

The gain from the sale of Illinois real property as the sole partnership asset is allocated to this State under Section 303 or Section 304 of the Illinois Income Tax Act. (This is a GIL.)

July 28, 2025

NAME  
ADDRESS  
EMAIL

Re:    Illinois Income Tax – Capital Gains on Sale of Illinois Real Property as Partnership Asset

Dear NAME:

This letter is in response to your letter dated June 14, 2025, in which you requested information regarding the treatment of capital gains on the sale of Illinois real property as a partnership asset. The Department issues two types of letter rulings. Private Letter Rulings (“PLRs”) are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c). You may access our website at <https://tax.illinois.gov/> to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

First let me state that I am writing this on my own, as NAME, Tax Payer. I am not a lawyer or accountant. I already spend plenty of money on lawyers and accountants and they did not advise me correctly. They should have advised me to distribute the assets to the two partners before selling the family farm and avoid PPRT. They did not.

I am in this mess because of lack of proper advice.

I inherited 100% of a farm from my mother in YEAR A lawyer advised me to set up a partnership which consist of %%% PARTNERSHIP which is owned %%% by me and %%% which is a trust set up for my son.

The sole purpose of the partnership was in case of my death, the assets would pass to my heirs.

The partnership does not do business in Illinois; does not have employees; does not have meetings in Illinois; does not have a telephone number and does not even have an address in Illinois. It does not conduct business in Illinois. It is a structure for inheritance taxes.

The last time I was even in Illinois was over 5 years ago (note: I will be there end of DATE).

### **Background**

Based my research, the Personal Property Replacement Tax (PPRT) in Illinois, enacted in 1970, was introduced as a mechanism to replace revenue lost from the abolition of the personal property tax on businesses, as mandated by the Illinois Constitution. Its primary purpose was to impose a tax on corporations, partnerships, and other entities for the privilege of conducting business operations within the state, thereby generating funds to support local governments and municipalities. The tax targets entities actively engaged in commercial activities, with the intent to capture income derived from business conducted in Illinois.

In contrast, my organizational structure was established exclusively for liability protection and to manage inheritance tax obligations, designed to facilitate the orderly transfer of assets to heirs in accordance with estate planning objectives.

This structure was not created to conduct business operations, generate revenue, or engage in commercial activities within Illinois. Its sole function pertains to the administration of inheritance-related matters, which is distinct from the business-oriented activities the PPRT was intended to tax. Applying the PPRT to my structure misconstrues its purpose and imposes a tax liability that does not align with the original legislative intent of the PPRT, as my entity does not benefit from the privilege of doing business in the state. Consequently, subjecting my structure to the PPRT represents an inappropriate application of the tax, given its non-business, inheritance-focused purpose.

## **Request**

I am requesting a private letter ruling (PLR) pursuant to 2 Ill. Admin. Code 1200 regarding the application of the Personal Property Replacement Tax (PPRT) to a one-time capital gain reported on the YEAR Illinois Form IL-1065 for a partnership with FEIN ###. This request follows correspondence with NAME2, Revenue Tax Specialist I, who advised that further clarification on this matter requires a formal letter ruling process. I seek binding guidance on whether the capital gain can be excluded from the PPRT as nonbusiness income and reported on the personal return of the partnership's primary owner, prior to incurring the cost of amending the federal return.

## **Background and Factual Scenario**

The partnership, established for inheritance tax planning and liability protection purposes rather than business operations, owns an Illinois LLC that held real estate as its sole asset. The assets of the LLC, specifically the ###-acre farm, should have been distributed to the partners of PARTNERSHIP Limited prior to the sale, but I was not correctly advised, leading to the sale being conducted within the LLC structure. There are two partners, TRUST (%%%) which my son is the beneficiary and PARTNERSHIP (%%%) which is %%% owned by me. The structure was set up by an attorney for Federal inheritance tax purposes over ### years ago. The farm has been in my family for over ### years. I inherited 100% of it in YEAR.

In YEAR, the LLC sold the real estate, generating a significant one-time capital gain. The LLC also earned rental income from leasing the property prior to the sale and this income is subject to PPRT. The partnership received a 1099-S for the sale, and the original federal return (Form 1065) was filed by my non-Illinois-based accountant, who was unfamiliar with Illinois PPRT tax requirements. The capital gain was incorrectly reported on Line 9 (Other Income) of the Federal Schedule K, treating it as ordinary business income, which contributed to its initial inclusion in the PPRT calculation on the IL-1065.

I am considering amending the federal return (Form 1065X) to reclassify the capital gain from Line 9 to Line 9a (Net Long-Term Capital Gain), reflecting its status as a capital gain rather than business income, to align the federal reporting with the Illinois filing. However, I seek your guidance on the feasibility of this approach before incurring the expense of preparing and filing the amended federal return. I propose to exclude the capital gain from the

PPRT as nonbusiness income and report it on my personal Illinois return (IL-1040), where the PPRT does not apply, while the rental and ordinary business income will remain on the IL-1065, subject to the PPRT.

### **Request for Ruling**

I respectfully request a private letter ruling on the following:

Whether a one-time capital gain from the sale of real estate, held by an LLC within a partnership established for inheritance tax planning and liability protection (not business operations), can be excluded from the PPRT on the IL-1065 as nonbusiness income under 35 ILCS 5/201(c), and instead reported on the personal return of the partnership's primary owner, particularly given that the assets should have been distributed to the partners prior to the sale but were not due to incorrect advice, and prior to amending the federal return.

Whether the proposed reclassification of the capital gain from Line 9 to Line 9a on a potential amended federal return (Form 1065X) would support its exclusion from the PPRT on the IL-1065, given the 1099-S issued to the partnership and the failure to distribute the asset prior to sale.

What additional documentation or steps are required to support this exclusion, considering the partnership's nonbusiness purpose, the potential federal return amendment, and the incorrect advice that prevented asset distribution.

### **Legal Basis for the Request**

My research suggests the following legal support for excluding the capital gain:

**Legislative Intent:** The PPRT was enacted to replace the Personal Property Tax, which applied to tangible personal property, not real estate or capital gains. *General Telephone Co. v. Johnson* (103 Ill. 2d 363, 1984) and *Kraft, Inc. v. Edgar* (138 Ill. App. 3d 550, 1985) emphasize that the PPRT should align with this purpose.

**Nonbusiness Income:** Under 35 ILCS 5/1501(a)(1), nonbusiness income includes gains not arising from regular business activities. *Zeigler v. Department of Revenue* (158 Ill. App. 3d 543, 1987) holds that the PPRT applies only to income with a nexus to business activities, which a one-time

sale may lack, especially if the asset should have been distributed to the partners.

Entity Purpose: People ex rel. Scott v. Chicago Thoroughbred Enterprises, Inc. (56 Ill. 2d 210, 1973) indicates that an entity's purpose can affect tax treatment, supporting exclusion if the partnership's intent was not business-related and the sale resulted from an improper structure.

Statutory Interpretation: 35 ILCS 5/201(c) taxes the "privilege of earning or receiving income," which may not apply to a one-time capital gain from real estate, particularly if the partnership's role was misconstrued due to incorrect advice.

### **Additional Information**

1. The partnership has no employees, no business meetings, and no operational activities beyond holding the LLC and collecting rental income, reinforcing its nonbusiness nature.
2. My next door neighbor, using a single-member LLC owned directly, avoided PPRT on a similar sale by reporting the gain personally, suggesting a potential inequity in the partnership structure's tax treatment. He sold the exact same sized piece (### Acres) to the exact same buyer for the exact same price but with zero PPRT.

I am awaiting your guidance on the feasibility of amending the federal return and would like advice on interim filing options for the IL-1065 (e.g., filing with the full PPRT and amending later, or filing with the exclusion pending federal approval).

### **Request for Process**

Please advise on the procedure for submitting this PLR request, including any required forms (e.g., Form IL-1065-X or a specific PLR application), fees, and the timeline for a response. I am prepared to provide the draft IL-1065, original Federal Schedule K, and supporting documentation upon request once I determine the need to proceed with the federal amendment. Due to my location in COUNTRY (### hours ahead of Illinois), I am available for a call at your earliest convenience and can be reached at PHONE1 or EMAIL. I am in USA DATE RANGE and can be reached at PHONE2.

Thank you for your consideration of this request.

Your submission includes the following additional information pertinent to your request:

1. ### Acre Farm was COMPANY1 located in TOWN1, COUNTY1 Illinois (PIN ###; ###)
2. There are two other corn/soy farm properties I inherited from my mother:
  - a) COMPANY2 in TOWN2, COUNTY2, Illinois (PIN ###)
  - b) COMPANY3 in TOWN3, COUNTY3, Illinois (PIN ### and ###)

### **DEPARTMENT'S RESPONSE**

Internal Revenue Code ("IRC") section 7701(a)(2) provides the term "partnership" to include a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a trust, estate, or a corporation. The term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

This definition is essentially identical to Section 1501(a)(16) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/1501) which defines "partnership" and "partner" as follows:

The term "partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such syndicate, group, pool, joint venture or organization. The term "partnership" includes any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, classified as a partnership for federal income tax purposes. The term "partnership" does not include a syndicate, group, pool, joint venture, or other unincorporated organization established for the sole purpose of playing the Illinois State Lottery.

86 Ill. Admin. Code 100.9700(d)(1) provides that every entity treated as a partnership for federal income tax purposes is a partnership for purposes of the IITA, and no entity that is not treated as a partnership for federal income tax purposes is a partnership for purposes of the IITA. For example, if an entity elects to be treated as a partnership for federal income tax purposes under 26 CFR 301.7701(a), then it is a partnership for purposes of the IITA.

IITA Section 1501(a)(1) defines "business income" as follows:

The term “business income” means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

Business income is explained in greater detail in the Illinois Administrative Code, including how the definition has evolved over the years. A person’s income is business income unless clearly classifiable as nonbusiness income (86 Ill. Adm. Code 100.3010(a)(3)(C)).

IIITA Section 1501(a)(13) defines “nonbusiness income” as follows:

The term “nonbusiness income” means all income other than business income or compensation.

IIITA Section 301(c)(1) provides that any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is referred to in Section 302, 303 or 304 (relating to compensation, nonbusiness income and business income, respectively) shall be allocated to this State only to the extent provided by such section. Your letter indicates the partnership was formed upon the death of your mother and invested in Illinois real property. As such, the allocation rules pertaining only to real property will be addressed in this response.

IIITA Section 303 governs the allocation of nonbusiness income of persons other than residents. Section 303(b) outlines when capital gains and losses are allocable to this State. For real property, capital gains and losses are allocable to this State if the property is located in this State.

IIITA Section 304 governs the allocation and apportionment of business income of persons other than residents. In general, pursuant to Section 304(a), the business income of a person other than a resident shall be allocated to this State if such a person’s business income is derived solely from this State. For tax years ending on or after December 31, 1998, Section 304(h) provides if a person other than a resident derives business income from this State and one or more other states, then the apportionment factor shall be equal to the sales factor. For taxable years ending on or after December 31, 2008, Section 304(a)(3)(C-5)(i) provides that sales from the sale or lease of real property are in this State if the property is located in this State.

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The gain on the sale of a partnership asset must first be classified as either business income or nonbusiness income. If the gain is business income, nonresidents must include the gain in income apportioned under IITA Section 304. Business income of a partnership flows through to nonresident partners as business income in accordance with IITA Section 305(a). If the gain on the sale of a partnership asset is not business income as defined in IITA Section 1501(a)(1), then it is nonbusiness income pursuant to IITA Section 1501(a)(13).

If the gain is nonbusiness income, nonresidents must include the gain in income allocated under IITA Section 303. Nonbusiness income of a partnership is taxed to the partner as if that partner had received the income directly, rather than through the entity, as provided in IITA Section 305(b).

You indicated on your YEAR federal Form 1065 the partnership's principal business activity is ACTIVITY, and the principal product is PRODUCT. In this matter, regardless of whether the gain on the sale of real property is classified as business or nonbusiness income, the gain will be assigned to Illinois on Form IL-1065 as this partnership asset is located in Illinois. Therefore, the Department will not accept an amended Illinois partnership tax return reflecting a decrease in the amount of the Personal Property Replacement Tax reported on an original return relating to the gain on the sale of Illinois real property held as the sole partnership asset. In addition, the Department will not accept an amended Illinois Form IL-1040 individual tax return filed by or on behalf of the partnership's primary owner to report this gain. The partnership cannot ignore its own structure and treat the gain as that of the partnership's primary owner. (See *Moline Properties, Inc. v. Commissioner*, 319 US 436 (1943)) The establishment of the partnership structure most likely resulted in some benefit to the partners. The gain is the partnership's gain and is subject to Illinois Personal Property Replacement Tax.

The Department cannot advise on the question of whether you should file an amended federal tax return.

As stated above, this is a General Information Letter. A General Information Letter does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you require additional information, please visit the Department's website at <https://tax.illinois.gov/> or contact the Department's Taxpayer Assistance Division at 800-732-8866.

Sincerely,

Jennifer Uhles

Associate Counsel (Income Tax)

NAME

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