

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:1-PLR-107346-99

Date:

September 1, 1999

Legend

X =

State =

D1 =

D2 =

a =

b =

c =

d =

Pursuant to a power of attorney on file in this office, this responds to your letter dated April 13, 1999, submitted on behalf of X, requesting a ruling that the rental income received by X from renting commercial real estate (Properties) is not passive investment income within the meaning of section 1362(d)(3)(C)(i).

FACTS

X was incorporated in State on D1 and elected under section 1362(a) to be taxed as a subchapter S corporation effective D2.

Through X's employees, as well as through independent contractors, X provides

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various services to Properties. Services provided in the last year include property inspection, grounds maintenance and general upkeep, and cleaning and trash removal. X is also responsible for the maintenance and repair of the buildings, their structural components, and operating systems. In addition to the services provided to tenants, X handles the usual leasing and administrative functions involved in overseeing the management of real estate. Of X's a employees, b devote time to rental activities.

X received or accrued approximately c in rents and paid or incurred approximately d in relevant expenses in D3 on Properties.

LAW AND ANALYSIS

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

Section 1362(d)(3)(A)(i) provides that an election under section 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 section 1362(d)(3)(C), section 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 the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

CONCLUSION

After applying the applicable law and regulations to the facts as presented in this

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ruling request, we conclude that the rents X receives from Properties are not passive investment income under 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding X's election to be taxed as a subchapter S corporation. Further, the passive investment income rules of section 1362 are completely independent of the passive activity rules of section 469; unless an exception under section 469 applies, the rental activity remains passive for purposes of section 469.

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 request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is also being sent to X's other authorized representative.

Sincerely,

DIANNA K. MIOSI
Chief, Branch 1
Office of the Assistant chief counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of letter
Copy for section 6110 purposes