

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B03 PLR-134887-02

Date:

January 10, 2003

### Legend

Company =

State =

Date 1 =

Date 2 =

Properties =

n =

o =

p =

q =

r =

Year 1 =

Year 2 =

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Dear \_\_\_\_\_ :

This letter responds to your letter dated June 12, 2002, and subsequent correspondence submitted on behalf of Company, requesting 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.

### **STATEMENT OF FACTS**

Company was incorporated on Date 1 in State and elected to be an S corporation effective Date 2. Company has accumulated earnings and profits. Company owns and operates commercial rental real estate (the Properties). Through Company's officers, n employees, and outside contractors, Company provides various services to the Properties in connection with its real estate business. These services (not all services are provided to all properties) include maintenance of the Properties' structural integrity, exteriors, roofs, heating and plumbing systems, sprinkler systems, fire alarm systems, landscaping, outside lighting, sidewalks and parking lots; routine maintenance consisting of snow removal (where applicable), lawn care, and repairs; cleaning services; overseeing a security system; and reviewing and approving all repairs and services performed by outside contractors. In addition, Company handles the usual leasing and administrative functions involved with managing real estate.

Company received or accrued approximately o in rents and paid or incurred approximately p in relevant expenses for Year1 on the Properties. Company projects that the rental and expense figures for Year2 will be q and r, respectively.

### **LAW**

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.

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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**

Based on the facts submitted and representations made by Company, 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, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion on whether Company is 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 requesting it. Section § 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

/s/

Mary Beth Collins  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

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