



Estate Tax Considerations for Non-Illinois Residents holding Illinois Real Estate

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Illinois imposes a state estate tax on taxable estates exceeding \$4 million.¹ By contrast, thirty-three other states, including Florida and Arizona, impose neither a state estate tax nor an inheritance tax.² Taxpayers seeking to reduce estate taxes often relocate to, and become domiciled³ in, one of these states. However, if they own Illinois real estate at death, their estates may still owe Illinois estate tax. This result can be an unwelcomed surprise, arising because the Illinois estate tax applies to real property located in Illinois, regardless of the owner's state of domicile.

Simply stated, if a taxpayer owns real property located in Illinois at the taxpayer's death, the taxpayer's estate may be subject to Illinois estate taxes. Moreover, Illinois estate taxes are calculated based on the entire value of a taxpayer's taxable estate, not just the value of the Illinois real property.

Consider the following example: *Susan is domiciled in Florida at her death. Susan's estate consists of a diversified investment portfolio, retirement accounts, her primary residence in Florida, and personal effects, with a total value of \$7 million, plus a \$1 million secondary residence in Illinois. Assume no deductions apply and that \$8 million is the value of Susan's taxable estate.*

Because Susan's \$8 million taxable estate is well below the \$15 million federal estate tax exemption, no federal estate taxes are owed. Susan was domiciled in Florida, a state that has no state estate tax, so no Florida estate taxes are owed. However, because Susan's estate includes real property located in Illinois and the value of Susan's taxable estate is over \$4 million, Susan's estate owes Illinois estate taxes.

Even though Susan was not an Illinois domiciliary, Susan's Illinois estate tax is calculated based on her entire \$8 million taxable estate, not just the \$1 million of Illinois

real property. The resulting Illinois estate tax of \$680,000 is then multiplied by (reduced to) the percentage of Susan's taxable estate comprised of Illinois real property (1/8 or 12.5%) to arrive at the \$57,500 payable by Susan's estate to the State of Illinois.

This is a shocking result for many taxpayers domiciled outside Illinois who own Illinois real property.

What can be done? A limited liability company ("LLC") may be the answer.

Real estate is real property, and the location, or "situs" of real property generally determines how it is taxed, including for estate tax purposes. By contrast, intangible personal property generally has its situs in the owner's state of domicile. Common examples of intangible personal property are stocks, bonds, bank and brokerage accounts, partnership interests, patents, and copyrights. Generally, LLC membership interests are also considered intangible personal property.

Accordingly, under this approach, many estate planning attorneys take the position that contributing Illinois real property to an LLC in exchange for LLC membership interests is a way to convert an individual's ownership of Illinois real property (estate taxable in Illinois) to ownership of intangible personal property (estate taxable, if at all, in the owner's state of domicile). If this thinking is correct, non-Illinois domiciled individuals, the change of taxable situs to the individual's state of domicile eliminates Illinois estate taxes.

Using the Susan example above, assume that during her lifetime Susan transferred ownership of her Illinois real property to an LLC in exchange for all the LLC membership interests, and that at Susan's death Susan still owns all the LLC membership interests. The thinking is that, at Susan's passing, her LLC membership interests will be considered intangible personal property situated in Florida (Susan's state of domicile) and Susan will not own any real property situated in Illinois; therefore, Susan's estate will not be subject to Illinois (or any) state estate taxes.

Many consider the absence of prohibitive legislation or judicial action tacit consent to the conversion result. However, the conversion result is not guaranteed in Illinois. Illinois has not enacted legislation specifically affirming (or denying) the conversion outcome. No Illinois appellate (or higher) court has squarely held (or denied) that a

non-Illinois decedent's membership interests in a single member LLC owning Illinois real property will be treated as non-Illinois situated intangible personal property for Illinois estate tax purposes.

Nor are other states in agreement on this issue. States such as Washington and Oregon have recognized LLC membership interests as intangible personal property excluded from their respective state estate tax calculations. New York and Connecticut, on the other hand, have taken the opposite approach that supports "looking through" single member LLCs and classifying the sole owner of the LLC membership interests as the taxpayer and subjecting local real estate held in non-residents' single member LLCs to their respective state estate tax calculations.

In addition to estate tax implications, there are other important considerations with respect to the formation and operation of an LLC, as well as potential unintended consequences on financing, insurance coverage, property tax exemptions, and other matters resulting from the transfer of real property. In some cases, individuals domiciled in a state with an estate tax may be better served by holding real property located in an estate-tax-free state directly, rather than through an LLC, so that the property's tax situs remains in the estate-tax-free state and is not converted into intangible personal property. Accordingly, individuals should consult experienced legal and tax advisors before taking any action.

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¹ Illinois has a \$4 million per person estate tax exemption. However, for taxable estates over \$4 million, the entire taxable estate, not just the amount over \$4 million, is subject to Illinois estate taxes. Additionally, for a married couple, steps must be taken to ensure that each spouse's \$4 million Illinois exemption is used at that spouse's passing.

² The federal estate tax exemption is \$15 million in 2026 and applies to all U.S. citizens wherever located.

³ Many factors determine a person's "domicile" state. A few such factors may include a person's voter registration, driver's license, state ID, and passport information. In general, a person is domiciled in the state where the person's primary residence is located. A person can have homes in different states, but only one state of domicile.