

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 PLR-119854-98

Date:

February 19, 1999

Company:

Shareholders:

Property:

State:

a:

b:

c:

d:

e:

f:

g:

h:

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i:

j:

k:

m:

n:

Dear

This letter responds to a letter from your authorized representative dated September 25, 1998, and perfected October 22, 1998, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i). Company represents the following facts.

Company was incorporated in State on a. Company and its shareholders intend to elect under § 1362(a) to be an S corporation effective b. It has C corporation earnings and profits.

Company leases the Property to various commercial tenants.

Through its employees (c full-time and d part-time), as well as through independent contractors, Company provides various services in its real estate leasing and management business. These services include cleaning and maintenance of common areas; maintenance and repair of roofs, sidewalks, the parking lot, and roadways; pest control, as required; trash collection (for some tenants); extra security patrols for certain holidays; tenant promotional events and advertising assistance; dispute resolution; additional tenant storage, as needed; and advice to tenants regarding business practices, insurance, repairs, and space planning. In addition to the services provided to tenants, Company handles the usual marketing, leasing, and administrative functions involved in managing real estate.

None of the leases on the Property is a net lease. Company received or accrued approximately e in rents and paid or incurred approximately f in relevant expenses for g on the Property. The comparable figures for h are i and j, and those for k are m and n.

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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.

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).

After applying the applicable law and regulations to the facts as presented in this ruling request, we conclude that the rents Company receives from the Property 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 eligibility to elect S corporation status. 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

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passive for purposes of § 469.

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

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)

encl: copy for § 6110 purposes