increase capital accounts under Treasury Section 1.704-1(b)(2)(iv), including (without duplication)—*

*(1) The amount of money contributed by the Member to the Company,*

*(2) The fair market value of Property contributed by the Member to the Company (net of liabilities that the Company is considered to assume or take subject to), and*

*(3) Allocations to the Member of Company “book” income and “book” gain (or items of “book” income and “book” gain), including “book” income and “book” gain exempt from tax; and*

*(b) The Company will decrease each Member's Capital Account by all items that decrease capital accounts under Treasury Section 1.704-1(b)(2)(iv), including (without duplication)—*

*(1) The amount of money distributed to the Member by the Company,*

*(2) The fair market value of Property distributed to the Member by the Company (net of liabilities that the Member is considered to assume or take subject to),*

*(3) Allocations to the Member of expenditures of the Company described in Section 705 (a)(2)(B), and*

*(4) Allocations of Company “book” loss and deduction (or items of Company “book” loss and deduction).*

*(c) A Member who has more than one interest in the Company will have a single Capital Account. That single Capital Account will reflect all of the Member's interests in the Company. This rule in this paragraph (c) will apply regardless of the class of interests owned by the Member. This rule in this paragraph (c) will apply regardless of the time or manner in which the interests were acquired.*

*(d) References to “liabilities” for liabilities assumed before June 24, 2003, include only liabilities secured by the contributed or distributed Property that are taken into account under Section 752(a) and (b).*

*(e) The Company may determine that the adjustments to Capital Accounts are necessary or appropriate upon an event described in Sections 1.704-1(b)(2)(iv)(e) and (f)(5) of the Treasury Regulations. In that event, the Company will make these adjustments to Capital Accounts in the manner described in Sections 1.704-1(b)(2)(iv)(e), (f) and (g) of the Treasury Regulations.*

§ 10:11.Longer form definition of “Capital Account” based..., Draft. Partn. and LLC...

---

*(f) A Membership Interest may be transferred pursuant to the terms of this Agreement. In that event, the transferee will succeed to the Capital Account and the respective Percentage of the Transferor to the extent that the Capital Account and Percentage is attributable to the Membership Interest so Transferred.*

Westlaw. © 2017 Thomson Reuters. No Claim to Orig. U.S. Govt. Works.

---

End of Document

© 2018 Thomson Reuters. No claim to original U.S. Government Works.

Purchase Agreement; (ii) Equity Securities of the Company or any of its Subsidiaries in connection with the redemption in full or liquidation of all of the Class B Preferred Units; (iii) obligations, evidences of Indebtedness or other securities or interests convertible or exchangeable into Units or other equity interests in the Company or its Subsidiaries; or (iv) Equity Securities offered to the public pursuant to a registration statement filed under the Securities Act, including pursuant to an IPO, that has been approved in accordance with the terms of this Agreement.

(g) If any regulatory approval, including the filing and the expiration of any waiting period under HSR Act, is required prior to the issuance of any Equity Securities (assuming the exercise of the rights of the Preemptive Rights Holders under this **Section 3.3**), the Company shall not issue such Equity Securities until such approval has been obtained (or in the case of the HSR Act, such filing has been completed and such waiting period has expired). The Company and the Members shall use their commercially reasonable efforts to comply promptly with all applicable regulatory requirements in connection with the issuance of Equity Securities by the Company and the purchase thereof by any Preemptive Rights Holder exercising such Preemptive Rights Holder's rights pursuant to this **Section 3.3**.

### **Section 3.4 Capital Accounts.**

(a) The Company shall maintain a separate Capital Account for each Member according to the rules of Treasury Regulations Section 1.704-1(b)(2)(iv). For this purpose, upon the occurrence of the events specified in Treasury Regulations Section 1.704-1(b)(2)(iv)(f) (including a transaction to redeem any Class B Preferred Unit pursuant to this Agreement), the Book Value of each asset of the Company immediately prior to the occurrence of such event shall be adjusted upward or downward to reflect any unrealized gain or unrealized loss attributable to such asset. Any such unrealized gain or unrealized loss shall be treated, for purposes of maintaining Capital Accounts, as if it had been recognized on an actual sale of each such property for an amount equal to its Fair Market Value immediately prior to such event and had been allocated to the Members at such time pursuant to **Section 4.5**. In the event, however, of (i) an issuance of Units for a de minimis amount of cash or contributed property, (ii) a Distribution of a de minimis amount of cash or property to a Member, or (iii) an issuance of Units as consideration for the provision of a de minimis amount of services, the Board in its reasonable judgment may determine that such adjustments are unnecessary for the proper administration of the Company. With unanimous prior approval of the Board (excluding any Independent Manager), the Company may determine that no adjustments shall be made pursuant to this **Section 3.4(a)**.

(b) For purposes of computing the Profits or Losses of the Company for any period, and any item of the Company's income, gain, loss or deduction to be allocated pursuant to **Article IV** and to be reflected in the Capital Accounts, the determination, recognition and classification of any such item shall be the same as its determination, recognition and classification for federal income tax purposes (including any method of depreciation, cost recovery or amortization used for this purpose); *provided, that*:

(i) the computation of all items of income, gain, loss and deduction shall include those items described in Code Section 705(a)(1)(B) or Code Section 705(a)(2)(B) and Treasury Regulations Section 1.704-1(b)(2)(iv)(i), without regard to the fact that such items are not

includable in gross income or are not deductible for federal income tax purposes;

(ii) if the Book Value of any the Company's property is adjusted pursuant to Treasury Regulations Section 1.704-1(b)(2)(iv)(f), the amount of such adjustment shall be taken into account as gain or loss from the disposition of such property;

(iii) items of income, gain, loss or deduction attributable to the disposition of the Company's property having a Book Value that differs from its adjusted basis for tax purposes shall be computed by reference to the Book Value of such property;

(iv) items of depreciation, amortization and other cost recovery deductions with respect to the Company's property having a Book Value that differs from its adjusted basis for tax purposes shall be computed by reference to the property's Book Value in accordance with Treasury Regulations Section 1.704-1(b)(2)(iv)(g);

(v) to the extent an adjustment to the adjusted tax basis of any asset of the Company pursuant to Code Sections 732(d), 734(b) or 743(b) is required, pursuant to Treasury Regulations Section 1.704-1(b)(2)(iv)(m), to be taken into account in determining Capital Accounts, the amount of such adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis); and

(vi) any items of income, gain, loss, or deduction which are specially allocated pursuant to **Section 4.6** shall not be taken into account in computing Profits and Losses.

**Section 3.5 Negative Capital Accounts.** No Member shall be required to pay to any other Member or the Company any deficit or negative balance which may exist from time to time in such Member's Capital Account (including upon and after dissolution, termination, or cancellation of the Company).

**Section 3.6 No Withdrawal.** No Member shall be entitled to withdraw any part of such Member's Capital Contributions or Capital Account balance or to receive any Distribution from the Company, except as expressly provided herein.

**Section 3.7 Transfer of Capital Accounts.** The original Capital Account established for each Substituted Member shall be in the same amount as the Capital Account (or portion thereof) of the Member attributable to the Units of such Member to which such Substituted Member succeeds, at the time such Substituted Member is admitted as a Member of the Company. The Capital Account of any Member whose interest in the Company shall be increased or decreased by means of the Transfer to it of all or part of the Units of another Member or the repurchase of Units shall be appropriately adjusted to reflect such Transfer or repurchase. Any reference in this Agreement to a Capital Contribution of or Distribution to a Member that has succeeded any other Member shall include any Capital Contributions or Distributions previously made by or to the former Member on account of the Units of such former Member transferred to such Member.