September 28, 2026

The Illinois Income Tax Investee Apportionment Rule: Nuances and Opportunities

by David A. Hughes , Lauren A. Ferrante , Kylan S. Memminger

Introduction

In 2025, the Illinois General Assembly enacted a new law for taxing income of a nonresident derived from the sale of an interest in an S corporation or a partnership interest (collectively, "PTE"). Illinois law now imposes "investee apportionment" on a nonresident taxpayer's gain from the sale of a PTE, requiring the taxpayer to allocate the gain to Illinois to the extent of the PTE's Illinois apportionment factor under the Illinois Income Tax Act ("Investee Apportionment Law" or "Law"). The Law applies to nonresident investors regardless of whether they maintain a physical or operational presence within Illinois and regardless of whether the gain from the sale of a PTE is characterized as business income or nonbusiness income.

For nonresident investors faced with Illinois tax filing obligations, they must now carefully evaluate their income reporting and apportionment strategies to determine both opportunities and compliance related to the Law. In this blog post, we will provide an overview of the Investee Apportionment Law as well as practical strategies and takeaways.

Overview of the Investee Apportionment Law

Effective for tax years ending on or after June 16, 2025, the Investee Apportionment Law provides that a nonresident's gains from the sale of an interest in a PTE is allocated to Illinois on the basis of the PTE's Illinois apportionment factor in the year of the sale and the two years prior to the year of sale. Significantly, if the PTE did not exist during the two years prior to the sale, then the Investee Apportionment Law requires apportionment based only the PTE's year(s) of existence.

The Law marks a substantial departure from the state's prior approach to sourcing a nonresident's gain or loss from the sale of a PTE. Historically, Illinois generally allocated those gains to the taxpayer's commercial domicile if the gain was "nonbusiness income." *See* GIL IT-22-0008 (May 10, 2022) (nonresident partner that sells its share of non-unitary partnership allocates nonbusiness capital gain from the sale under Section 303 of the Illinois Income Tax Act).

Under the new framework, however, this long-standing allocation method is replaced by a sourcing regime that presents significant challenges and opportunities for investors as explained below.

Challenges and Strategies Presented by the Law

The Law's new methodology presents various challenges, risks, and opportunities for taxpayers and the state.

1. **While "new" to Illinois, the concept of "investee apportionment is not "new" in the state and local tax world**

   Historically, state income tax law generally disallowed the use of a target's apportionment factor to determine the tax liability of a seller unless the two were engaged in a unitary business. This foundational limitation, designed to ensure that only income arising from a sufficiently integrated and interdependent business operation could be apportioned, was explicitly recognized by the United States Supreme Court in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980). The Court identified the unitary business principle as the "linchpin of apportionability" in state taxation, underscoring its central role in safeguarding against arbitrary or inequitable income allocation. *See id*.

   Investee apportionment, by contrast, arguably ignores the unitary business principle by permitting a state to tax a nonresident seller's gain even when the seller and target are not unitary. As such, it is no surprise that other states' investee apportionment rules have been challenged in court. *See*, *e.g.*, *VAS Holdings & Investments LLC v. Commissioner of Revenue*, 185 N.E.3d 1069 (2022) (invalidating the taxing agency's use of "investee apportionment" because the state lacked a statutory basis but observed in dicta that federal constitutional principles would not necessarily bar such taxation even in the absence of a unitary relationship); *In the Matter of Goldman Sachs Petershill Fund Offshore Holdings (Delaware) Corp. v. New York City Tax Appeals Tribunal*, 2022 N.Y Slip Op 02361 (N.Y. App. Div. 2022) (upholding application of a New York City tax "investee apportionment" rule); Ohio Dep't of Taxation, Final Determination, Refund Claim No. 0044350439 (Mar. 28, 2024) (Tax Commissioner rejected taxpayers' constitutional arguments that the gain at issue had an insufficient connection with the state and upheld use of the "investee apportionment" statute).

Faced with evolving judicial guidance and the increasing willingness of states to assert taxing jurisdiction over non-unitary gains, Illinois took legislative action to expand its authority through enacting the Investee Apportionment Law. But such laws, including the new Illinois law, are not necessarily immune from attack. For example, the U.S. Supreme Court in *MeadWestvaco Corp. v. Illinois Dept. of Revenue*, 553 U.S. 16 (2008) overturned Illinois courts' rulings that the state was permitted to tax a taxpayer's sale of a business even if the businesses were not unitary. The Court expressly declined to address the question of investee apportionment because it had not been properly raised and argued in the Illinois courts. Thus, we have not (yet) heard the final word on the constitutionality of "investee apportionment."

2. **Use of the PTE's Illinois Apportionment Factor**

As noted, the Investee Apportionment Law requires that the sale of an interest in a PTE be allocated to Illinois: (1) using the PTE's own Illinois apportionment factor; and (2) in the year of the sale and the two years prior to the year of sale, or if the PTE did not exist during the two years prior to the sale, then only the PTE's year(s) of existence.

In a multi-step buy/sell transaction, the plain language of the Law and Illinois Department of Revenue ("Department") guidance support looking to the actual PTE sold. *See, e.g.*, Department, Publication 129, Pass-Through Entity Information (Dec. 2025). For purposes of the Investee Apportionment Law, the PTE uses an apportionment formula based on a factor composed of sales made in Illinois over sales made everywhere. 35 ILCS 5/304(a)(3), (h)(3).

For a PTE that has existed for less than two years, the Law instructs using the apportionment data during the PTE's time of existence. Depending on the transaction structure, a PTE may be in existence for one year, one month, or perhaps only one day. In such instances, although the plain language of the Law instructs using the PTE's apportionment factor for the duration of the entity's existence, there may be facts and circumstances where such use yields impractical results or may be viewed as distortive of the taxpayer's market or business activities. Those cases where mechanical application of the Law does not "fit" a taxpayer's facts may present opportunities for tax strategizing.

Moving forward, please reach out to us with any questions or concerns with respect to the Law. While states may view “investee apportionment” as expanding the reach of their income tax base to capture gains from business sales, viable arguments and strategies exist to challenges this approach.