

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-139703-16

Date: June 21, 2017

Legend

X =

State =

Date 1 =

LLCs =

Properties =

Year =

M1 =

M2 =

N =

P =

Dear :

This letter responds to a letter dated December 21, 2016, submitted by X's authorized representative on behalf of X, requesting a ruling that rental income that X and its limited liability companies (LLCs) received from certain real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code (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 has accumulated earnings and profits. X owns interests in LLCs treated as disregarded entities or partnerships for U.S. federal income tax purposes. X and the LLCs own, lease and manage certain real estate properties (Properties).

X and the LLCs, through their officers, employees and independent contractors, have provided and continue to provide certain services with respect to the leasing of some of the Properties. These services include making repairs to structural components of properties, including rooftops, floors, walls plumbing, parking lots, air conditioning and heating. These services also include maintaining common areas of

properties, janitorial services, landscaping and grass cutting, snow and ice removal from sidewalks and parking lots, pest control, window washing, periodic inspection of properties, maintaining exercise facilities, handing and installing fixtures within residential units, maintaining plumbing and lighting in residential units, screening visitors for residential tenants, delivering packages to residential tenants, negotiating renewal of leases, establishing parameters of acceptable tenants and conditions of the leases, reviewing financial information of prospective tenants, creating the form lease with respect to certain properties and effecting any modifications necessary for execution of certain leases, managing procurement of insurance and handling of claims, and making all decisions related to property tax appeals.

For the Properties for which it provided services in the Year taxable year, X collected itself and received through the LLCs approximately \$M1 in gross rents and paid or incurred approximately \$M2 in relevant operating expenses excluding depreciation and interest.

Approximately N% of the total gross rents from the Properties were attributable to net leases. With the exclusion of self-developed Properties, the remaining net leases constituted approximately P% of the gross rents.

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)(1) defines "rents" as 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).

Section 1.1362-2(c)(5)(ii)(B)(4) provides that "rents" does not include compensation, however, designated, for the use of, or right to use, any real or tangible personal property developed, manufactured, or produced by the taxpayer, if during the taxable year the taxpayer is engaged in substantial development, manufacturing, or production of real or tangible personal property of the same type.

Based solely on the information submitted and the representations made, we conclude that the rental income that X receives itself and through its LLCs from Properties 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.

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.

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
Copy for § 6110 purposes