

Internal Revenue Service

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Person To Contact:

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PLR-120295-07

Date:

November 15, 2007

Legend

X:

Y:

Z:

State:

Year 1:

Year 2:

Year 3:

a:

b:

c:

d:

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Dear _____ :

This responds to a letter dated April 27, 2007, submitted on behalf of X, requesting a ruling that the rental income received by X from Z's leasing activities is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that Z was incorporated in Year 1. Z and its affiliates are owned by Y, all of which are qualified subchapter S subsidiaries (QSubs) filing as one small business corporation with X, their parent banking corporation.

Z's equipment leasing operations involve a employees, several of whom are employed by Y and its subsidiaries. Z's equipment leasing operations require the following activities: new equipment lease identification, qualification and bidding; credit underwriting and administration; economic and accounting analysis; legal negotiation and documentation; equipment re-lease and re-marketing; insurance administration; sales and use tax collection, payment, reconciliation, and administration; personal property tax payment, reimbursement, reconciliation, and administration; rent collection, servicing and administration. In addition, Z utilizes Y's accounting, tax, legal and servicing operations.

Z's annual equipment leasing expenses in Year 2 and Year 3 were \$b annually. The annual equipment leasing revenues for Year 2 and Year 3 were \$c and \$d respectively.

Section 1361(a)(1) defines "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)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation—(I) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (II) 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) defines "passive investment income" as gross receipts from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5) of the Income Tax Regulations provides, in relevant part, that in general "passive investment income" means gross receipts derived from rent.

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Section 1.1362-2(c)(5)(ii)(B)(1) provides that “rents” means 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 representations submitted, we conclude that the rents X receives from its equipment leasing activities conducted by Z are not passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express no opinion concerning the federal income tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding Z's eligibility to be an S corporation or to be treated as a QSub of Y. Further, the passive investment income rules of § 1362 are 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.

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Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

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

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes