

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 – PLR-143230-04

Date:

December 08, 2004

Company:

Corp:

Partnerships:

Properties:

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State:

a:

b:

c:

d:

e:

f:

g:

h:

i:

Dear _____ :

This letter responds to a letter from your authorized representative dated August 5, 2004, as well as subsequent correspondence, submitted on behalf of Company,

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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.

FACTS

Company, a State corporation, intends to elect under § 1362(a) to be an S corporation effective a. Within a year, Company intends also to acquire all of Corp's outstanding stock, after which it will elect under § 1361(b)(3)(B)(ii) to treat Corp as a qualified subchapter S subsidiary. Company has accumulated earnings and profits.

Company owns, leases, and manages nonresidential real estate located in State. It owns these Properties both directly and indirectly through the Partnerships.

Company employs b persons full-time (c of whom are officer-shareholders) and c persons part-time. Through these employees, as well as independent contractors, Company provides various services in leasing and managing the Properties. These services include periodic inspection of the Properties; maintenance and repair of building structure and systems, including roofs, exterior walls, foundations, heating and air conditioning, plumbing, and electrical systems; maintenance of interior walls, including painting; testing and maintenance of fire alarms, sprinklers, and security systems; parking lot and pavement maintenance, including cleaning and upkeep; landscape and grounds maintenance; provision of janitorial services; pest control; assisting tenants with move-in and the construction of tenant improvements; and handling tenants calls and resolving issues. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing rental real estate.

Company received or accrued approximately d in rents and paid or incurred approximately e in relevant expenses for f on the Properties. The comparable figures for g are h and i, respectively.

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.

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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).

CONCLUSION

Based solely on the facts and representations submitted, 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 regarding Company'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.

Under a power of attorney on file with this office, we are sending copies of this letter to Company's authorized representatives.

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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,

/s/

JAMES A. QUINN
Senior Counsel, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes

cc: