

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B02  
PLR-136311-14  
Date:  
February 04, 2015

Legend

X =

State =

Date 1 =

Year 1 =

N1 =

N2 =

Dear :

This letter responds to a letter dated September 25, 2014, submitted by X's authorized representative on behalf of X, requesting a ruling that rental income that X received from certain real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State and anticipates making an election to be treated as an S corporation effective Date 1. X owns, leases and manages a certain commercial real estate property (the "Property").

X, through its officers, employees and independent contractors, has provided and continues to provide certain services with respect to the leasing of the Property. These services include daily janitorial and rubbish removal services, regular maintenance, repairs and inspection covering plumbing, electrical and drainage systems as well as roofing, landscaping and building improvements. These services also include daily security services and management and control of all common areas, including parking

lots and picnic table areas. X additionally negotiates and executes leases with tenants, settles tenant disputes and collects rents and monthly sales reports, negotiates bank loans and insurance contracts for the Property and performs background checks on prospective tenants.

For the Year 1 taxable year, X collected approximately \$N1 in gross rents and paid or incurred approximately \$N2 in relevant operating expenses excluding depreciation. X represents that these figures are generally representative of the amounts of income and expenses it incurs with respect to the Property in a typical year.

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for such 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) 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 information submitted and the representations made, we conclude that the rental income that 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 on whether X is a small business corporation under § 1361(b). 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 who requested 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 authorized representative.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: (2)

Copy of this letter

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