

# Handling Investment Club Fees & Expenses

MYICLUB.COM INVESTMENT CLUB WEBINARS • JUNE 2022



## Your Hosts



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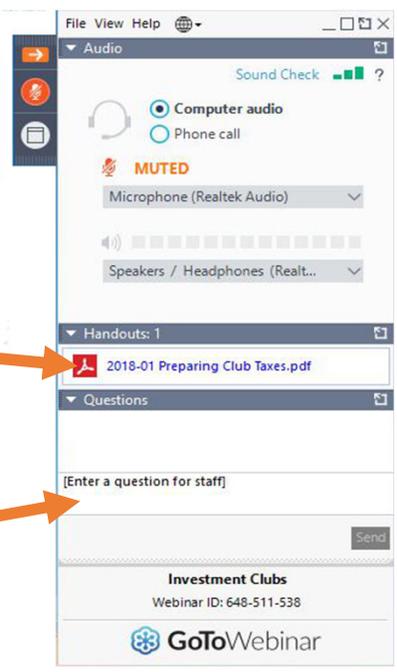


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**Handout & Questions**

Handout in PDF format is available in Handouts tab.

Type questions in Questions box.



**Managing Investment Club Fees & Expenses**

**ICLUBCENTRAL INC. JUNE 2022**





## THE BASICS: MEMBER PAYMENTS, FEES, AND EARNINGS

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### Member Payments



- **Payments** are “dues” paid in by members on monthly (or other regular) basis.
  - As determined by club’s operating agreement.
  - Used to buy units in club at current unit value.

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## Member Fees



- **Fees** are monies paid in by members that **DO NOT** buy units.
- Fees should **ONLY** be used in very-specific circumstances (to be covered later).

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## Paid In Plus Earnings (PIPE)



- **Paid In Plus Earnings** (PIPE) is sum of member payments, fee, & their share of **Earnings** allocated to them each year.
- Members are responsible for taxes on their share of club's earnings (passed through club to member on Schedule K-1).
- Thus, member can withdraw monies paid in AND any previously-allocated earnings without tax consequences.
  - According to IRS, paid-in capital + earnings is withdrawn **BEFORE** any member gains.

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## HANDLING INVESTMENT CLUB MEMBER FEES

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## What Should Fees Be Used For?



- Fees should only be used for “penalty” situations:
  - Late fees.
  - Bounced check fees.
- However, ICLUBcentral recommends that clubs **DO NOT** collect late fees from members.
  - Collecting & recording late fees makes treasurer’s job harder.
  - Member who misses monthly payment only hurts themselves (as long as club’s portfolio value grows over time).

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## Alternatives to Late Fees



- Clubs worried about timely club member payments should have members set up electronic deposit/e-pay/ACH to automatically make monthly payments.
- Alternately:
  - Have members pre-pay dues quarterly/annually.
    - Due to market fluctuations, members who make lump sum payments might end up with significantly different number of units than those who pay month to month.
  - Have members write 12 post-dated checks at start of year.
    - Depending on how many in club might do this, treasurer might have **MUCH** more to keep track of during the year.

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## What Should Fees NOT Be Used For?



- Fees **SHOULD NEVER** be used to cover club expenses.
  - Expenses should be paid out of club's cash on hand.
  - OR collect additional member payments to cover expenses.
  - **HOWEVER**, collecting fees OR payments makes little difference to bottom line when considering club expenses.

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## HANDLING INVESTMENT CLUB EXPENSES

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## Investment Expenses Pre-2017



- Prior to 2017, myICLUB.com supported expenses in 2 IRS categories:
  - **Deductible:** software, postage, copies, memberships, subscriptions, tax-preparation related to investing & club operations.
  - **Non-Deductible:** flowers, snacks, meals, gifts, & items not considered valid “investment expense” by IRS.
- Reported on Schedule K-1s so members who itemized could potentially make use of federal deduction for investment expenses.
  - Most individuals not able to deduct any investment expenses since deduction was limited to amount that exceeded 2% of AGI.

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## Investment Expenses Post-2017



- Tax Cuts & Jobs Act of 2017 **eliminated** investment expenses from miscellaneous itemized deduction.
  - **ALL** expenses (except Margin Interest) now non-deductible & individuals no longer can deduct investment expenses on federal tax return.
- Schedule K & partner K-Is include “partnership expenses,” but club members are not generally able to make use of this on personal returns.
- Some (professional) investing partnerships may need to report business expenses.

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## Club Expenses in myICLUB.com



- Deductible & Non-Deductible Expense types are now known as “**Investment**” or “**Non-Investment**” Expenses.
  - Definitions based primarily on prior IRS deductibility rules.
- myICLUB.com Reports show both types.
- On federal & state tax returns, expenses reported as required.
- If tax laws change in future, both expense types could be more relevant.

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## NEW: Expense Categories



- myICLUB.com has recently added expense **categories** for both Investment & Non-Investment expenses.
- Aids in identifying rationale for club paying particular costs.
- Categories include most common types of expenses related to club investments & operations.

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## Record an Expense

Date	<input type="text" value="6/15/2022"/>	Date of the expense.
Amount	\$ <input type="text"/>	Amount of the expense.
Account	<input type="text" value="Sea*Trade"/>	Account from which funds were drawn to pay the expense.
Type	<input type="text" value="Investment"/>	Is this an Investment or Non-Investment Expense? ( <a href="#">What's this?</a> )
Category	<input type="text" value="Uncategorized"/>	Expense Category
Distribution method	<input type="text" value="Uncategorized"/>	Equally divided among members or weighted by percentage ownership share? ( <a href="#">What's this?</a> )
Comments	<input type="text"/>	
<input type="button" value="Submit"/> <input type="button" value="Cancel"/>		

- Accounting & Tax Preparation
- Backup Withholding
- BetterInvesting Membership
- Club Fidelity Bond
- Educational Materials
- Investment Research
- Margin Interest

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## Investment Expense Categories



- Uncategorized
- Accounting & Tax Preparation
- Backup Withholding
- BetterInvesting Membership
- Club Fidelity Bond
- Educational Materials
- Investment Research
- Margin Interest
- Meeting Space Rental
- Office Supplies
- P.O. Box Rental
- Postage & Printing
- Safety Deposit Box
- Software Purchases & Subscriptions

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## Non-Investment Expense Categories



- Uncategorized
- Food & Drink
- Gifts & Flowers
- Seminars & Conferences
- Parties & Gatherings

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## NEW: Expense Report



- Lists expenses for any period by type & category & with description & amount.
- Can sub-total by type to show Investment & Non-Investment expenses separately.

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## Expenses



Report for dates from 1/1/2021 to 12/31/2021 (generated on 6/15/2022).

Date	Type	Category	Remarks	Account	Amount
<b>Investment Expenses</b>					
02/01/21	Inv.	Accounting & Tax Preparation	myICLUB.com subscription renewal	Pacific Credit Union	\$77.99
06/15/21	Inv.	Postage & Printing	Postage stamps.	Pacific Credit Union	\$27.00
12/21/21	Inv.	Accounting & Tax Preparation	State Club Tax Printer	Pacific Credit Union	\$89.99
12/21/21	Inv.	Accounting & Tax Preparation	Federal Club Tax Printer.	Pacific Credit Union	\$89.99
<b>Sub Total:</b>					\$284.97
<b>Non-Investment Expenses</b>					
05/20/21	Non-Inv.	Uncategorized	flowers for John Shark in hospital	Pacific Credit Union	\$22.56
12/22/21	Non-Inv.	Parties & Gatherings	Year-end party.	Sea*Trade	\$253.33
<b>Sub Total:</b>					\$275.89
<b>Total:</b>					\$560.86

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## PITFALLS TO AVOID IN RECORDING EXPENSES

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## Methods of Recording Club Expenses



- Expenses can be charged against members' capital accounts in 2 ways:
  - By ownership share of each member's capital account in club (IRS says this is default, should almost **always** be used).
  - By member (so each member pays an equal amount, should almost **never** be used).

## One Simple Rule for Recording Expenses

- ICLUBcentral recommends: **Always allocate expenses by percentage ownership share.**
- **NEVER** allocate expenses equally by member.

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## Why Not to Allocate Expenses “Equally”

- Would you allocate club **profits** by member? (**NO, you wouldn't!**)
- IRS expects partnerships to allocate expenses by ownership.
  - If you use different method, it must be in partnership agreement (& signed by all members).
    - *If not, your club is in risky legal territory.*
    - *Make sure club has clear policy about recording expenses if you utilize Equal Allocations.*

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## Entire Club Should Benefit from Expenses



- Investment expenses should benefit club & all members.
  - It's in interest of largest members for smaller members to be engaged, enlightened, educated members.
  - Largest members will benefit from increase in all members' knowledge, engagement, & experience.

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## Alternative to Equal Expense Conundrum



- If members object to allocating equally (for items like BetterInvesting membership for members), **then keep expense off books.**
- Have members write checks payable to BetterInvesting for their share, & treasurer sends all with club renewal.

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## Pitfall of Equally-Allocated Expenses



- If you ignore our advice to NOT collect member fees & to NOT allocate expenses equally, then:
  - **Never collect fees in attempt to offset expenses that are equally-allocated.**
  - This can unintentionally penalize members with smaller capital accounts & reward members with larger accounts.

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## Equally-Allocated Expenses Hurt Small Owners



- To comply with IRS regulations, Equally-Allocated Expenses are treated as **partial withdrawals in amount of expense.**
  - Thus, this decreases total number of units owned by members.
- However, smaller owners have **larger** percentage of units removed.
  - **Thus, smaller owners in effect pay more for expense than larger owners.**

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## Equal Allocation Example\*



Member	Before Equally Allocated Expense		After Equally Allocated Expense	
	Units	%Ownership	Units	%Ownership
Jane Ree	240	60 %	239	60.2 %
John Doe	150	37.5 %	149	37.53 %
Lisa Minima	10	2.5 %	9	2.23 %

\* Assumes an expense equal to 3X the value of one unit so one unit is deducted from each member.

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## Final Thoughts on Club Expenses



- Each expense immediately reduces club value & overall return.
  - For new clubs, expenses often cause returns to be below market average.
- But don't be "penny-wise/pound foolish" when it comes to expenses that make club more successful.
  - Some expenses are unavoidable in operating club & should be considered costs of operations.
- Clubs are important investment education tool for members, so focus on maximizing that aspect along with gains.

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## Best Practices for Investment Club Fees & Expenses



1. Never charge member fees.
2. Never equally-allocate expenses.
3. (If you ignore #1 & #2): Never collect member fees to offset equally-allocated expenses.

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## Questions?



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# Thank You!

