

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B01-PLR-112592-01
Date:
August 2, 2001

Legend

Company =

State =

City =

Properties =

Year =

D1 =

D2 =

\$a =

\$b =

y =

Dear :

This responds to a letter dated February 28, 2001, together with subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income derived from the operation of its rental properties does not constitute passive investment income within the meaning of section 1362(d)(3)(C)(i) of the Internal Revenue Code.

Facts

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Company was incorporated in State on D1, and was a C corporation until it filed an election to be treated as an S corporation effective D2.

Company owns several commercial plots of land (the Properties) located in City, State, which are rented primarily for the purpose of y.

Company is responsible for the maintenance of the Properties, including outside lighting, side walks and parking lots, fences and gates, and all plumbing and electrical requirements of the tenants. Company also provides routine maintenance, consisting principally of cleaning, snow removal and repairs. In addition, Company provides toilet facilities, pay telephone facilities, assistance with unloading of tenants' trucks, and assistance with tenants' moving of heavy equipment by providing forklift and forklift operators for all tenants. Company employs a full time maintenance staff whose responsibilities include policing the common areas, periodically assisting tenants with repair and maintenance needs, and contracting, meeting with and overseeing the work of various contractors and subcontractors. In addition, Company utilizes a number of outside vendors to supply other needed services, including sanitation, fence installation, paving, plumbing and sewer, installation of sprinkler systems, security and fire protection, and electrical services. Company also handles the usual leasing and administrative functions involved in overseeing the management of the Properties, including securing tenants, negotiating leases, billing and rent collection, and dispute resolution.

According to the information submitted, Company received or accrued \$a in rents and paid or incurred \$b in relevant expenses with respect to the Properties in Year.

Law and Analysis

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

Section 1362(d)(3)(A)(i) provides that an election under section 1362(a) terminates whenever the corporation (I) has accumulated earnings and profits at the close of each of three consecutive years, and (II) has gross receipts for each of such tax years more than 25 percent of which are passive investment income.

Except as otherwise provided in section 1362(d)(3)(C), section 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)(ii)(B)(1) of the Income Tax Regulations provides that "rents" means amounts received for the use of, or the right to use, property (whether

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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 significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Conclusion

After applying the law to the facts submitted and representations made, we conclude that the rental income Company receives from the Properties is not passive investment income under section 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding whether Company otherwise satisfies the S corporation eligibility requirements under section 1361. Further, the passive investment income rules of section 1362 are completely independent of the passive activity rules of section 469; unless an exception under section 469 applies, the rental activity remains passive for purposes of section 469.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Matthew Lay
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes