

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-148237-01

Date:

February 15, 2002

Company:

Subsidiary:

Property:

Shareholders:

State:

a:

b:

c:

d:

e:

f:

g:

h:

i:

Dear

This letter responds to a letter dated September 7, 2001, from your authorized representative, as well as subsequent correspondence, requesting a ruling that the rental income received by Company from the Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b. Company is primarily engaged in leasing and operating a retail shopping center (the Property), with approximately c tenants. It also operates certain small retail and service businesses within the Property, as well as running Subsidiary and engaging in extensive real estate development.

Company represents that it is directly and actively involved in the day-to-day operations of the Property. Through approximately d employees and officers (all but 2 of whom work full-time), Company provides various services to the Property in its real estate leasing and management business. (In addition, Company employs approximately e persons to operate the small businesses within the Property and f persons to operate Subsidiary.) The services provided include maintaining common

areas, including restrooms; bussing tables and cleaning food trays; providing electricity, water, heating, and air conditioning; maintaining property exteriors, including roofs; maintaining the parking lots; constructing tenant modifications; monitoring and coordinating safety measures; promoting and coordinating holiday activities; landscaping and grounds maintenance; carpentry repairs and modifications; trash removal; pest control; security services; and common marketing. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing real estate.

Company received or accrued approximately g in rents and paid or incurred approximately h in relevant expenses for i on the Property.

LAW AND ANALYSIS

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) terminates whenever the corporation (I) has accumulated earnings and profits at the close of each of three consecutive tax 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 § 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)(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 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).

Based solely on the facts submitted and representations made, we conclude that the rents Company receives from the Property are not passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's election to be treated as an S corporation. 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.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,
JEANNE SULLIVAN
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes