

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-155231-02
Date:
May 13, 2003

X =

a =

Properties =

b =

i =

j =

l =

m =

State =

d1 =

d2 =

d3 =

d4 =

Dear :

This letter responds to a letter dated September 3, 2002, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling that X's rental income from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

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FACTS

X was incorporated under the laws of State on d1. X elected to be treated as an S corporation effective d2. X has accumulated subchapter C earnings and profits.

X owns, leases, and manages a commercial rental properties (the Properties) to various tenants. X represents that it spends approximately b hours per year providing services with respect to the Properties. Through X's employees and independent contractors, X provides the following services with respect to the leasing of its properties: inspects the properties on a periodic basis, handles tenant disputes, oversees tenant improvements, purchases equipment, maintains common areas, provides janitorial and cleaning services, removes trash and hazardous materials, provides security services, contracts for heat, water, and other utilities, and provides marketing and advertisement services. X also handles the usual leasing and administrative functions involved in managing real estate.

X received or accrued approximately i in rents and paid or incurred l in relevant expenses for taxable year ending d3. For taxable year ending d4, X received or accrued approximately j in rents and paid or incurred m in relevant expenses.

LAW AND ANALYSIS

Section 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).

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the rental income X receives from the 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 tax consequences of the facts of this case under any other provision of the Internal Revenue Code. Specifically, we express or imply no opinion on whether X is 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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Sincerely yours,

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

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes