

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-107423-01
Date:
November 16, 2001

X =

State =

Properties =

D1 =

D2 =

D3 =

n =

\$z =

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\$y =

Dear :

This responds to a letter dated January 29, 2001, and subsequent correspondence submitted on behalf of X, requesting a ruling that X's rental income from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

According to the information submitted, X was incorporated under State law on D1, and elected under § 1362(a) to be an S corporation effective D2. X has accumulated earnings and profits.

X is in the business of owning, operating, and managing the Properties, which are commercial rental real estate. Through its n full time employees and contractors, X provides various services in operating the Properties. These services include: repairing and maintaining the properties; snow removal; lawn care; managing the construction of all tenant improvements and remodeling; and parking lot maintenance.

In addition to the services X provides to tenants, X performs the usual leasing and administrative activities involved in managing real estate. These activities include: soliciting and screening prospective tenants; negotiating the terms of each lease; and ensuring that tenants understand and comply with lease terms.

In the fiscal year ending D3, X accrued approximately \$z in rents and incurred \$y in relevant expenses.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

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

Section 1362(d)(3)(C)(i) provides that except as otherwise provided, 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)(ii)(B)(1) of the Income Tax Regulations provides that "rents" means amounts received for the use of, or 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

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corporation are derived in an active trade or business of renting property only if, based on all 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 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 and the representations submitted, we conclude that the rental income that X derives from the Properties is income from the active trade or business of renting property and is not passive investment income as described in § 1362(d)(3)(C)(i).

Except as specifically set forth above, we express no opinion as to the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, we express no opinion on whether X is a small business corporation eligible to make an S election. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 yours,
SHANNON COHEN
Assistant to the Branch Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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