

Club Accounting Withdrawals

Withdrawals happen! No sooner is your investment club fully invested than one of the charter members resigns from the club because of a job transfer or another reason, and wants the money right now. What to do?

Warning! Do not, please, do not make an educated guess and write a check before the proper procedures have been followed. And no, a withdrawal is not a club expense. Assuming the club uses Club Accounting software from [ICLUBcentral](#), use the software's Members Section > Withdraw Member procedure in order to allow for proper tax allocations.

When a member withdraws and the club doesn't have enough cash on hand to cover the payout, the club has three options:

- Transfer stock
- Sell stock
- Accumulate cash

Transfer Stock

Transferring stock to a departing member defers capital gains for all members. (See section below about taxes.) Usually it's quicker and less expensive if the withdrawing member has an account with the same brokerage firm as the club. If not, most brokers are happy to open accounts. Call the club's broker and ask for details about what needs to be done to transfer stock, and about fees. Give the broker instructions to transfer the required number of shares to the member's account. By the way, don't transfer stock for a partial withdrawal - the IRS rules governing a partial withdrawal are different.

Sell Stock

No transfer candidates? Take advantage of the opportunity to re-evaluate and rebalance the portfolio. Sell those companies not likely to grow (increase in price); or sell part of a large holding that's too big a slice of the pie. Tip: this may provide the perfect excuse to finally sell that dog you've been arguing about for months! Capital gains or losses will be recorded for all members at the time of the transaction.

Accumulate Cash

Not enough available cash? Rather than make the withdrawing member wait for the club to accumulate funds, invite other members to buy additional units. No, they are NOT buying units from the member who's leaving. Don't go there. The departing partner's units are withdrawn. The remaining members buy new units at the current price. NEVER let a member write a personal check to the withdrawing member to buy his/her stake in the club - it creates an accounting nightmare.

Accounting for Withdrawals

OK, how do you go about processing a withdrawal? Club Accounting 3 software and Club Accounting Online (formerly NAIC Online Club Accounting or NOCA) are designed to make the withdrawal process accurate and easy - as long as things are done in the proper order.

If you are still using NAIC Club Accounting (NCA) 2.5 or earlier, or spreadsheet accounting, you should be aware that there are likely to be tax-reporting problems. It's to your advantage to download a demo and free trial of ICLUBcentral products, and upgrade to the current version.

- [Club Accounting for Windows version 3](#)
- [Club Accounting Online](#) (formerly known as NOCA) at [myiclub.com](#) is the most popular and widely used website in the world for investment club administration and communication.

Withdrawal Procedure

A good Partnership Agreement (PA) spells out the club's procedures. Generally, a resignation and withdrawal request are submitted in writing and announced at a meeting. The treasurer should keep a signed, written notice with the club's permanent records.

The effective *valuation* date for the withdrawal should be the regularly scheduled valuation *following* that meeting. (Why the following valuation? To eliminate the temptation to try market timing withdrawals.)

Using Club Accounting, go to Members Section > Withdraw Member. Select the member name, enter the effective date of the withdrawal, and select "full" as the withdrawal type.

The withdrawal date should be after, not on the valuation date, and after any necessary sales have been entered. Do this before another valuation comes up. If the payout is delayed, leave the payout date blank. But, don't make the member wait for his/her own money any longer than absolutely necessary. The amount due will transfer to Withdrawal Liability until you enter the payout date.

Withdrawal Fees

If your club's partnership agreement or bylaws define a withdrawal fee, enter it in the fee section along with any expenses incurred. Examples of expenses are commissions and other fees.

Some partnership agreements impose an unreasonably high withdrawal fee on long-term members. If your club falls into that category, I suggest the club consider amending it to something fair to both the departing and remaining members. Don't wait to reconsider the withdrawal fee until it's time to process a withdrawal. Remember that today's broker fees are significantly lower than when most example partnership agreements were written. Use the Golden Rule as a guideline.

If the payout is all in cash and you are ready to write the check, complete the payout date and step through the remaining prompts in the software.

Stock Transfer Option

If transferring stock, for Type of Withdrawal select Cash/Stock. In the next window, fill in the number of shares chosen. Determine the number of shares to transfer based on the member's current market value on the effective valuation date.

The software will automatically select the oldest blocks. Verify that the price used matches the price on the effective valuation date. If not, correct it. The share price used should normally be the price on the valuation statement that was used to determine the total value of the withdrawal.

Selecting the Stocks

The biggest advantage to the club will come from transferring shares of a stock (or stocks) with the most appreciation. The withdrawing member's basis in the stock is his/her basis (Paid In Plus Earnings) in the club, less any cash received. In a full withdrawal, it is NOT the club's basis in the stock.

The screenshot shows a software window titled "Stock Withdrawal" with the following details:

- Withdrawal for: Bettv Boop
- Withdrawal Date: 4/16/2006

Security	Price/share	Shares	Market Value	Withdraw
Cheesecake Factory Inc	37.45	60	2,247.00	0
Chico's	40.64	100	4,064.00	50
Danaher Corp	63.55	25.0184	1,589.92	0
GARMIN LTD	79.43	50.4046	4,003.64	0
Home Depot Inc	42.3	100.1564	4,236.62	50
Headwaters Incorp	39.79	60	2,387.40	0

Below the table, the following values are displayed:

- Stock value withdrawn: \$4147.00
- Cash withdrawn: \$1535.43

Buttons for "OK" and "Cancel" are visible at the bottom of the window.

Step through the prompts and write a check for the Cash Withdrawn amount shown on the withdrawal report (below).

Stock Withdrawal				
Withdrawal for:	Bettv Boob			
Withdrawal Date:	4/16/2006			
Security	Price/share	Shares in Lot	Date acquired	Withdraw
Chico's	40.64	100	10/15/2004	50
Home Depot In	42.3	43.87026	10/22/1997	43.87026
Home Depot In	42.3	27.191839	6/19/1998	6.12974
Home Depot In	42.3	0.2029	4/2/2002	0
Home Depot In	42.3	0.1951	6/28/2002	0
Home Depot In	42.3	0.2296	9/20/2002	0
Stock value withdrawn:		\$4147.00		

The final [withdrawal report](#) follows this. It states the cost basis of any transferred stock.

So, When Does the Tax Man Call?

Each year as the club buys and sells stock, the realized gains and losses accrue to the individual members through the annual Allocation of Income and Expenses. Each member receives a Schedule K-1 summarizing his/her share of that taxable gain or loss for the year. But, what happens when a stock is transferred instead of sold?

When a stock is transferred, the gain in value remains as part of the overall club Market Value, apportioned to each member in accordance with his/her membership share. The departing member gets a new tax basis on the transferred stock, and doesn't report any tax liability until the stock is sold. The remaining members won't report their share of the gain until they withdraw.

You don't duck the IRS; you simply put off the day of reckoning by transferring stock in lieu of a cash payout. It doesn't avoid capital gains tax liability, but gives both the departing and the remaining members some control over the timing.

Follow these procedures to keep everything in balance and fair to all club members.

The BetterInvesting Club-Treasurers email discussion list is an excellent resource for new and experienced treasurers. It's free and you may subscribe on the www.BetterInvesting.org website. Select Community > Discussions (Read More) > Club-Treasurers.

Gene Rooks learned club accounting via the sink or swim method -- either do it herself, or watch her investment club disband. This experience made her empathetic with new or floundering treasurers who need help over the bumps in the road. She is a frequent contributor to the [BetterInvesting Club-Treasurers](#) email discussion list. Gene retired after twenty-eight years with General Motors Acceptance Corp. in Orlando. She lives nearby in Gotha with her husband. She is a BetterInvesting Space Coast Chapter Director and club accounting instructor.

From BITS, May 2006

Full stock withdrawal by Betty Boop

Withdrawal date: 4/16/2006

Partner's Allocation of Income, Credits, Deductions to Date

Dividends Qualifying Dividends	Taxable Interest	Federal Tax Free Interest	Short Term Capital Gain	5 Year Capital Gain	Long Term Capital Gain	Misc. Income	Misc. Expense	Non-deductible Expense	Charitable Donation	Foreign Taxes Paid
8.76	8.76	0.12	0.00	121.54	0.00	170.24	0.00	0.00	0.00	0.00

Current year – report separately on this year's tax return, then becomes part of Adjusted Tax Basis.

Partner Information

Fair Value Units Withdrawn (-312.46 units x\$18.27 /unit)	5707.43	Tax Basis prior to Allocation	3988.42
Less Withdrawal Fee	25.00	Current Year Earnings/(Loss)	300.66
Net Proceeds	5682.43	Adjusted Tax Basis	4289.08
Cash	1535.43	Less Cash	1535.43
Total Distribution at Fair Value	5682.43	Realized Gain/(Loss)	0.00

Member's basis in the club after adjusting for current year.

Cash received is non-taxable *Return of Capital* if stock is transferred.

No taxable gain until stock is sold.

Securities Transferred (including basis adjustment)

<u>Date</u>	<u>Symbol</u>	<u>Company</u>	<u>Shares</u>	<u>Fair Market Value</u>	<u>Club's Cost Basis</u>	<u>Partners Adjusted Basis</u>
4/16/2006	CHS	Chico's	50.00	2,032.00	919.48	1,333.99
4/16/2006	HD	Home Depot Inc	43.87	1,855.71	840.16	1,218.54
4/16/2006	HD	Home Depot Inc	6.13	259.29	166.57	201.12
				4,147.00	1,926.21	2,753.65

Each block of stock transferred is reported separately.

Member's total basis in stock received is the same as member's Adjusted Tax Basis *minus* Cash Received, not the club's basis in the stock.