



Memo

From: Douglas Gerlach, President, ICLUBcentral Inc. (gerlach@iclub.com)

Date: January 24, 2025

Re: Investment Club Tax Filing Requirements in the State of Illinois

Summary Conclusion: BetterInvesting-style investment clubs in Illinois continue to be exempt from filing Form IL-1065 after the 2023 changes to state tax laws.

Many of our investment club customers in the State of Illinois have asked about the impact of recent tax code changes in the state with respect to partnership tax filing requirements.

The following is our understanding of Illinois filing requirements as of this date as they pertain to pass-through entities (PTEs) such as general partnerships and especially to investment partnerships operating as investment clubs and that fall within the scope of our myICLUB.com club accounting and tax preparation tools.

This interpretation was subsequently confirmed by the Illinois Department of Revenue.

As background, investment clubs come in many different forms with many different objectives. BetterInvesting and myICLUB support investment clubs that are most typically formed by non-professional individual investors who contribute capital regularly to the club which is used to build a portfolio of common stocks and other publicly-traded securities for the benefit of partners. It is these types of clubs that are supported by the myICLUB accounting platform, and about which this memo is concerned. Note that the following information may not serve other types of “investment clubs” or investment partnerships that have a scope outside of investing in securities.

The State of Illinois has had a long-standing exemption (effective for years after December 31, 2004) for investment clubs. Clubs located in the state were not required to file Form IL-1065 informational partnership returns with the state.

In 2023, the Illinois Department of Revenue adopted a new rule reflecting legislation that modifies the definition of “investment partnerships,” and provides that for taxable years ending on or after December 31, 2023, these partnership must **withhold and remit** to the state Illinois income and replacement taxes from certain **nonresident partners** based on the partner’s share of distributable **income from in-state sources**. Only partnerships that include partners who are not Illinois residents are affected by this change.

However, our reading of the new regulations is that most BetterInvesting-style investment clubs continue to **not be required** to file an annual tax return with the state even if they have non-resident partners. This is for two reasons:

1. According to the state, income and gains from investments in publicly-traded securities **do not generally generate business income** and thus **do not constitute Illinois source income**; and as such there is **no need for the partnership to withhold and remit tax payments**, and
2. Investment partnerships that have **no tax withholding or remittances** are **specifically exempted from the state's annual filing requirements**.

Our understanding is based on the following.

In 35 ILCS 5/709.5 (emphasis added):

(d) For taxable years ending on and after December 31, 2023, every investment partnership, as defined in Section 1501 of this Act, **shall withhold from each nonresident partner** (other than a partner who is exempt from tax under Section 501(a) of the Internal Revenue Code or under Section 205 of this Act, or who is a retired partner, to the extent that partner's distributions are exempt from tax under Section 203(a)(2)(F) of this Act) an amount calculated as follows:

(1) the sum of (i) **the share of income that, but for the provisions of subsection (c-5) of Section 305 of this Act, would be apportioned to Illinois by the investment partnership** under subsection (a) of Section 305 of this Act and (ii) **the share of nonbusiness income that, but for the provisions of subsection (c-5) of Section 305 of this Act, would be allocated to Illinois by the investment partnership** under subsection (b) of Sections 305 and Section 303 of this Act (other than an amount allocated to the commercial domicile of the taxpayer under Section 303 of this Act) that is distributable to that partner under Sections 702 and 704 of the Internal Revenue Code, whether or not distributed; multiplied by..

Section 305 subsection (c-5) as referenced above states (emphasis added):

(35 ILCS 5/305) (from Ch. 120, par. 3-305) Sec. 305. Allocation of Partnership Income by partnerships and partners other than residents.

(a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident.

(c-5) Taxable income of an investment partnership, as defined in Section 1501(a)(11.5) of this Act, **that is distributable to a nonresident partner shall be treated as nonbusiness income and shall be allocated to the partner's state of residence (in the case of an individual)** or commercial domicile (in the case of any other person). However, any income distributable to a nonresident partner shall be treated as business income and apportioned as if such income had been received directly by the partner if the partner has made an election under Section 1501(a)(1) of this Act to treat all income as business income or if such income is from investment activity:

(1) that is directly or integrally related to any other business activity conducted in this State by the nonresident partner (or any member of that partner's unitary business group);

(2) that serves an operational function to any other business activity of the nonresident partner (or any member of that partner's unitary business group) in this State; or

(3) where assets of the investment partnership were acquired with working capital from a trade or business activity conducted in this State in which the nonresident partner (or any member of that partner's unitary business group) owns an interest.

Note: The exceptions in (c-5) (1) thru (3) would not apply to BetterInvesting-style investment clubs.

Subsection (c-5) above clearly indicates that the partnership's non-business income for non-residents shall be allocated to the state of residence of the partner. This would make **this partnership income non-taxable in IL for non-resident partners.**

Finally, according to the instructions for Form IL-1065 for 2023 (page 5):

If the investment partnership has no income subject to investment partnership withholding, the investment partnership is not required to file Form IL-1065.

Subsection c-5 of section 305 makes **all non-business income distributed to IL non-residents partners not taxable.** Therefore, BetterInvesting-style investment clubs in the State of Illinois will **not need to withhold taxes for non-residents** and thus are **not required to file an annual return with the state.**

Investment partnerships in the state that earn Illinois-source income directly or through an investment in a partnership, exchange-traded fund, or other investment would likely not be covered by this exemption and should expect to prepare and submit annual filings.

Note: *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.*

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