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Person To Contact: _____, ID No. _____

Telephone Number: _____

Refer Reply To:
CC:PT&E:B01
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Date:
December 22, 2025

LEGEND

X =

Date 1 =

Date 2 =

Year 1 =

Year 2 =

State =

n =

Properties =

\$a =

\$b =

\$c =

Business =

Dear _____ :

This responds to a letter dated December 30, 2021, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting

a ruling that rental income received by X from certain rental real estate activities 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 has had approximately \$a in accumulated earnings and profits since Date 2.

Until Year 1, X owned and operated Properties, which were used in Business. In Year 1, X sold Business to a buyer. X retained ownership of certain Properties and leased those Properties to the buyer.

The current leases provide for the payment of rent equal to a fixed amount plus a percentage of X's gross receipts over a certain threshold from the operation of each property. During Year 2, X collected approximately \$b in gross rents and paid or incurred approximately \$c in related operating expenses, including management fees, legal and professional fees, repairs and maintenance, utilities, and mortgage interest.

X entered into an agreement with a management company, which provides the following services: communicating with tenants regarding any remodeling and renovations to Properties; approving or disapproving renovations; supervising the renovation process; participating in any applications for building permits, zoning variances and similar requirements; identifying new tenants; negotiating and executing leases, renewals and other agreements with tenants; collecting rents and other amounts due from tenants; enforcing tenants' obligations under the leases; inspecting the structural and exterior portions of Properties; arranging for maintenance of Properties, including lawn and landscaping maintenance, snow removal services and repairs. Two of the management company's employees are assigned to work on X matters.

The shareholders of X have extensive experience in building, developing, operating, and owning real estate. The shareholders of X communicate daily with the management company to discuss income, expenses, tenant issues, renovations, and other business issues. The shareholders monitor the operations of Business to ensure that Business is operating profitably. The shareholders also communicate regularly with the management company and the managers of Business to discuss the operations of Business. Additionally, the shareholders regularly search for new properties to acquire and develop.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "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 S corporation election shall be terminated 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. The termination is effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i). Section 1362(d)(3)(A)(ii).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income.

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 the term “rents” does not include rents derived in the active trade or business of renting property. Rents 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).

CONCLUSION

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.

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 the 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. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Joy C. Spies
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure

Copy for § 6110 purposes

cc: