

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:P&SI:3 PLR-106503-99  
Date:  
July 27, 1999

Company:

Properties:

a:

b:

c:

d:

e:

f:

g:

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h:

i:

This letter responds to your letter dated March 9, 1999, and received March 29, 1999, requesting a ruling that Company's rental income from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code. Company represents the following facts.

Company was incorporated on a and elected under § 1362(a) to be an S corporation effective b (it is changing to a calendar tax year pursuant to § 1378). Company owns, leases, and manages the Properties. It also manages some other properties by contract, which it does not own.

Company has c full-time employees and d part-time employees and contractors. In addition, though no longer a salaried employee, Company's chairman is available full-time at Company's corporate office for consultation and advice. Through this staff, Company provides various services in its real estate leasing and management business. These services include maintenance and repair of heating, ventilation, and air conditioning systems, electrical systems, and plumbing; site maintenance and repair operations as needed (e.g., interior and exterior painting, parking lot sealing and restriping, landscaping upgrades, roof repair, and carpet replacement); maintenance of grounds, including landscape irrigation systems and security fencing; tenant buildout and improvement projects; maintenance and repair of fire protection systems, including sprinklers and alarms (to which alarms Company's employees respond); maintenance of private potable water and sanitary sewer systems; provision of common area electricity or gas, including lighting; management of tenant utilities (negotiation and payment for, with subsequent collection from tenants); and pest control. In addition to the services provided to tenants, Company handles the usual marketing, leasing, and administrative functions involved in leasing and managing real estate.

The Company received or accrued approximately e in rents and paid or incurred approximately f in relevant expenses on the Properties for g. The figures for h and i are comparable.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S

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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 three consecutive tax years, and (II) has gross receipts for each of such tax years more than 25 percent of which are passive investment income.

Except as otherwise provided in subparagraph (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 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 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 facts as presented in this ruling request, and viewed in light of the applicable law and regulations, we conclude that the rents Company receives from the Properties are not passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's status as an S corporation. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

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

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.

Sincerely,

WILLIAM P. O'SHEA  
Chief, Branch 3  
Office of Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

enclosure: copy for § 6110 purposes