Understanding the New IRS Audit Rules for Investment Clubs

Doug Gerlach,
President,
ICLUBcentral Inc.

Russell Malley,
Club Accounting Advisor,
ICLUBcentral Inc.

July 2018

1

If You Need Webinar Help

- If you are unable to hear anything:
  1. Check speakers or headphones are plugged in.
  2. Check volume.
  3. Use GoToWebinar sound settings wizard to resolve problems.
- If graphics or audio drops in & out:
  1. Turn off any unnecessary programs.
  2. Don't connect to Internet using wifi.
  3. Listen using telephone.

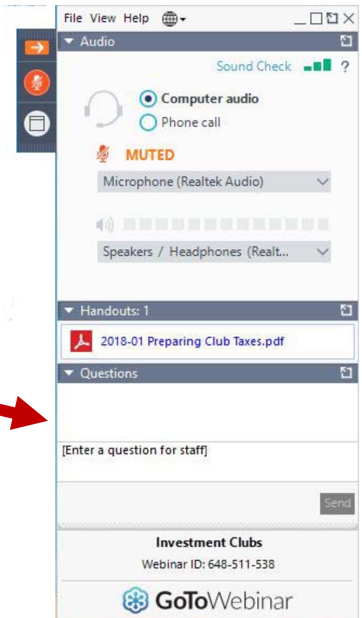
For help, go to
www.gotowebinar.com
or call 1-800-263-6317.

2

Have a Question?

You don't need microphone.

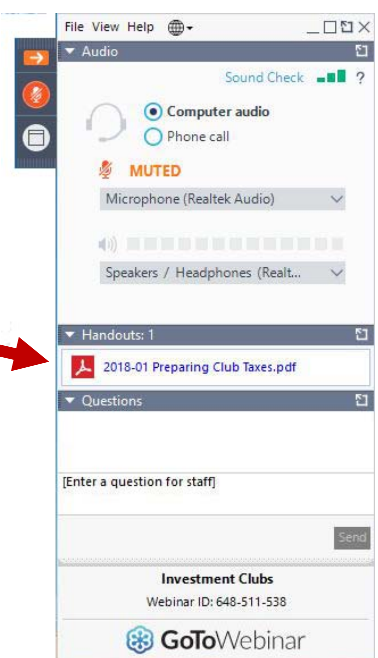
We'll answer questions during presentation & at end.



3

Download the Handout

- Look for the Handouts section of the GoTo applet. (Click triangle to expand if necessary.)
- Click on Acrobat icon or linked filename to download.



4

New IRS Audit Rules for Partnerships

5

Why New 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 beginning after December 31, 2017.
  - All clubs should be aware of rules & procedures for opting-out <u>before filing 2018 returns by March 2019</u>.
  - Clubs disbanding in 2018 <u>should consider opting-out when filing final 1065 return</u>.

6

What Are the Provisions of the New Rules?

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

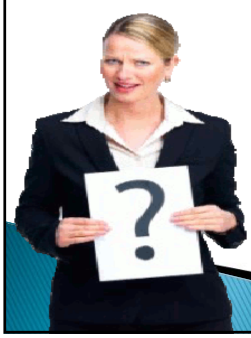
7

Who Is Affected by New Rules?

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

8

Questions?



9

What Should Clubs Do?

10

Assign IRS "Partnership Representative"

- Provision of new rules requires partners to have **partnership representative** (PR).
  - This person is authorized to be sole representative to IRS in event of audit.
- If partnership doesn't have designated representative, IRS may appoint one of their choice!
- This representative is NOT same as designated tax matters partner (TMP) listed on Form 1065.
  - PR need not be a partner, but must have "substantial presence" in U.S.

11

Consider Whether to Permit Trusts

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

12

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 new audit rules when filing returns in each year from 2018 onward.

13

Opt Out of New Audit Rules

- <u>Each year</u>, qualifying partnerships can opt out of new rules when filing IRS Form 1065 tax return (the Section 6221 "Small Partnership" Election).
- <u>Electing Small Partnerships</u> (ESPs) are eligible to opt out if:
  - They have fewer than 100 partners.
  - They do NOT have any trusts or partners as partners (including family revocable living trusts).
    - Partners may be individuals, C corporations, foreign entities that would be C corporations under U.S. law, S corporations, or estates of deceased partners.

14

How to Opt Out

- Mailing a paper return:
  - Include statement that club is making Section 6221 election.
  - This is a letter signed by PR that says:
    - Partnership is making Section 6221 election; and
    - All partners are qualified partners; and
    - All partners have been informed of the election; and
    - Includes list of all partners with their tax ID numbers.
- E-Filing a return:
  - IRS has not yet released procedure to attach Section 6221 statement to e-file returns.
- Remember: **<u>This must be done each year.</u>**

15

Opting Out If Disbanding in 2018

- Clubs disbanding in 2018 & using 2017 forms to file “short-year” final returns, follow the procedure for mailed paper returns.
- Include statement that club is making Section 6221 election.
  - This is a letter signed by PR that says:
    - Partnership is making Section 6221 election; and
    - All partners are qualified partners; and
    - All partners have been informed of the election; and
    - Includes list of all partners with their tax ID numbers.

16

Or, File Amended Returns If Audited

- If club did NOT opt out when filing its return for a particular year, IRS Code Section 6225 allows partnership to file **amended return** to report any changes to income determined by IRS audit.
  - Makes individual partners in year of audit liable for their share of tax liability, not current partners.
- However, this would also require **all partners from audited tax year to file amended personal returns**.

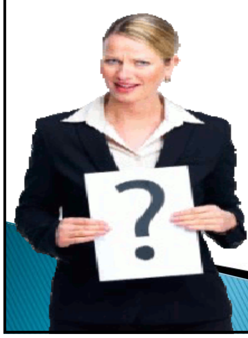
17

Inform Prospective New Members

- If club chooses to NOT address new IRS rules in its partnership agreement & operations, should make policy to inform prospects of this decision.
- New members who are thinking of joining club should be aware that they *could be liable for past tax problems of club*.

18

Questions?



19

» How Likely Are Clubs Audited?

20

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.
- You can limit possibility of audit by:
  - Keeping good records of investment activities.
  - Filing timely partnership tax returns.

21

Questions?

22

Thank You!

ICLUBcentral Inc.
www.iclub.com

Write us:
gerlach@iclub.com
rmalley@iclub.com