Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 1362.02-03

Number: **199937037**
Release Date: 9/17/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:2-PLR-103959-99
Date:
June 23, 1999

Company =

Subsidiary =

Date 1 =

Properties =

x =

y =

$n =

$o =

$p =

$q =

$r =

$s =

Dear :

This letter responds to your February 10, 1999 ruling request and subsequent correspondence submitted on behalf of Company concerning § 1362(d)(3) of the Internal Revenue Code.

Historically, Company and several wholly owned subsidiaries comprised a consolidated return group for federal income tax purposes. Effective Date 1, Company elected to be treated as an

S corporation under section 1362(b) of the Code. In addition, Company elected to treat all of its wholly-owned subsidiaries, including Subsidiary, as qualified subchapter S subsidiaries as defined in section 1361(b)(3)(B).

Subsidiary engages in the business of renting various types of personal Properties. Subsidiary has a full-time sale, accounting, fleet, and support maintenance staff that consists of x professionals who perform services with respect to its rental operation. These services include managing the installation and removal of leased equipment, bad debt collection, repossessing equipment on defaulted leases, and handling the accounting of multi-jurisdiction property and uses taxes. Subsidiary owns five garages nationwide at which pre-delivery preventive maintenance and normal maintenance, repair, and upgrades are performed. These services are also provided at customer locations, or at outside vendors identified and hired by Subsidiary.

Subsidiary also employs y employees who actively market its products and services. These employees locate, meet, and make proposals to potential customers. Further, these employees maintain customer and industry relationships.

For taxable years ending 1996, 1997, and 1998, Subsidiary's gross rents from the equipment rental business were $n, $o, and $p respectively while operating costs totalled $q, $r, and $s respectively.

Section 1362(d)(3)(C)(i) of the Code 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) of the regulations defines "Rents" as 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) of the regulations provides that "rent" does not include rents 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).

Section 1375(a) of the Code provides that if, at the close of a taxable year, an S corporation has subchapter C earnings and profits and gross receipts more than 25 percent of which are passive investment income, a tax is imposed on the excess net passive income of the corporation.

Section 1375(b)(3) of the Code provides that the terms "passive investment income" and "gross receipts" have the same respective meanings as when used in § 1362(d)(3).

Based solely on the information submitted and the representations made, we conclude that under § 1.1362-2(c)(5)(ii)(B)(2) of the regulations, the gross receipts that Company derives from Subsidiary's business of renting Properties are income from an active trade or business and are not passive investment income as described in §§ 1362(d)(3)(C)(i) or 1375(b)(3) of the Code.

Except as specifically set forth above, we express no opinion as to the federal tax consequences of the transaction described above under any other provision of the Code. Further, we express no opinion concerning Company's election under § 1362(a) to be an S corporation, Company's qualification to be a small business corporation eligible to make an S election, or Company's election to treat its wholly-owned subsidiaries as qualified subchapter S subsidiaries.

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.

In accordance with the power of attorney submitted, we are sending a copy of this ruling to Company.

Sincerely yours,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and Special
Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes