

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:2-PLR-104630-02  
Date:  
June 27, 2002

Legend

X =

A =

f =

g =

h =

D1 =

D2 =

Dear :

This responds to a letter dated January 14, 2002, and subsequent correspondence, submitted on behalf of X, by X's authorized representative requesting a ruling that X's income from a commercial building 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. X requests this ruling in anticipation of making an election to be an S corporation effective D2.

X is engaged in owning and operating a commercial building containing f retail stores. X, directly and through contractors, provides various services in operating the

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commercial building. Services with respect to the commercial building are uniform for each of the leases. X's responsibilities for the commercial building include, but are not limited to, monitoring and inspecting the premises, performing masonry work, inspecting and maintaining roofing structural components, maintaining structural foundation, maintaining sewers, maintaining outside lights, repairing sidewalks, providing security, handling tenants' complaints, contracting and scheduling repair work, supervising all independent contractor work, supervising employees, negotiating and preparing leases, preparing payment for vendors, providing 24-hour on call services for emergencies, performing collection duties, reviewing and contracting for insurance coverage. X is also responsible for paying the property tax assessments on the commercial building.

For the taxable year ending D1, X received approximately \$g in gross rental income and paid approximately \$h 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 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 the commercial building 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).

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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

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

Enclosures: 2

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