

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B01- PLR-103483-02
Date:
March 25, 2002

Legend:

X =

a =

b =

c =

Year 1 =

State =

Dear

This letter is in response to your request, dated November 6, 2001, on behalf of X, seeking a private letter ruling under section 1362(d) of the Internal Revenue Code that X's rental income from commercial properties is not passive investment income.

Facts

X is a corporation, incorporated under the laws of State. X anticipates making an election under section 1362(a) to be treated as an S corporation. X owns commercial real estate property.

X provides various services with respect to the leasing of its property. These services include conducting regular inspections of property; maintaining the roofs, exterior walls, heating and air conditioning systems, plumbing, foundations, and structures of property; maintaining fire and casualty insurance on the property; reviewing and supervising all tenant alterations, additions, or improvements to the property; paying all property taxes; reviewing all property tax assessments; pursuing property appeals; marketing property to potential tenants and evaluating those potential

tenants; negotiating all leases relating to the property along with any amendments or extensions of the leases; and maintaining all financial and accounting records for the property.

X received or accrued a in rents and paid or incurred b in relevant expenses for Year 1.

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 an S corporation.

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

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts 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) defines "rent" 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 the term "rents" does not include rents derived in the active trade or business of renting property. Rents 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 types and amounts of costs and expenses incurred (other than depreciation).

Conclusion

Based solely on the facts as presented in the ruling request, and viewed in light

of the applicable law and regulations, we conclude that X provides significant services and incurs substantial costs in its business. Accordingly, we conclude that the rents X receives from its rental property will not be passive investment income under section 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X satisfies the S corporation eligibility requirements of 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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the Power of Attorney on file with this office, a copy of this ruling will also be sent to the taxpayer representative.

Sincerely,
Carolyn Hinchman Gray
Acting Assistant to the Branch Chief,
Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

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