Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:2-PLR-100712-00
Date: May 10, 2000

X =

Company 1 =

Company 2 =

Company 3 =

Company 4 =

Company 5 =

LLC =

Company 6 =

Company 7 =

LLC 1 =

LLC 2 =

Company 8 =

X Properties =

Company 1
Properties =

Company 2 Property =

LLC Properties =

$a =

$b =

$c =

$d =

$e =

$f =

$g =

$h =

Date 1 =

Dear :

This letter responds to a December 21, 1999 ruling request and subsequent correspondence submitted on behalf of X by X's authorized representative concerning section 1362(d)(2) of the Internal Revenue Code and concerning an extension of time in which to elect to treat Company 8 as a qualified subchapter S subsidiary (QSub) under § 1361(b)(3)(B).

The information submitted states that X incorporated as a C corporation on May 28, 1953, and made an election to be taxed as an S corporation for the calendar year 1997 when it had C earnings and profits.

X has 24 employees who devote time to X's real estate operations and those of its affiliated entities. X has five wholly-owned subsidiaries (Company 1, Company 2, Company 3,

Company 4, and Company 5) and has elected to treat each subsidiary as a Qsub within the meaning of § 1361(b)(3).

X also owns 100 percent of LLC which owns 100 percent of Company 6 and Company 7. LLC also owns 99 percent of LLC 1 and LLC 2. The remaining one percent membership interest in LLC 1 and LLC 2 are owned respectively by Company 6 and Company 7.

Company 1 owns 100 percent of Company 8, which was formed in 1998. X and Company 1 intended to make a QSub election for Company 8 effective Date 1. However, an election to treat Company 8 as a QSub was not made. Company 1 and Company 8 own and operate a shopping center. Company 1 has eight employees, all of whom are engaged in Company 1's real estate operations.

X owns several commercial office buildings, warehouses and other rental real estate (X Properties). X is actively involved in the development and construction of new buildings on undeveloped property. X also, through its employees, makes all major decisions affecting the management of the buildings, including all of the decisions with respect to repairs, lease negotiations, improvements and expenses. Some of the services that X provides to its tenants through its own employees, or independent contractors, include janitorial services; parking lot and sidewalk repairs; trash pick-up; exterior and interior renovations and structural repairs.

For 1998, X received rental income of $a and incurred expenses of $b with respect to X Properties.

Company 1 directly or indirectly owns and operates three shopping centers (Company 1 Properties). X uses management companies to oversee the ordinary daily affairs of the Company 1 Properties. Services provided to tenants of Company 1 Properties include, but are not limited to, safety and maintenance inspections; cleaning, maintenance, and repair of common areas, including parking lots and garages; maintenance and repair of building structural components and systems; landscaping and grounds care.

For 1998, X received rent of $c and incurred expenses of $d for Company 1 Properties.

Company 2 owns an office building (Company 2 Property). Company 2 uses a management company to manage daily affairs of the Company 2 property including cleaning, maintenance, and repair of common areas; maintenance and repair of structural components and systems; landscaping and grounds care. Company 2's expenses include payment for property management, property taxes, and insurance.

For 1998, X received rent of $e and incurred rental expenses of $f for Company 2 Property.

As described earlier, X owns 100 percent of LLC, which owns 99 percent of the membership interests in LLC 1 and LLC 2. The remaining 1 percent interest in LLC 1 and LLC 2 are owned by Company 6 and Company 7, respectively.

LLC 1 owns a shopping center and LLC 2 owns another shopping center (hereafter both shopping centers are collectively referred to as LLC Properties). X employs a management company to manage LLC Properties. These services include safety and maintenance inspections, landscaping and grounds care, and security and patrol services.

For 1998, X received rent of $g and incurred expenses of $h for LLC Properties.

X does not have any net leases.

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 "rents" 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 X receives from renting X Properties, Company 1 Properties, Company 2 Property, and LLC 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.

Section 1361(b)(3)(B) defines the term "qualified subchapter S subsidiary" as a domestic corporation which is not an ineligible corporation, if 100 percent of the stock of the corporation is owned by the S corporation, and the S corporation elects to treat the corporation as a QSub. The statutory provision does not, however, provide guidance on the manner in which the QSub election is made or the effective date of the election.

On January 13, 1997, the Service published Notice 97-4, 1997-1 C.B. 351, providing a temporary procedure for the making of a QSub election. Under Notice 97-4, a taxpayer makes a QSub election with respect to a subsidiary by filing a Form 966 (Corporate Dissolution or Liquidation), subject to certain modifications, with the appropriate service center. The election may be effective on the date Form 966 is filed or up to 75 days prior to the filing of the form, provided that the date is not before the parent's first taxable year beginning after December 31, 1996, and that the subsidiary otherwise qualifies as a QSub for the entire period for which the retroactive election is in effect.

Section 301.9100-1(c) of the Procedure and Administration Regulations provides that the Commissioner has the discretion to grant a reasonable extension of the time, under the rules set forth in §§ 301.9100-2 and 301.9100-3, to make a regulatory election. Section 301.9100-1(b) defines regulatory election as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Section 301.9100-2 provides the rules governing automatic extensions of time for making certain elections.

Section 301.9100-3 provides the standards the Commissioner will use to determine whether to grant an extension of time for regulatory elections that do not meet the requirements of

§ 301.9100-2. Under § 301.9100-3, a request for relief will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that (1) the taxpayer acted reasonably and in good faith, and (2) granting relief will not prejudice the interests of the government.

Based solely on the information submitted and the representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. As a result, X is granted an extension of time for making the election to treat Company 8 as a QSub, effective Date 1, until 60 days following the date of this letter. The election should be made by following the procedure set forth in Notice 97-4. A copy of this letter should be attached.

Except as specifically set forth above, we neither express nor imply any opinion as to the federal income tax consequences of the transactions described above nor related transactions under any other provision of the Code. Specifically, we express no opinion concerning the formation of any entity or concerning X's status as an S corporation and X's subsidiaries' status as QSubs.

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 on file in this office, a copy of this letter will be sent to X's authorized representative.

Sincerely,
PAUL F. KUGLER
Assistant Chief Counsel
(Passthroughs and Special Industries)

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