

Handling Member Withdrawals
By Doug Gerlach, ICLUBcentral Inc.



Club Treasurer Workshop:
Investment Club Accounting for New Treasurers

Handling Member Withdrawals

March 2020



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Your Hosts



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Purpose of This Webinar

- ▶ Review best practices for processing member withdrawals from investment clubs.
- ▶ Outline differences between full & partial member withdrawals.
- ▶ Discuss cash vs. stock withdrawal options & when to use each.
- ▶ Demonstrate tools that can assist in identifying best withdrawal method to use for types of withdrawals.
- ▶ Consider portfolio management tasks for withdrawals involving sale or transfer of stock.



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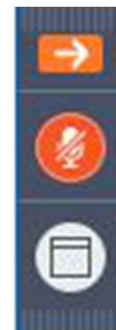


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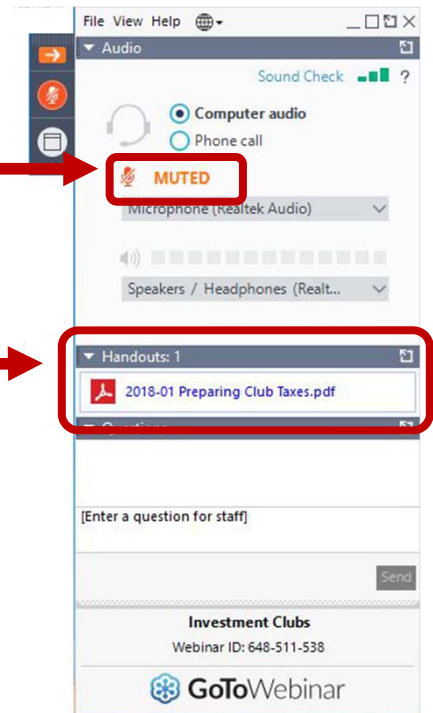


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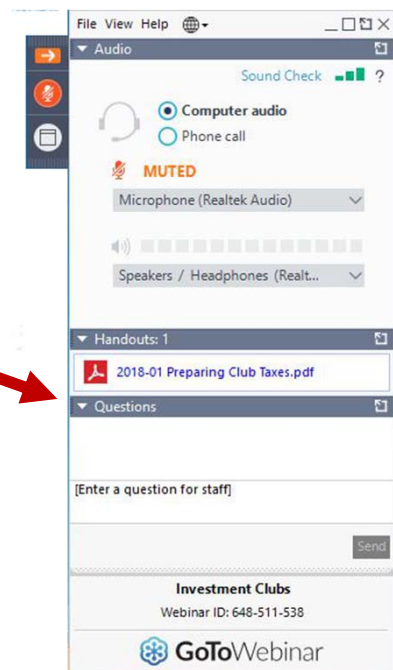
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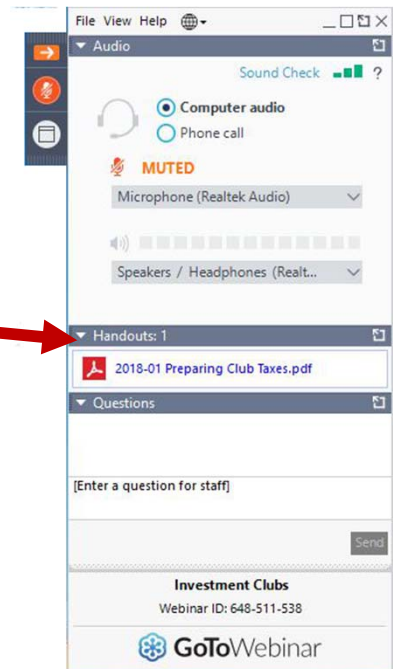


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» Handling Member Withdrawals

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Club Operating Documents Rule!

- ▶ “Operating documents” are partnership agreement and/or bylaws.
- ▶ Operating documents **must** detail procedures for member withdrawal.
- ▶ Refer to operating documents for guidance in processing withdrawal.
- ▶ For recommended agreement, see:
www.myiclub.com/clubhub/samplepart.aspx



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Best Practices for Withdrawals

- ▶ Do not deviate from procedures outlined in your club operating documents.
- ▶ Do not limit member's ability to withdraw.
- ▶ Do not penalize members when they withdraw.
- ▶ Do not allow withdrawing member to dictate terms.
- ▶ Be timely in processing withdrawals.
- ▶ Let club accounting software do heavy lifting.



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Ways Members Can Withdraw

1. Involuntary.
 - a) Full.
2. Voluntary.
 - a) Full.
 - b) Partial.
3. Death or Incapacitation.
 - a) Full.



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Ways Members Can Be Paid

- ▶ Cash Only.
- ▶ Stock Only (rare).
- ▶ Cash + Stock.



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» Involuntary Member Withdrawals



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Sample Terms for Involuntary Withdrawal

- ▶ 16 (b) Removal of a Partner.
 - Any partner may be removed by agreement of majority.
 - Written notice of meeting where removal will be considered must be made.
 - Removal become effective upon payment, which shall be in accordance with provisions on full withdrawal of partner in paragraphs 18 (Voluntary Withdrawal, Partial & Full) & 20 (Terms of Payment).
 - Vote treated as receipt of request for withdrawal.
 - Source: www.myiclub.com/clubhub/samplepart.aspx



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Why Would Club Remove Member?

- ▶ Operating documents should outline basis for removal:
 - Not making member payments.
 - Not attending meetings.
 - Not doing required work.
 - Majority of partners wish to remove member.
- ▶ Should process as full withdrawal.



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» Death or
Incapacity
of Member



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Sample Terms for Death of Partner

► 19. Death or Incapacity of a Partner.

In event of death or incapacity of partner, receipt of notice of death is notice of full withdrawal.

Source: www.myiclub.com/clubhub/samplepart.aspx



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Withdrawing Deceased Partner

- Process according to operating documents as full withdrawal.
- Make check payable to partner (or “Estate of <Partner Name>”).
- Mail or deliver check to last known address.
- Do not write check payable to spouse or any other person.
 - May deviate from above if proper documentation from executor is presented to club.
 - Otherwise, you don’t know what partner’s will/estate says.
 - Giving money to any other entity could leave club liable.



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Transferring Stock to Deceased

- ▶ Follow same procedures as for living member.
- ▶ May be more complicated if club does not already have or can easily get details of deceased member's brokerage account.
- ▶ Paying out in cash may be easier option.



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» Voluntary Member Withdrawals



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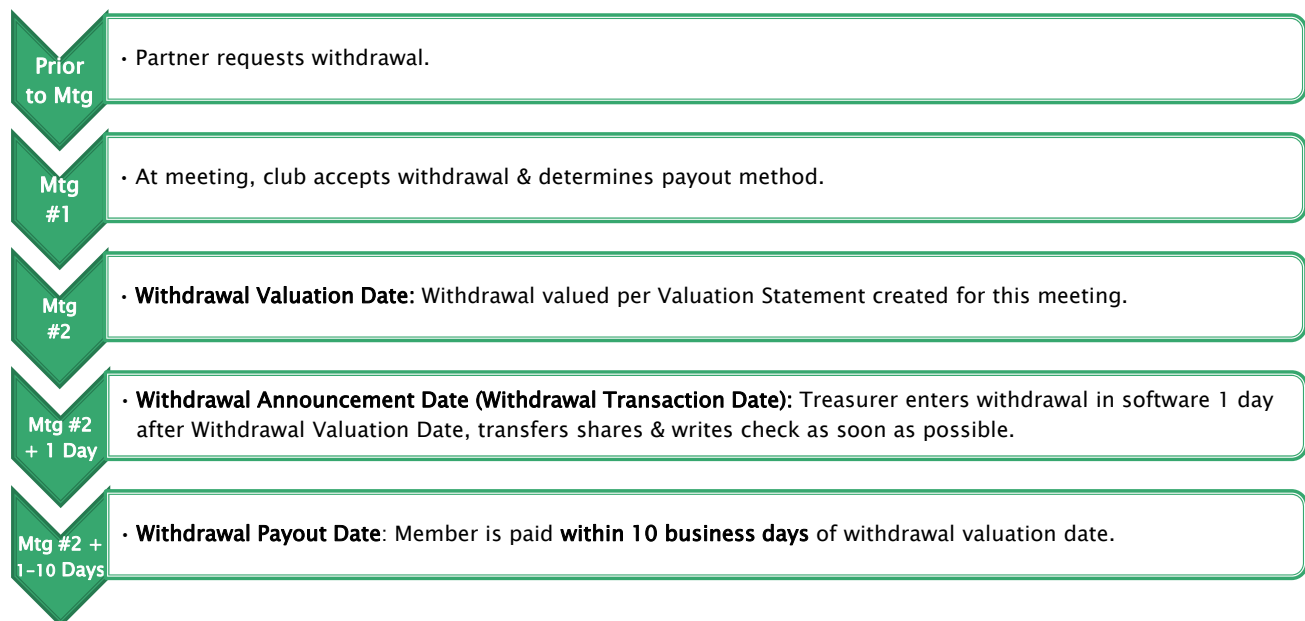
Terms for Voluntary Withdrawal

- ▶ 18. Voluntary Withdrawal (Partial or Full) of a Partner.
 - Any partner may withdraw in part or fully.
 - Partner withdrawing shall give notice in writing.
 - Written notice deemed received at first meeting at which is presented.
 - If received between meetings, treated as received at first following meeting.
 - Value of partnership set by valuation statement prepared for 1st meeting following meeting at which notice is received. This determines value of partner's account.
 - Partnership shall pay partner in accordance with paragraph 20 (Terms of Payment) of Agreement.
 - Source: www.myiclub.com/clubhub/samplepart.aspx



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Steps to Complete Voluntary Withdrawal



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»» Terms of Payment of Withdrawals



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Terms of Payment

- ▶ 20. For partial withdrawals, payment may be made in cash, securities, or mix.
 - For full withdrawal, payment may be made in cash, securities, or mix at option of remaining partners.
 - In either case, where securities are distributed, remaining partners select securities.
 - Partnership shall transfer value of account being withdrawn less any actual expenses related to withdrawal.
 - Value of securities transferred shall be as shown on the Club's valuation statement & transferred as of that date (the "Withdrawal Valuation Date").
 - Club's broker shall be advised that ownership of securities are transferred to partner as of Withdrawal Valuation Date.
 - Cash shall be paid within 10 business days after Withdrawal Valuation Date.
 - If withdrawing partner desires immediate payment in cash, partnership may pay 80% of estimated value of account & settle balance in accordance with procedures in items 18 & 20.
 - Source: www.myiclub.com/clubhub/samplepart.aspx



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Important Payment Concepts

- ▶ Do not unnecessarily delay payment.
 - Differences in stock value between withdrawal date & payment date is immaterial.
 - Valuation date rules, so don't delay payments too long.
- ▶ Do not penalize withdrawals.
 - Withdrawal fee concept is outdated. Charge only actual costs of withdrawing.
 - Most transfers have withdrawing member open brokerage account at same firm, & transfers are made at no charge.
- ▶ Be smart about paying in cash and/or stock.



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» Paying Out
in Cash
and/or Stock



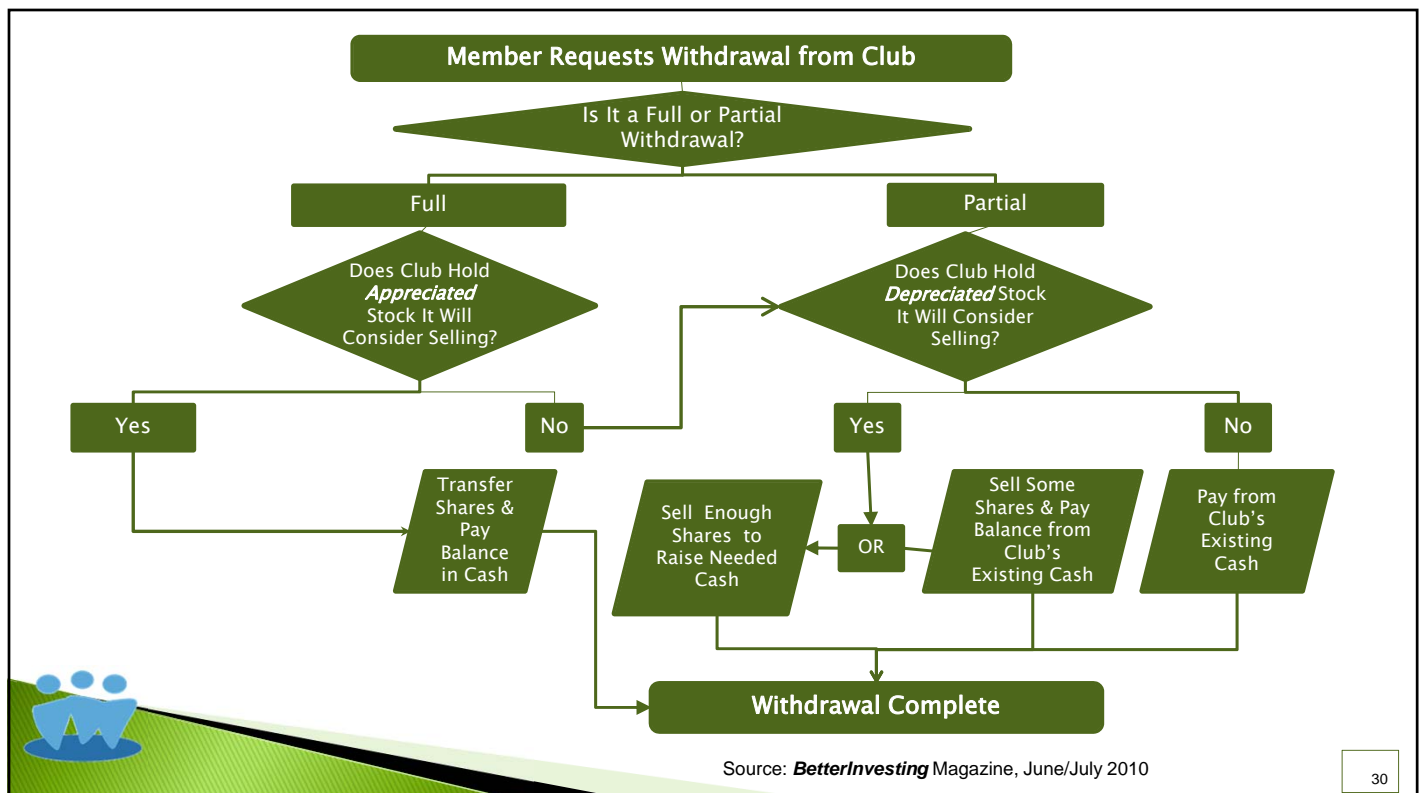
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Paying Out in Cash/Stock

- ▶ Withdrawals can be made with cash, stock, or mix of both.
- ▶ Use appropriate method of payout to serve club's (& member's) best interests.
 - Transferring securities can be particularly wise in certain circumstances.
- ▶ **Note: There is no such thing as a “buyout.”**



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For Partial Withdrawals

- ▶ Strongly consider selling weak, depreciated stocks.
 - Club gets to record capital loss.
 - Club gets rid of problematic stock.
- ▶ Do not transfer depreciated stock.
 - Club loses out on chance to record capital loss.
- ▶ Resist transferring appreciated stock.
 - May have small advantages to club or member – may be easier to sell appreciated stock if necessary.
- ▶ Or pay cash.
 - Raise from additional member payments if needed.



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For Full Withdrawals

- ▶ Strongly consider transferring appreciated shares.
 - No impact on withdrawing member's basis.
 - Capital gains deferred for remaining members until they withdraw.
 - Great tactic to postpone capital gains.
 - Do not sell appreciated shares – transfer instead.
 - Use cash on hand to repurchase shares right away.
- ▶ Strongly consider selling depreciated shares.
 - Do not transfer depreciated shares – would lose capital loss.
 - Records capital loss.
 - Cleans out underperformers, strengthens remaining portfolio.
- ▶ Or pay cash.
 - Raise from additional member payments if needed.



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Tax Consequences of Withdrawals

- ▶ Whether you sell shares, transfer shares, or pay cash has little impact on withdrawing partner.
- ▶ Smart moves to benefit remaining partners include:
 - transferring highly-appreciated shares to fully-withdrawing members.
 - selling depreciated shares to raise cash.
- ▶ Dumb moves include:
 - selling appreciated shares to fund full withdrawals
 - transferring depreciated shares for any withdrawal.
- ▶ Otherwise, there's not much you can do to manage taxable impact.



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» Entering Withdrawals
in myICLUB.com



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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:

David R Cod

Is this a full or a partial withdrawal?

☒ Full ☐ Partial

Withdrawal Date

3/19/2020

Calculate best possible withdrawal scenarios

Cancel

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Possible Scenarios for a Full Withdrawal for David R Cod, calculated using the portfolio valuation as of 12/31/2019.

Amount due to member: \$72,240.19

Recommended Scenarios:

1. Transfer appreciated securities (with any remaining balance in cash).

In the case of a full withdrawal, IRS rules have some tax benefits when a partnership transfers shares of an appreciated security to the withdrawing member. Remaining club members and the withdrawing member can defer the realization of capital gain and therefore the taxes on that gain. You should consider those stocks in your portfolio with the highest appreciation (those stocks that have increased the greatest amount in value since purchase) as candidates to transfer to the withdrawing member. The myICLUB.com club accounting system adjusts the cost basis of remaining members so that the gain deferred will be included in their club investment gain when each member leaves the club which may be many years in the future. The withdrawing member can control when the gain from their club investment is realized. Much, or even all, of their gain from the withdrawal will be realized only when the shares transferred are sold. Even if they sell immediately, they would likely incur no more gain than if paid in cash for their withdrawal. You may need to transfer shares from more than one security and will likely have to pay some additional cash.

Here are the club's securities, ranked in order from largest capital gain to smallest. It is best to analyze the securities for potential future gain before transfer. Note: If the total amount of capital gains is not very large, it may not be worth the effort to transfer securities and selling may be a more reasonable option.

Security	Shares owned	Total cost	Price per share	Market value	Capital Gain
Apple Computer (AAPL)	430.0000	\$8,505.14	\$273.3600	\$117,544.80	\$109,039.66
O'Reilly Automotive (ORLY)	110.0000	\$1,917.50	\$368.7200	\$40,559.20	\$38,641.70
Universal Display Corporation	80.0000	\$2,674.30	\$168.7900	\$12,703.20	\$10,028.90

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Record Cash + Stock Full Withdrawal

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	<input type="text" value="Maddy Dorado"/>	Select the member who is withdrawing assets from the club.
Withdrawal type	<input checked="" type="radio"/> Partial <input type="radio"/> Full	Choose whether the member is withdrawing only some assets, or is withdrawing completely from the club.
Announcement Date	<input type="text" value="03/02/2020"/>	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	<input type="text" value="03/02/2020"/>	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 checked="" type="checkbox"/> Check this box if the user is withdrawing stock from the club. (What's this?)		



Confirm Amount & Enter Fee

Record a Withdrawal

Below are the number of dollars and units available to the withdrawing member on the specified date. Enter the amount the member will be withdrawing, as well as any penalties assessed by the club against the amount of the withdrawal. Your club's unit value on 3/2/2020 was \$76.63. Maddy Dorado had \$7,110.39 (92.79 units) available for withdrawal.

<input type="button" value="Recalculate"/>	
Total value of withdrawal \$	<input type="text" value="1000"/> The total dollar amount withdrawn by Maddy Dorado on 3/2/2020.
Units withdrawn	0.000 The total units withdrawn.
- Percent penalty	<input type="text" value="0"/> % Enter the percent penalty to be assessed on the units withdrawn.
- Withdrawal fee \$	<input type="text" value="0"/> 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 Maddy Dorado for this withdrawal.
Dollars withdrawn \$	<input type="text" value="1000"/> This is the net value of the withdrawal - the dollar amount Maddy Dorado actually receives.
Account	<input type="text" value="Bank"/> Choose the account from which the funds were transferred to Maddy Dorado.
Comments	<input type="text"/>



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Select Stock

Record a Withdrawal

Select the number of shares of each club security the member is withdrawing. On the previous screen, you selected the dollar value of the withdrawal. If the total value of all withdrawn securities is smaller than the net amount of the withdrawal, then any shortfall will be made up for in cash transferred from the club to the withdrawing member.

Recalculate

Dollars withdrawn: \$1,000.00			Net dollar amount of the withdrawal.		
Security	Price per share	Total shares owned	Market value of security	Value of withdrawn shares	Shares to withdraw
AAPL	\$293.65	430.00000	\$126,269.50	\$0.00	0
AL	\$47.52	200.00000	\$9,504.00	\$0.00	0
NXGN	\$16.07	100.00000	\$1,607.00	\$0.00	0
OLED	\$206.07	80.00000	\$16,485.60	\$0.00	0
TGT	\$128.21	25.00000	\$3,205.25	\$897.47	7
WBA	\$58.96	40.00000	\$2,358.40	\$0.00	0
Stock value withdrawn: \$897.47			Value of the stock withdrawn.		
Cash withdrawn: \$102.53			Value of cash withdrawn.		
Dollars withdrawn: \$1,000.00			Total dollar amount of the withdrawal.		

Submit

Cancel

Reset

Select Lots

Record a Withdrawal

Select the number of shares of each club security the member is withdrawing. On the previous screen, you selected the dollar value of the withdrawal. If the total value of all withdrawn securities is smaller than the total amount of the withdrawal, then any shortfall will be made up for in cash transferred from the club to the withdrawing member.

Recalculate

Please click this button to recalculate values for new inputs

Dollars withdrawn: \$1,000.00			Total dollar amount of the withdrawal.		
Security	Price per share	Shares in this lot	Date acquired	Value of withdrawn shares	Shares to withdraw
TGT	\$128.21	25.00000	10/27/2008	\$897.47	7
Stock value withdrawn: \$897.47			Value of the stock withdrawn.		
Cash withdrawn: \$102.53			Value of cash withdrawn.		
Dollars withdrawn: \$1,000.00			Total dollar amount of the withdrawal.		

Submit

Cancel

Reset

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Transaction Complete

Transaction Description



Type	Withdrawal	The action taken.				
Date	2/2/2018	Date of the transaction.				
Withdrawal type	Partial stock	This is a partial stock withdrawal.				
Member	Maddy Dorado	Member making the withdrawal.				
Total amount of withdrawal	\$1,000.00	Total dollar amount of the withdrawal, including all penalties and fees.				
Units	21.4110	The total valuation units withdrawn (includes all penalties and fees).				
Flat fee	\$0.00	Flat fee charged by your club for the withdrawal.				
Penalty	0.00%	Percent penalty charged by your club for withdrawal.				
Penalty amount	\$0.00	Total cash amount of the penalty, including both the flat fee and the percentage penalty.				
Net amount of withdrawal	\$1,000.00	The net dollar amount that Maddy Dorado actually received after subtracting the penalty.				
Symbol	Purchase date	Share price	Shares withdrawn	Market value	Cost basis	Member basis
TGT	10/27/2008	(\$35.8600)	18.000000	\$961.02	(\$645.48)	\$645.48



Print Withdrawal Report

Partial stock withdrawal for Maddy Dorado on 2/2/2018
Valuation date: 4/14/2017

Member's share of Distributions

Dividend \$0.20

Qualifying Dividend \$0.20

Securities Transferred (including basis adjustments)

Date Purchased	Symbol	Company	Shares	Fair Market Value	Club's Cost Basis	Partners Adjusted Basis
10/27/08	TGT	Target	18.0000	\$961.02	\$645.48	\$645.48
				\$961.02	\$645.48	\$645.48

Withdrawal details (including tax consequences)

Gross withdrawal amount (21.4110 units at \$46.70 per unit)	\$1,000.00	Tax Basis prior to withdrawal	\$2,400.38
Fees and penalties	- \$0.00	Current Year Earnings / (Loss)	+ \$0.20
Net withdrawal amount	= \$1,000.00	Adjusted Tax Basis	= \$2,400.58
Cash received	\$38.98	Cash Received	\$38.98
Stock value withdrawn	+ \$961.02	Member's adjusted basis in stock withdrawn	\$645.48
Net value withdrawn	= \$1,000.00	Realized Gain (Loss)	\$0.00



» Tax Matters



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What About Taxes?

- ▶ General partnerships are pass-through entities.
- ▶ All taxable transactions pass through to partners & must be reported by partners to IRS (& some states).
- ▶ For withdrawn members, additional tax information is provided on the withdrawal report (Info that doesn't appear on Form K-1.)



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Taxes & Withdrawn Partners

- ▶ Withdrawing members have 2 tax matters:
 1. As in any year, member must report their share of club's gains, losses, income, & expenses to IRS (& state if applicable) on personal tax returns.
 2. In year of withdrawal, member must report capital gain/loss as shown on withdrawal report (difference between market value & tax basis of their club account).
- ▶ Clubs usually pay no taxes to IRS or states.



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What Member Reports


- ▶ Software generates **Withdrawal Report** which includes tax basis of member's capital account.
- ▶ They will also receive Schedule K-1 from club for their last (partial) year of membership.
- ▶ **Both of these will be required for their personal tax return – don't forget to give any withdrawn members their Withdrawal Report & K-1 at tax time.**






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Withdrawal Report



Withdrawal Distribution Report



Partial stock withdrawal for Maddy Dorado on 3/2/2020
Valuation date: 12/31/2019

Due to partnership tax rules, the values given on this report should be considered tentative until the end of the tax year. If this report has been generated prior to the end-of-year allocation of income and expenses, its values should not be used by the withdrawing member to determine their tax liability. This report should be re-printed and given to the withdrawing member with that member's form K1 after the books are closed on this tax year and the allocation of earnings and expenses completed.

Member's share of Distributions
Nothing to distribute

Securities Transferred (including basis adjustments)

Date Purchased	Symbol	Company	Shares	Fair Market Value	Club's Cost Basis	Partners Adjusted Basis
10/27/08	TGT	Target	7.0000	\$897.47	\$251.02	\$251.02
				\$897.47	\$251.02	\$251.02

Withdrawal details (including tax consequences)

Gross withdrawal amount (13.0501 units at \$76.63 per unit)		\$1,000.00	Tax Basis prior to withdrawal	\$2,826.41
Fees and penalties		\$0.00	Current Year Earnings / (Loss) +	\$0.00
Net withdrawal amount =		\$1,000.00	Adjusted Tax Basis =	\$2,826.41
Cash received		\$102.53	Cash Received	\$102.53
Stock value withdrawn +		\$897.47	Member's adjusted basis in stock withdrawn	\$251.02
Net value withdrawn =		\$1,000.00	Realized Gain (Loss)	Cannot be determined until the year-end allocation of earnings

Partial Withdrawals – Cash

- ▶ Withdrawal up to value of member's tax basis (**Paid-In-Plus-Earnings, or "PIPE"**) in club is tax-free return of capital.
 - Partial Withdrawals of PIPE or less are NOT reported by member on personal tax return.
- ▶ However, any withdrawal in excess of member's tax basis is **taxable capital gain**.
 - Gains are reported by member on their personal tax return.

Full Withdrawals – Cash

- ▶ Full withdrawal of less than PIPE is capital loss & is reportable on member's Form 1040 Schedule D.
- ▶ Schedule K-1 will have other reportable numbers from club activities.



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Partial Withdrawals – Securities

- ▶ For partial withdrawal, club's tax basis in transferred securities becomes member's tax basis in securities.
- ▶ Taxable event is triggered when member eventually sells those shares.



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Full Withdrawal – Securities

- ▶ Withdrawing member's tax basis in the club (less any cash paid) becomes member's tax basis in transferred securities.
- ▶ Taxable event is triggered when member eventually sells those shares.
 - Holding period includes club's holding period.



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Member's Withdrawal Report

- ▶ Withdrawal Report shows tax basis, gain/loss, securities transferred, & other relevant info that is needed for member's individual tax return.
 - Some of this info is not available elsewhere!
- ▶ Treasurer should provide all Withdrawal Reports to withdrawn members at year-end with Schedule K-1s.



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» Other Withdrawal Issues



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What is “WD Liability?”

- ▶ This is the Withdrawal Liability Account, used in a 2-step withdrawal (where withdrawal is valued on one date & paid at later date).
- ▶ Reports created/printed between two dates show yet-unpaid WD Liability amount.



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»» Any Last Questions?



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Thank You!

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