

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-114125-00

Date:

November 13, 2000

Company:

Properties: 1.
2.

Shareholders:

State:

M:

N:

a:

b:

c:

d:

e:

Dear

This letter responds to your letter dated June 23, 2000, as well as subsequent correspondence, submitted on behalf of Company. You requested a ruling that the rental income received by Company 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.

FACTS

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Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b. It has accumulated earnings and profits.

Company owns and operates residential and commercial rental real estate (the Properties).

M and N, Company's officers and sole employees, devote all their working time to Company's rental business. Through its officer-employees, as well as an agent (whose duties are minimal) and various independent contractors, Company provides various services to the Properties in its real estate leasing and management business. These services include regular property monitoring and inspection; cleaning and maintenance of common areas and common or public facilities; maintenance and repair of building structural components (e.g., roofs, supporting sidewalls, and foundations); maintenance and repair of building systems (e.g., plumbing, electrical, and HVAC); maintenance of building exteriors (e.g., lighting, signage, awnings, and paint); provision of utilities; maintenance of fire alarms, sprinklers, and security systems; assistance with tenant improvements; trash removal and scavenger service; landscaping and grounds maintenance; pest control; and 24-hour staff availability. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing real estate.

Company received or accrued approximately c in rents and paid or incurred approximately d in relevant expenses for e on the Properties.

LAW AND ANALYSIS

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 § 1362(d)(3)(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.

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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).

Based solely on the facts as represented by Company in this ruling request, we conclude that the rents Company receives from the Properties are not passive investment income under § 1362(d)(3)(C)(i).

The ruling in this letter is based on information and representations submitted by Company 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 ruling, it is subject to verification on examination.

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.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to Company.

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,
MARY BETH COLLINS
Assistant to the Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes