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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-136392-16

Date:

March 02, 2017

Legend

X =

Y =

Date 1 =

Date 2 =

Date 3 =

State =

Property =

Year =

m =

n =

o =

p =

Dear _____ :

This letter responds to your letter dated October 28, 2016, submitted on behalf of X, requesting a ruling that the revenue received by X from Property under the Sharecropping Lease Arrangement and the rental income received by X from Property from its Rental Lease Arrangement were not passive investment income under § 1362(d)(3)(C)(i) of the Internal Revenue Code (Code).

FACTS

X was incorporated under State law on Date 1 and elected to be an S corporation effective Date 2. X has accumulated earnings and profits of m.

X is engaged in the business of farming and owns n acres in State. X has leased the land for sharecropping (Sharecropping Lease Arrangement) continuously beginning in Date 3. Beginning in Year, the land was leased to Y. Pursuant to the Sharecropping Lease Arrangement, all taxes, assessments or charges levied or assessed on products of the land must be paid by X and Y based in proportion to the percentage of crops to which X and Y are entitled. X and Y each pay one half of the actual cost of fertilizer and soil conditioner. X pays the cost of the power and fuel necessary to operate the drainage pumping plants as well as the cost of maintaining the irrigation and drainage canals and irrigation pipe line. X is also responsible for paying box rent and the grower's share of the state inspection fee. Any processing expenses incurred with the preparation of crops for sale, which are related to X's share of the crops, are paid by X. X also determines the percentage of Property to be farmed and the types of crops to be planted. Further, X is at risk for crop yields and marketing.

In Year, X signed a new lease agreement (Rental Lease Arrangement) with Y for lease of Property. Under the lease, X's expenses are between o% and p% of X's rental income. X is responsible for providing and maintaining insurance on all improvements and fixtures owned by X. Further, X pays the costs and expenses associated with the repair, maintenance and replacement of the irrigation drainage pumps as well as the insurance, water reclamation tax, water rights fees, water coalition dues and property taxes.

LAW AND ANALYSIS

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with § 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 3 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) provides that, except as otherwise provided in § 1362(d)(3)(C)(i), the term “passive investment income” means gross receipts derived from rents, royalties, 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 on the facts submitted and representations made, we conclude the revenue received by X under the Sharecropping Lease Arrangement and the rental income received by X under the Rental Lease Arrangement were not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes. Further, the passive investment 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.

These rulings are 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.

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

The rulings contained in this letter are 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 requests, they are subject to verification on examination.

Sincerely,

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

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes