

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200713017**

Release Date: 3/30/2007

Index Number: 1362.02-03, 1362.02-00,  
1362.00-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC: PSI: B02

PLR-141089-06

Date:

November 21, 2006

X =

Y =

State 1 =

State 2 =

State 3 =

State 4 =

Date 1 =

Date 2 =

Date 3 =

W =

X =

Dear :

This responds to a letter dated August 21, 2006, submitted on behalf of X by X's authorized representative, requesting a ruling that X's rental income from twenty-six properties in State 1, State 2, State 3 and State 4 (the "Properties") is not passive investment income within the meaning of § 1362(d)(3)(C)(i).

The information submitted states that X was incorporated in State 1 on Date 1. X intends to elect to be treated as an S corporation effective Date 2.

The information submitted states that X, either directly, through its affiliate, Y, or through independent contractors, provides various services to the tenants of the Properties. Services provided by X include but are not limited to the following: site inspections, maintenance and repairs relating to tenant space improvements; roofing; HVAC, plumbing, sprinkler, electricity and lighting systems; and also general janitorial, security and landscaping services. In addition to services provided to tenants, X,

directly, through Y, and through independent contractors, handles the leasing and administrative functions involved with the Properties, including the payment of taxes and insurance premiums, the billing of tenants and collecting of rents and the negotiation of leases.

In the taxable year ending Date 3, X received or accrued a total of approximately \$w in rents with respect to the Properties, and paid or incurred a total of approximately \$x 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)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

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. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to above.

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)(2) of the Income Tax Regulations 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 rental income that X derives from the Properties is not passive investment income as described in § 1362(d)(3)(C)(i).

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. Specifically, we express no opinion on whether X is a small business corporation eligible to make an S election. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of section § 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) 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 letter is being sent to X's first and second authorized representatives.

Sincerely,

J. Thomas Hines  
Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes