

Understanding IRS Audit Rules for Investment Clubs

MYICLUB INVESTMENT CLUB WEBINAR SERIES

Presented by myICLUB Team
March 2025



1

Your Hosts for This Presentation



Russell Malley
Club Accounting Advisor,
myICLUB



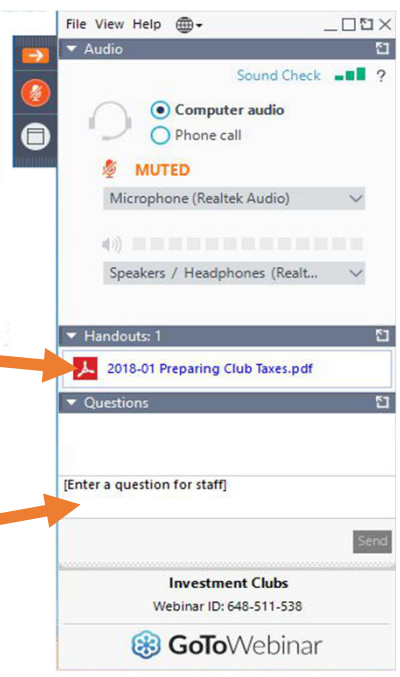
Sean Pulrang
Senior Support
Representative,
myICLUB

2

Handout & Questions

Handout in PDF format is available in Handouts tab.

Type questions in Questions box.



Purpose of This Webinar

- Explain IRS Audit Rules as they pertain to partnerships.
- Review requirements & procedures for opting out of rules.
- Discuss alternatives for not opting out & what might go wrong.

4

Disclaimer



Neither myICLUB, ICLUBcentral nor BetterInvesting provide personalized investment or tax advice to individuals or investment clubs. With respect to tax form preparation, we have done the utmost to make certain that the data that appears on tax forms produced by myICLUB Club Tax is correct as based on the data as entered in your books. Nevertheless, we do not warrant the accuracy or completeness of the data on the completed tax forms. All responsibility for accuracy and completeness rests with your investment club and with the person who handles the tax matters for your club. In addition, you are responsible for submitting accurate and complete information when preparing your tax return and for reviewing your tax return for indications of errors prior to electronically filing or printing your return. You are responsible for knowing and meeting tax filing deadlines, and for preparing your return early enough to meet any applicable deadlines.

5



IRS AUDIT RULES FOR PARTNERSHIPS

6

What Are These IRS Audit Rules?



- Bipartisan Budget Act of 2015 changed how IRS carries out audits of partnerships (including LLCs).
- Objective is to make it **easier for IRS** to collect taxes & penalties from partnerships.
- Rules became effective in tax year after December 31, 2017.

7

What Are Provisions of Audit Rules?



- Any taxes/penalties due after IRS audit are **payable by partnership** instead of passing liability to individual partners,
- Any taxes/penalties that IRS discovers are **effective in year of audit**, NOT in tax year that was audited.
- Current partners of partnership are thus liable to pay back taxes/penalties **even if they weren't partners in year audited**.

8

Who Is Affected by Audit Rules?



- Though primarily aimed at large partnerships (more than 100 partners), **all partnerships & LLCs fall under rules.**
- However, many small partnerships & BetterInvesting-style investment clubs **will be able to opt-out of these rules** (more on this later).

9



HOW TO OPT OUT OF IRS AUDIT RULES

10

Opt Out of Audit Rules



- Qualifying partnerships can opt out of rules using Section 6221 “Small Partnership” Election when filing IRS Form 1065 tax return.
- **Electing Small Partnerships (ESPs)** are eligible to opt out if:
 - Have **fewer than 100 partners**.
 - Have **no trusts as partners** (including family revocable living trusts).
 - Partners are individuals, C corporations, foreign entities that would be C corporations under U.S. law, S corporations, or estates of deceased partners.

11

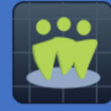
Consider Whether to Permit Trusts



- Since partnerships with trusts are **not eligible to opt out** of audit rules, clubs may wish to **disallow living revocable trusts** as members.
- If trusts are already permitted, club will either:
 1. Allow trusts, & fall under audit rules.
 2. Disallow trusts, & opt out of audit rules.

12

Assign IRS “Partnership Representative”



- If not opting out, identify **partnership representative (PR)**.
 - Authorized as sole representative to IRS in event of audit.
 - Must have “substantial presence” in U.S.
 - Need not be a partner of club (such as attorney or accountant).
- If partnership doesn’t designate, IRS will appoint their choice.
- PR is NOT same as designated tax matters partner (TMP) on Form 1065.

13

Update Partnership Agreement



- Include provisions to:
 1. Select partnership representative (PR) to deal with IRS audits.
 2. Require PR to inform partnership of any audit proceedings & update partnership throughout process.
 3. Set limits on representative’s authority to bind partnership to audit deals with IRS.
 4. Disallow living trusts as partners.
 5. Set expectation that club will opt out of audit rules when filing returns.
- See www.myiclub.com/blog/blog.aspx?id=3635 for sample text.

14

Suggested Partnership Agreement Text



26 US Code §§ 6221-6223 Designation and Election: The Club Treasurer shall be the designated Partnership Representative (PR) for purposes of Section 6223 and shall be responsible for dealing with the IRS in the event of an audit. Unless otherwise directed by the partners, the PR shall annually, in connection with filing the Club's Form 1065 tax return, indicate the Club elects to be treated under 26 USC subsection 6221(b)(1)(a), that is, an election out of the audit rules of Section 6221. The Treasurer shall include with such election any required information to make such election effective. In the event of an IRS audit, the PR will represent the club but is not authorized to make any settlement agreement without the three-quarters majority consent of the current partners. Partners of the Club shall consist only of individuals; no trust may be a partner.

Source: www.myiclub.com/blog/blog.aspx?id=3635

15

How to Opt Out



- As part of Form 1065 preparation, myICLUB Club Tax Federal will generate appropriate forms for clubs that opt out.
- Check box in Club Tax wizard to confirm club has no trusts or corporations as members, & fewer than 100 partners.
- Confirm Entity Type for each partner (none may be Trusts).
- **Opting out must be done each year.**

16

The screenshot shows a web browser window with the URL https://www.myiclub.com/club/tax/taxes_2024.aspx?club=15406&shor. The main question is: "Is the partnership electing out of the centralized partnership audit regime under section 6221(b)? If the partnership has no trusts or corporations as partners AND has fewer than 100 partners, then we recommend making this election." The "Yes" radio button is selected. A red callout box with an arrow pointing to the "Yes" button contains the text: "If club has fewer than 100 partners & no trusts as members, can answer YES." Below this, there is a section for entering a club-designated Partnership Representative (PR) if not electing out. It includes fields for Name, U.S. taxpayer identification number, U.S. phone number, Street, City, State, and Zip. A red callout box with an arrow pointing to these fields contains the text: "If NOT electing out of the centralized partnership audit regime under section 6221(b), enter club-designated Partnership Representative. Otherwise, leave blank." At the bottom of the form, there is a checkbox for "Club meets all four conditions (see below) for an exemption from filing schedules K-2 and K-3? We recommend making this election if possible." The "No" radio button is selected. Below this are four conditions: 1. The partnership has no or limited foreign activity. 2. The partnership's partners are restricted to the following: a. U.S. or resident alien individuals. b. Domestic trusts (grantor or non-grantor). The page number "17" is visible in the bottom right corner.

The slide features a decorative header with three horizontal bars in blue, orange, and green. Below the header is a square icon with a dark blue background and a grid pattern, containing three stylized human figures in green and yellow. The main text of the slide is "WHAT TO DO IF YOU DON'T OPT OUT" in a large, blue, sans-serif font. At the bottom right of the slide, the number "18" is displayed.

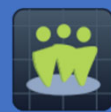
If Club Does NOT Opt Out



- IF club **did not opt out** when filing its return for a particular year, AND needs to change previously filed 1065.
- Changes made via Administrative Adjustment Request (AAR)
 - File using IRS form 8082.
- May also need to file an amended 1065.
- **Members may need to file amended personal returns**

19

IRS Form 8082



Form 8082 (Rev. October 2023) Department of the Treasury Internal Revenue Service	Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR) (For use by partners, S corporation shareholders, estate and domestic trust beneficiaries, foreign trust owners and beneficiaries, REMIC residual interest holders, TMPs, and PRs.) Go to www.irs.gov/Form8082 for instructions and the latest information.	OMB No. 1545-0074 Attachment Sequence No. 84				
Name(s) shown on return		Identifying number				
Part I General Information						
1 Check boxes that apply. (a) <input type="checkbox"/> Notice of inconsistent treatment (go to line 2) (b) <input type="checkbox"/> AAR (choose one below—see instructions)		<table border="1"> <thead> <tr> <th>Yes</th> <th>No</th> </tr> </thead> <tbody> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </tbody> </table>	Yes	No		
Yes	No					
For partnership tax years beginning before January 1, 2018 (unless electing into BBA)						
<input type="checkbox"/> TEFRA AAR <input type="checkbox"/> ELPs/REMICs						
For partnership tax years beginning after December 31, 2017 (or that elected into BBA for tax years beginning after November 2, 2015, and before January 1, 2018)						
<input type="checkbox"/> BBA AAR—go to item A below						
A Is the partnership revoking the immediately preceding partnership representative (and/or designated individual, if applicable) and designating a successor (including the appointment of a designated individual, if applicable) at the same time that the AAR is being filed? If "Yes," attach Form 8979		<table border="1"> <tbody> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </tbody> </table>				
B Do the adjustments on the AAR result in an imputed underpayment (IU) for the reviewed year? If "Yes," go to item C1. If "No," go to item D		<table border="1"> <tbody> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </tbody> </table>				
C1 Is the partnership making an election under section 6227(b)(2) to have the adjustments taken into account by the reviewed year partners? If "Yes," go to item D. If "No," go to item C2		<table border="1"> <tbody> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </tbody> </table>				

20

AAR information



- Two types of AARs:
 1. Default - Tax paid in year AAR filed by partnership.
 2. Push Out - Need to elect this option.
 - Tax paid by partners for year reviewed.
- myICLUB does not support IRS form 8082
- More information at IRS web page:

www.irs.gov/businesses/partnerships/file-an-administrative-adjustment-request-for-a-bba-partnership

21

Inform Prospective New Members



- If club chooses to **not** opt out of IRS rules in partnership agreement & operations, it should make policy to **inform prospective members of this decision.**
- New members who are thinking of joining club should be aware that they *could be liable for any past tax problems of club.*

22



HOW LIKELY ARE CLUBS AUDITED?

23

Your Club's Chances of Audit May Be Low



- BetterInvesting-style investment partnerships should not have high audit rate.
- Investment clubs don't have employees or business operations that generate tax liability for partnerships – all tax liabilities pass through to partners.

24

Limit Chances of IRS Audits



- You can limit possibility of IRS audit by:
 - Keeping good records of investment activities.
 - Filing timely partnership tax returns.
 - Make sure myICLUB settings are accurate, such as type & country of each security.
 - Avoid securities other than common stocks.
 - Do not use dividend reinvestment.
- These practices limit risks of errors or complications on IRS tax returns.

25



ANY QUESTIONS?

EMAIL ME: RUSSELL@ICLUB.COM

26