

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2-PLR-131525-01

Date:

December 7, 2001

Legend

X:

A:

B:

C:

D:

Properties:

f:

g:

D1:

Dear \_\_\_\_\_ :

This responds to your representative's letter dated April 30, 2001, submitted on behalf of X, requesting a ruling that X's income from Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X is a C corporation whose stock is held by A, B, C and D. X requests this ruling in anticipation of making an election to be treated as an S corporation effective D1.

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X is engaged in two businesses. X owns and manages timber property and owns, rents, and manages Properties. X, directly and through contractors, provides various services in operating Properties. Services with respect to Properties vary for each of the leases. X's responsibilities for Properties include, but are not limited to, inspecting, maintaining and repairing all structural portions of the buildings (including the roof, walls, ceiling, foundation, wiring, plumbing, elevators and similar equipment) except for equipment and alterations owned or made by the tenant. X is also responsible for the utilities expenses and all outside and common area maintenance expenses. X contracts for other tenants services such as replacing light fixtures, painting and replacing carpeting. An unrelated company is utilized to perform certain management and leasing functions.

X also represents that X's officers, employees and associates are responsible for evaluating the backgrounds of prospective tenants; negotiating and signing leases; settling tenant disputes; negotiating contract coverage, overseeing rental collections, communicating with tenants, arranging for pest control, arranging for outside services such as landscaping and snow removal, hiring and monitoring subcontractors as needed for repairs. X is also responsible for paying the property tax assessments on Properties.

For the taxable year ending D1, X received approximately \$f in gross rental income and paid approximately \$g in relevant expenses other than depreciation.

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 defines "rents" as 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 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

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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 income that X derives from 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. Further, we express no opinion on whether X is a small business corporation eligible to make an S election under § 1361(b)(3) of the Code.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely yours,  
J. Thomas Hines  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2

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