

Internal Revenue Service

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Person To Contact:
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Legend

X =

a =

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State =

Date1 =

Date2 =

Year1 =

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Dear _____ :

This responds to a letter dated January 15, 2009, submitted on behalf of X by X's authorized representative, requesting a ruling that the rental income received by X from certain rental real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code (the Code).

The information submitted states that X was incorporated under the laws of State on Date1. X elected to be an S corporation effective Date2. X is engaged in two lines of business, owning and operating convenience stores and owning and managing rental real estate. With respect to X's convenience store operations, X functions principally as a petroleum marketer, selling certain brands of gasoline, diesel and kerosene to retail customers through a network of a stores in State. X also sells unbranded gasoline purchased through an industry cooperative at b stores. Of the total number of c convenience store customers, X owns the building and property at d stores and rents these stores to independent operators. X also sells wholesale heating oil, kerosene, and diesel products to residential and commercial customers.

With respect to X's rental real estate operations, X owns, operates and manages a total of e commercial properties. X provides various services in its rental real estate business, including routine maintenance of the properties and related systems, maintenance of all common areas, negotiation of all tenant leases, coordination of all tenant functions, resolution of all tenant complaints, and management of all finances relating to its properties. X also handles the usual rental, leasing and administrative functions, and provides insurance coverage and security for the properties. X maintains a staff of f employees, all of whom devote all of their working time to management and service of the properties, including maintenance and repairs for heating and air conditioning, plumbing systems, ground maintenance, painting, electrical repairs, roof repairs and replacements, trash removal, carpet cleaning, renovations, pest control and general property up-keep. X meets most of its routine administrative and maintenance needs with its own employees, although X periodically contracts with third parties to perform certain functions.

In Year1, X collected approximately \$g in gross rents and incurred approximately \$h in relevant operating expenses for X's rental real estate properties. In Year2, X collected approximately \$i in gross rents and incurred approximately \$j in relevant operating expenses for X's rental real estate properties. X also represents that X has accumulated earnings and profits.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(iii)B(i) of the Income Tax Regulations provides that “rents” means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that “rents” does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based on all of the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all of the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts submitted and the representations made, we conclude that the rental income X receives from its operations described above is not passive investment income under § 1362(d)(3)(C)(i).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b). Further, the passive investment income rules of § 1362 are independent of the passive activity loss rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes