

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-126092-02

Date:

September 4, 2002

Legend

Company =

Shareholders =

Managers =

m =

n =

o =

p =

q =

r =

s =

t =

Date 1 =

State =

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Properties =

Dear :

This letter responds to your letter dated January 22, 2002, and subsequent correspondence, written on behalf of Company, requesting a ruling that Company's rental income from Properties is not passive investment income under § 1362(d)(3) of the Internal Revenue Code.

Facts

Company was incorporated in State on Date 1. Company has accumulated earnings and profits and intends to make an election under § 1362(a) to be an S corporation. Company owns, maintains, operates, and leases m commercial rental properties (Properties) in State to approximately n tenants.

Managers, two of Company's Shareholders, and independent contractors provide various services with respect to the Properties. These services include seeking and screening potential tenants; negotiating leases; overseeing tenant complaints; maintaining common areas (roadways, parkways, driveways, irrigation systems, lighting facilities, fences, gates, elevators, roofs, and roof drainage systems); providing and maintaining fire detection and sprinkler systems, water, gas, electricity, telephone service to common areas, trash disposal, pest control services, and security services; and inspecting and maintaining exterior walls and structural condition of interior bearing walls. In addition, a part-time employee of Company provides bookkeeping services and produces financial reports for Company.

Company received or accrued approximately o in rents and paid or incurred approximately p in relevant expenses for q. The rental and expense figures for r are s and t, respectively.

Section 1362(a)(1) provides that a small business corporation may elect to be an S corporation.

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Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) 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 in § 1362(d)(3)(C), 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 on 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).

Conclusion

Based on the facts submitted and representations made, we conclude that the rental income Company receives from Properties is 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 income 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 eligibility to be an S corporation under § 1361. Further, the passive investment income rules of § 1362 are completely independent from the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

Pursuant to a power of attorney on file with this office, we are sending the original of this letter to you, Company’s authorized representative, and a copy of this letter to Company.

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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.

Sincerely yours,

/s/

Mary Beth Collins
Senior Technician Reviewer,
Branch 3
Office of Associate Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes