

Internal Revenue Service

Department of the Treasury

Number: **200317004**
Release Date: 4/25/2003
Index Number: 1362.02-03

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-153896-02
Date:
December 19, 2002

Legend

Company:

Properties:

State:

Area:

a:

b:

c:

d:

e:

f:

g:

h:

i:

PLR-153896-02

Dear _____ :

This letter responds to a letter from your authorized representative, dated September 17, 2002, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Properties 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 in a and anticipates electing under § 1362(a) to be an S corporation if it receives a favorable ruling. Company has accumulated earnings and profits.

Company acquires, develops, leases, and manages commercial real estate (the Properties) throughout Area. It currently has b commercial tenants and c government tenants. None of the Properties are under net leases.

Company typically acquires one to three properties per year to develop for commercial tenants and sells on average one property per year. To date, Company has developed d properties.

Company has e employees, f of whom are full-time. Through these employees, as well as independent contractors, Company provides various services to the Properties in its real estate leasing and management business. These services include regular property inspection; common area maintenance; maintenance and repair of building structural components (roofs, walls, and foundations) and systems (plumbing, air conditioning, heating, and electrical); painting (for full maintenance properties); carpentry; maintenance of parking lot light fixtures; sidewalk sweeping and snow removal (except for certain government tenants); maintenance of perimeter fences and drainage systems; maintenance of enclosed garbage areas; and pest control. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing rental real estate.

Company received or accrued approximately g in rents and paid or incurred approximately h in relevant expenses for i on the Properties. These income and expense figures are consistent with those from prior years. Company anticipates that rental expenses will increase, in part because all of its new leases provide full maintenance responsibility for Company.

PLR-153896-02

Company is currently engaged in its historic business of actively developing substantial amounts of commercial real estate and expects to continue developing real estate each year for the foreseeable future. Company has no plan or intention to sell, dispose of, liquidate, or reduce in size its real estate development business.

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).

Section 1.1362-2(c)(5)(ii)(B)(4) provides that rents does not include compensation, however designated, for the use of, or the right to use, any real or tangible personal property developed, manufactured, or produced by the taxpayer, if during the tax year the taxpayer is engaged in substantial development, manufacturing, or production of real or tangible personal property of the same type.

PLR-153896-02

CONCLUSION

Based solely on the facts and representations submitted, we conclude that the rents Company receives from the Properties 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 eligibility to elect 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,

/s/

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

enclosures: copy for § 6110 purposes
copy of Exhibit A, dated 10-25-02