

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

September 20, 1999

Company:

Properties:

a:

b:

c:

d:

e:

f:

g:

h:

i:

j:

Dear

This letter responds to Company's letter signed June 14, 1999, plus subsequent correspondence, 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 in State in a and elected under § 1362(a) to be an S corporation effective b. It has accumulated subchapter C earnings and profits.

Company owns, leases, and manages c industrial properties (the Properties). It has d full-time employees, including its president and sole shareholder.

Through its employees, as well as through independent contractors, Company provides various services to the Properties in its real estate leasing and management

business. These services include regular property inspections; common area maintenance; maintenance and repair of building structural components and systems (e.g., roofs, exterior walls, foundations, heating, air conditioning, plumbing, and electrical); maintenance and repair of parking lots and pavement; landscaping and grounds maintenance; fire alarm and sprinkler maintenance; assistance to tenants in remodeling, financing, and vendor selection; trash collection and recycling; 24-hour emergency service; and resolution of tenant complaints. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in 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 comparable figures for h are i and j.

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 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.

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

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

cc: