

5/17/2022

# All You Ever Wanted to Know About Investment Club Withdrawals

MYICLUB.COM INVESTMENT CLUB WEBINARS • MAY 2022



## Your Hosts



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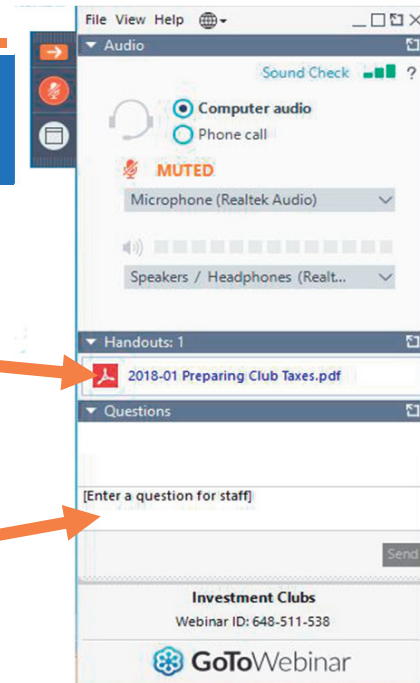
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## Handout & Questions

Handout in PDF  
format is available  
in Handouts tab.

Type questions in  
Questions box.



# ALL YOU EVER WANTED TO KNOW ABOUT INVESTMENT CLUB WITHDRAWALS

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## Don't Use Term "Buyout"



- Buyout can be used to describe sale of partnership interest to 3rd party.
- A sale to third party can trigger technical dissolution of partnership.
  - If sales cause 50% of partnership to change hands in tax year.
- Technical dissolution causes partnership paperwork headaches.
- Withdrawal is **not** sale, so cannot trigger technical dissolution.

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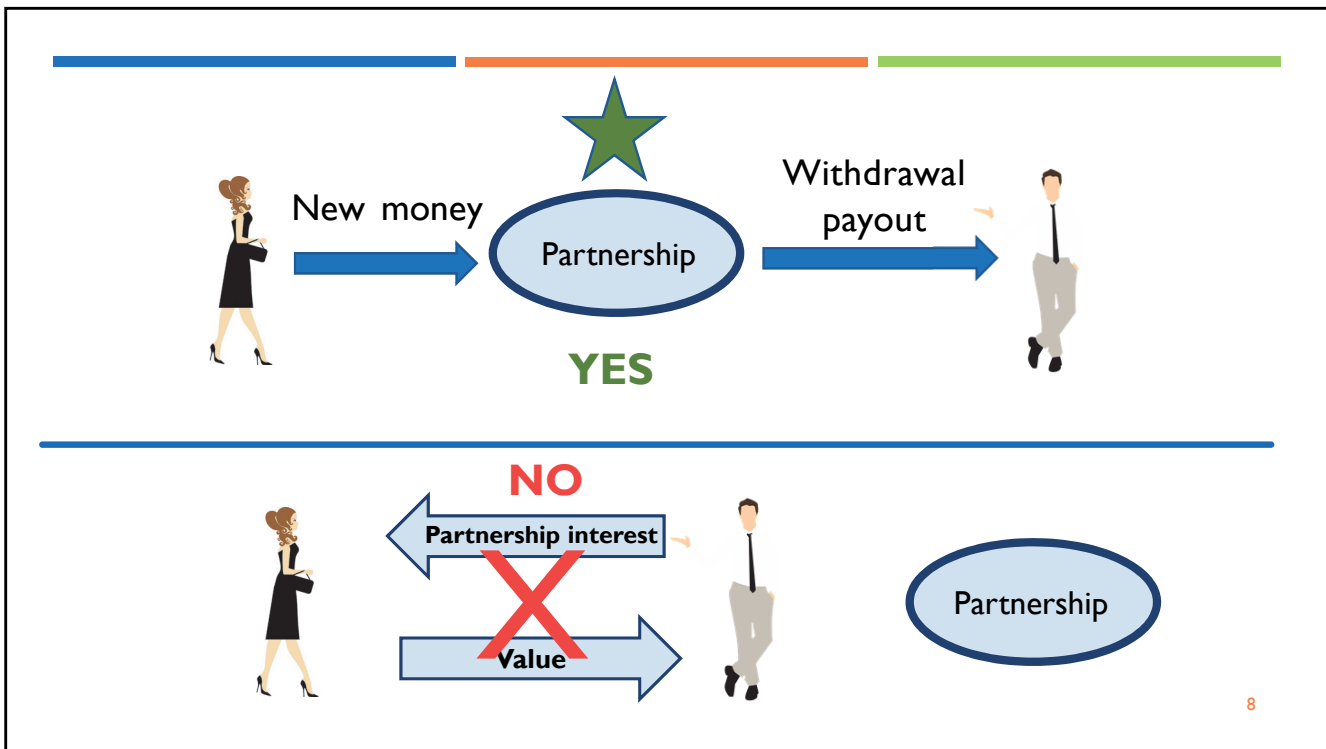
## Avoid Technical Dissolution Problems



- Fund member withdrawal only from club assets, **not** from any member's personal funds.
  - This includes other partners directly paying leaving partner.
- If current partners wish to contribute to paying for withdrawal:
  - Deposit into club first,
  - **Then** use club assets to pay withdrawing partner.

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## How to Proceed With Withdrawal



- How you proceed depends on type of withdrawal:
  - Partial Withdrawal.
  - Full Withdrawal.
- The tax ramifications for withdrawing partner are different for partial & full withdrawal.
- Some withdrawal payment plans are beneficial to club & withdrawing partner.
- Other plans benefit club more than withdrawing partner.
- **Always** follow withdrawal procedure outlined in your partnership agreement.

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# All You Ever Wanted to Know about Investment Club Withdrawals

## Russell Malley – myICLUB.com

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### Withdrawal Help in myICLUB.com



Online accounting platform, myICLUB.com, has Withdrawal Calculator in Utilities menu:

Members  
Deposit  
Member Withdrawal  
Withdrawal Calculator  
Member fee  
more ▼

Cash Accounts  
Interest  
Expense  
Bank/Money market  
dividend  
more ▼

Utilities  
Get stock quote  
Backup manager  
Import accounting records  
BrokerSync  
Export accounting records  
more ▼

#### Accounting Utilities

Accounting Utility	Description
<a href="#">Withdrawal Calculator</a>	Determine recommended methods for withdrawing a member of your club either fully or partially.
<a href="#">Get quote</a>	Get a current price, historical growth chart, or review the split and dividend history (including ex-dividend dates) about a security.
<a href="#">Backup manager</a>	Use this feature to create online backups of your club's accounting data. You can also use this tool to restore your club books from one of these backups, or export one of these backups to your personal computer for use with the desktop program, Club Accounting for Windows.

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### Can Also Access Calculator in Withdrawal Entry Screen & Members Section.



Members  
Deposit  
Member Withdrawal  
Withdrawal Calculator  
Member fee  
more ▼

Cash Accounts  
Interest  
Expense  
Bank/Money market  
dividend  
more ▼

Utilities  
Get stock quote  
Backup manager  
Import accounting records  
BrokerSync  
Export accounting records  
more ▼

#### Record a Withdrawal

Use this form to record a withdrawal. (Before continuing, you may wish to use our [club member withdrawal calculator](#) to determine the best methods for processing this withdrawal.)

Member	Russell M	Select the member who is withdrawing assets from the club.
Withdrawal type	<input type="radio"/> Partial <input checked="" type="radio"/> Full	Choose whether the member is withdrawing only some assets, or is withdrawing completely from the club.
Announcement Date	10/17/2020	Enter the date after which the member will no longer have units added or removed, or be counted for further capital gains. (This is known in Club Accounting 3 as the Transaction Date.)
Payout Date	10/17/2020	Enter the date on which the withdrawal will be paid. If currently unknown, you can leave this blank and come back and complete the withdrawal at a later date.

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# All You Ever Wanted to Know about Investment Club Withdrawals

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## Parameters Page for Withdrawal Calculator



### Withdrawal Scenario Calculator



Members can be withdrawn from your investment club on a full or partial basis, and paid off with stock, cash, or a combination of the two (depending on your club's operating agreement). There may be significant advantages and disadvantages to each method of processing a withdrawal, depending on the type of withdrawal and the club's portfolio, so it can be difficult to determine the best course of action. myICLUB's unique Withdrawal Scenario Calculator is a useful tool to help you understand the ramifications and potential best course of action when a member departs your club. Get started by entering the details below to receive a full analysis of the possible withdrawal scenarios that may be best suited for your club's particular circumstances:

Select the withdrawing partner:	Russell M
Is this a full or a partial withdrawal?	<input checked="" type="radio"/> Full <input type="radio"/> Partial
Withdrawal Date	10/17/2020
<button>Calculate best possible withdrawal scenarios</button> <button>Cancel</button>	

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### Withdrawal Scenario Calculator



Possible Scenarios for a Partial Withdrawal for **Russell M**, calculated using the portfolio valuation as of 8/31/2020.

#### Recommended Scenarios:

##### 1. Sell depreciated securities to raise cash.

This method is the first approach to consider when paying out a partial member withdrawal. The club gets to clean out one or more of the underperforming stocks in its portfolio (and thus hopefully improve its overall rate of return). The club will record a capital loss on the sale of the shares, which will be distributed to partners at year-end. Note that the withdrawing partner will not receive any of that capital loss allocation if their withdrawal is dated before the sale transaction. The following stocks are listed by the greatest amount of capital losses which would be recorded if sold as of the current price (using the "First In, First Out" accounting method). You may need to sell shares from more than one security.

Security	Shares owned	Total cost	Price per share	Market value	Capital Loss
Methode Electronics (MEI)	1,000.0000	\$39,549.08	\$30.3400	\$30,340.00	\$9,209.08
Evercore Inc. Class (EVR)	700.0000	\$80,065.98	\$78.4100	\$54,887.00	\$5,178.98
Middleby Cp (MIDD)	200.0000	\$24,424.85	\$102.8500	\$20,570.00	\$3,854.85
Pfizer Inc (PFE)	1,000.0000	\$39,315.46	\$37.9500	\$37,950.00	\$1,365.46
Baidu.com (BIDU)	400.0000	\$52,461.46	\$130.3700	\$52,148.00	\$313.46

##### 2. Pay off with cash.

The total amount of cash in all of your accounts is \$160,554.17. If this is enough to pay off the partially withdrawing member, this is probably your next best option. If this is not enough to pay off the partially withdrawing member, you can raise enough cash to cover the withdrawal from other members, through additional capital contributions, this is probably your next best option. If this is enough to pay off the partially withdrawing member, this is probably your next best option. If this is not enough to pay off the partially withdrawing member, but you can raise enough cash to cover the withdrawal from other members, this is probably your next best option.

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## Methods of Funding Partial Withdrawal



- Sell Depreciated Stock



- Pay with Cash



- Sell Appreciated Stock

**AVOID**

- Transfer Securities

**AVOID**

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## Funding Partial Withdrawal



### ■ Recommended scenarios

#### ■ Sell Depreciated Stock

- Club can harvest losses to offset gains
- If no gains to offset, remaining members get loss to offset personal capital gains
- Can be used as portfolio management opportunity

#### ■ Pay with Cash

- Easiest on treasurer
- May need additional capital contributions or stock sales to raise enough cash

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## Funding Partial Withdrawal



- **Avoid if possible**
- **Sell Appreciated Stock**
  - Members will have tax liability for their share of gains
  - Possible you sell stock with good future potential
- **Transfer Securities**
  - An advantage to club but not so much to withdrawing partner
  - Withdrawing partner gets club cost basis & holding period
    - When stock sold by withdrawing member they may have realized gain that could be avoided if paid in cash. (Covered later)

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## Methods of Funding Full Withdrawal



- Transfer Securities
- Sell Depreciated Stock
- Pay with Cash
- Sell Appreciated Stock



**AVOID**

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## Methods of Funding Full Withdrawal



- **Recommended scenarios:**
- Transfer Securities.
  - Club conserves cash.
  - Payout valued at market value **not** cost.
  - Deferred capital gains on transferred shares.
- Sell Depreciated Stock.
  - Club can harvest losses to offset gain.
  - If no gains to offset, remaining members get loss to offset personal capital gains.
  - Can be used as portfolio management opportunity.
- Pay with Cash.
  - Easiest on treasurer.
  - May need additional capital contributions or stock sales to raise enough cash.

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## Funding Full Withdrawal



- **Avoid if possible:**
- Sell Appreciated Stock
  - Members will have current year tax liability for their share of gains
  - Possible you sell stock with good future potential

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## When to Date Sell Transaction



- If club decides sales are needed to fund withdrawal, should these transactions be dated **before** or **after** withdrawal?
- It depends!
- Do you want withdrawing partner to share in gains/losses at their pre-withdrawal ownership percentage?
  - If yes, date sell transactions before withdrawal.

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## When to Date Sell Transaction



- Do you want withdrawing partner to share in gains/losses at their lower post-withdrawal ownership percentage?
  - If yes, date sell transactions **after** withdrawal.
- For full withdrawal, it matters less to withdrawing partner as their total gain from their share of partnership income plus their gain from their club ownership does not change if sell transactions are before or after withdrawal date.

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## Tax Intricacies of Security Transfers



- What is treatment of securities received in partner liquidation event?
- Controlling factors:
  - Is partnership a business partnership or an investment partnership?
  - Is this a partial or complete liquidation of partner's interest?

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## Tax Intricacies of Security Transfers



- |  |  |
|--|--|
| <ul style="list-style-type: none"><li>■ <b>Type of Partnership</b><ul style="list-style-type: none"><li>■ Business partnerships always treat securities as cash equivalents.</li><li>■ Investment partnerships treat securities as property.</li><li>■ BetterInvesting style investment clubs are investment partnerships.</li></ul></li></ul> | <ul style="list-style-type: none"><li>■ <b>Type of Withdrawal</b><ul style="list-style-type: none"><li>■ Partial Withdrawal.<ul style="list-style-type: none"><li>■ Holding period for member is same as club.</li><li>■ Cost basis to member is same as for club.</li></ul></li><li>■ Full Withdrawal.<ul style="list-style-type: none"><li>■ Holding period for member is same as club.</li><li>■ Total cost basis of all securities transferred is member's adjusted basis in club.</li></ul></li></ul></li></ul> |
|--|--|

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## Tax Intricacies of Security Transfers: Partial



Club transfers 3 tax lots from 3 different companies:

Company	Shares	Club cost	Club purchase date
AAPL	50	1758	4/15/2015
ZM	50	3495	12/10/2019
ULTA	50	5000	2/15/2014

Withdrawing member's details after transfer:

Company	Shares	Member cost	Member purchase date
AAPL	50	1758	4/15/2015
ZM	50	3495	12/10/2019
ULTA	50	5000	2/15/2014

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## Tax Intricacies of Security Transfers: Partial Withdrawal



- Possible pitfall for withdrawing member - Unnecessary capital gain.
- For partial withdrawal, member's gain is calculated at end of tax year.
- If member's cost basis in club is *negative* at year end:
  - Magnitude of negative basis is gain.
  - Cost basis is reset to zero for next tax year & gain is declared.

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## Example: Stock vs. Cash



### Stock Withdrawal

- Member basis is 10,000.
- Takes partial withdrawal all in stock worth 5000.
- Basis of stock is 1758 for 50 shares of AAPL (example from previous slide). Market value = 5000.
- Member sells all 50 shares for 5000 & realizes gain of  $5000 - 1758 = 3242$ .

### Cash Withdrawal

- Member cost basis in club = 10,000.
- Takes partial withdrawal of 5000 in cash.
- Cost basis after withdrawal = 5,000.
- Member's basis has not gone negative. If no more withdrawals during tax year,
- The 5,000 in cash is **not taxable**, it just decreases member's cost basis in club.

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## Tax Intricacies of Security Transfers: Full Withdrawal



- What is member adjusted basis?
  - **Member Paid-in-Plus-Earnings (PIPE)** from Member Status Report from valuation closest to Withdrawal date.
  - Add member's share of club YTD earnings to PIPE (myICLUB.com does this).
  - Subtract any cash received in withdrawal (myICLUB.com does this).

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## Example: Member's Adjusted Basis



Member's PIPE = 11,250.

Member's share of club income at withdrawal = 1,250.

Cash received with withdrawal = 3,000.

Members adjusted basis = 11,205 + 1,250 – 3,000 = 9,500

Sum of cost basis to member of all securities transferred = 9,500

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## Does Change in Club's Cost Basis Affect Member Cost Basis?



- If only one tax lot transferred, then no affect at all.
- If multiple tax lots are transferred, then club basis plays role in allocating member's adjusted basis among lots received.
- Rules for allocating member's adjusted basis among multiple lots is complex & outside scope of this presentation.
  - See IRS Publication 541 – Partnerships — property distribution discussion starts about page 4.
- myICLUB withdrawal algorithm adheres to these rules.
  - Withdrawal Distribution report will show member's cost basis & acquisition date for each individual tax lot transferred to withdrawing member.

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## Questions?



## LITTLE DETAILS FOR TREASURERS

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## When Entering Withdrawals in myICLUB.com



- Do not date withdrawal on same day as valuation.
- You can enter as many cash withdrawals as you want with same transaction date.
- If you are entering multiple withdrawals that include stock transfer, do not date any of them on same day.
  - Keep them at least 1 day apart.
- You can mix multiple cash withdrawals with 1 withdrawal with stock on same date.
- Be sure to give withdrawing member copy of Withdrawal Distribution Report.

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## When Entering Withdrawals in myICLUB.com



- Gain from partial withdrawal can not be accurately determined until after year end allocation of earnings is completed.
- Gain from partial withdrawals is reported on Allocation Report also.
- Withdrawal Distribution reports for partial withdrawals are accurate after Allocation has been performed.
- IRS Schedule K-1 must be prepared & filed for partner who was partner for **any** part of tax year.

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## When Entering Withdrawals in myICLUB.com



- I personally do not recommend using 2-part withdrawal process.
- Alternative:
  - Use **same date** for announcement date & payout date.
  - Choose **Suspense** account as source of funds. (This account will go negative.)
  - When you make actual payment, enter as **cash transfer** from broker (or bank) account to Suspense account.
  - Add comment – “Payment of withdrawal for Jane Doe.”
- Alternative is better especially if withdrawal & payment date are in 2 different tax years.

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## When Entering Withdrawals in myICLUB.com



### Record a Withdrawal

Use this form to record a withdrawal. (Before continuing, you may wish to use our [club member withdrawal calculator](#) to determine the best methods for processing this withdrawal.)

Member	Russell M	<input type="checkbox"/>	Select the member who is withdrawing assets from the club.
Withdrawal type	<input type="radio"/> Partial <input checked="" type="radio"/> Full		Choose whether the member is withdrawing only some assets, or is withdrawing completely from the club.
Announcement Date	10/18/2020		Enter the date after which the member will no longer have units added or removed, or be counted for further capital gains. (This is known in Club Accounting 3 as the Transaction Date.)
Payout Date	10/18/2020		Enter the date on which the withdrawal will be paid. If currently unknown, you can leave this blank and come back and complete the withdrawal at a later date.
<input type="checkbox"/> Check this box if securities will be transferred as part of the withdrawal. ( <a href="#">What's this?</a> )			
<input type="button" value="Continue"/> <input type="button" value="Cancel"/> <input type="button" value="Reset"/>			

Use same dates

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## When Entering Withdrawals in myICLUB.com



**Recalculate** Please click this button to recalculate the penalty amount and net units sold for new inputs

Total value of withdrawal	\$ <input type="text"/>	The total dollar amount withdrawn by Russell M on 10/18/2020.
Units withdrawn	20,643.453	The total units withdrawn.
- Percent penalty	<input type="text"/> %	Enter the percent penalty to be assessed on the units withdrawn.
- Withdrawal fee	\$ <input type="text"/>	Enter any additional penalties here. These will be added to the above assessed penalties.
(Penalty amount)	\$0.00	The dollar amount of the penalty assessed against Russell M for this withdrawal.
Dollars withdrawn	\$ <input type="text"/>	This is the net value of the withdrawal - the dollar amount Russell M actually receives.
Account	 <input type="text" value="Suspense"/>	Choose the account from which the funds were transferred Russell M
Comments	<input type="text"/>	

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## Questions?



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## COMMON QUESTIONS

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### Common Questions



- When appreciated shares are transferred, what happens to unrealized gain? Do remaining members ever realize that gain?
  - The gain is realized at some point by remaining members. Each member has their share deferred to when they fully withdraw. It becomes part of their gain from their investment in club. If they take stock at their full withdrawal, it can be deferred even longer.

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## Common Questions



- If time lag between date of withdrawal & when shares actually get deposited in withdrawing member's account, how do you account for market value changes during period?
  - Most partnership agreements state ownership takes effect on transaction date used to enter withdrawal.
  - So member accepts risk of market changes during this period.
  - This is why it is important to do little planning to minimize this delay.
  - In-house transfers typically are completed in 4 business days.
  - Transfers to different broker than club may take longer & your broker may charge a fee.

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## Common Questions



- Does gain from withdrawal appear on partner's K-1?
  - **No.** Total value of distribution appears on K-1. (Different lines are used for cash & property received.)
  - Remember, for investment partnerships securities are treated as property.
  - A member who had withdrawal during tax year will need their Withdrawal Distribution Report to get information on gains for their personal tax return.

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## Common Questions



- Where does partner report their club withdrawal gains on their personal tax return?
  - These are reported on Schedule D & related Form 8949.
  - Use “Partnership interest” as property type.
  - Acquisition date is date of first capital contribution to club.
  - Sale date is withdrawal date.
  - Use Cost Basis & Proceeds from Withdrawal Distribution report.

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## Common Questions



- **My broker won't use cost basis & acquisition dates on Withdrawal Distribution report for stocks received as part of withdrawal.**
- This is not uncommon, but **do not** use broker-assigned figures for your personal records.
- Withdrawal Distribution report is more likely to be accurate.
- ICLUBcentral developed memo to help convince brokers to use club's Withdrawal Report figures, available at:
  - [www.iclub.com/faq/Home/Article?id=672](http://www.iclub.com/faq/Home/Article?id=672)
  - or
  - [www.iclub.com/tps/ICLUBcentral-StockTransferBasisMemo.pdf](http://www.iclub.com/tps/ICLUBcentral-StockTransferBasisMemo.pdf)

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## Questions?



## Thank You!

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