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Person To Contact:
, ID No.

Telephone Number:

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Date:
March 01, 2010

LEGEND

X =

Date =

1

Date =

2

Year =

State =

A

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C

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Dear :

This letter responds to a letter dated November 3, 2009, as well as subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling that rental income received by X is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

X was incorporated under the laws of State on Date 1, and elected under § 1362(a) to be an S corporation effective Date 2. X owns, leases, and manages A single-family residential properties. X leases its properties to unrelated individual tenants under rental arrangements involving a term of one year or less that are not net leases.

X is actively involved in performing all of the leasing and administrative functions necessary for managing its properties, including repair and maintenance services. Specifically, X supervises and ensures that all vacancies are properly prepared for re-rental, advertizes for new tenants, and processes prospective tenant applications, including performing credit checks on prospective tenants and negotiating the lease and rental agreements. Once the property is rented, X collects the rent, communicates with tenants during their tenancy, and monitors tenant compliance with lease terms. If a tenant experiences a repair or maintenance problem with the rental property, X customarily arranges, supervises, and pays for the required repair and maintenance work as to major building elements, such as the heating and cooling systems, plumbing, exterior walls, and roof. In addition, X pays all property taxes and maintains the casualty and liability insurance on these properties. X has B employees and multiple independent contractors involved in the day-to-day activities associated with its single-family residential rental operations.

In Year, X had C in gross rental receipts and incurred D in operating expenses (other than depreciation). X also represents it has accumulated earnings and profits. X does not engage in any business other than its residential rental operations.

LAW AND ANALYSIS

Section 1362(a)(1) provides that, except as provided in § 1362(g), 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) 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, and annuities.

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 the 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).

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the rental income X receives from its operations described above is not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation. 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) of the Code 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 representatives.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes