

A =

B =

C =

D =

E =

F =

G =

H =

Dear :

This letter responds to the letter dated August 21, 2007, as well as subsequent correspondence, submitted on behalf of X, requesting a ruling that rental income received by X is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

X was incorporated under the laws of State on D1, and elected under § 1362(a) to be an S corporation effective D2. X has accumulated earnings and profits. X owns, leases, and manages an office building and a parking lot. Each Shareholder owns A percent of X.

X, through its B employees, provides various services in leasing and managing Property. These services include routine maintenance and repair of Property; maintenance and repair of the structural components of Property, including the roof; and retrofitting Property to comply with local standards for natural disasters. The employees of X also negotiate leases; establish rules for safety, care and cleanliness of the common areas; approve and supervise tenant improvements; solicit new tenants for vacancies; screen prospective tenants; monitor the surrounding area to keep abreast of market rate for rent; mediate complaints between tenants and surrounding neighbors; and attend meetings of various civic or governmental organizations in the area to keep abreast of community issues or projects. None of the leases on Property are net leases.

In Year1, X reported C in gross receipts, D in gross rents, and E in rental expenses. In Year2, X reported F in gross receipts, G in gross rents, and H in rental expenses.

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) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable 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.

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 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).

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the rental income X receives from the rental of Property is not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation. Further, the passive investment income rules of § 1362 are independent of

the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: