

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-132453-04

Date:

September 29, 2004

Company:

Manager:

Shareholders:

PLR-132453-04

Properties:

State:

a:

b:

c:

d:

e:

f:

Dear :

This letter responds to your letter dated June 8, 2004, as well as 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.

FACTS

Company, a State corporation, intends to elect under § 1362(a) to be an S corporation. It owns, operates, leases, and manages commercial real estate.

Through its Directors/Officers, an independent property management company (Manager), and various independent contractors, Company provides various services in leasing and managing the Properties. These services (not all services are provided to all properties) include the installation, cleaning, maintenance, repair, and replacement (as appropriate) of building structural components, including roofs, exterior walls, and

PLR-132453-04

foundations; building heating, ventilation, and air conditioning systems and equipment; parking, sidewalk, and driveway areas; exterior and other common area lighting; service and loading areas; exterior stairs; trash enclosures and disposal facilities; fire sprinkler systems; sanitary sewer and storm drainage systems; underground gas, electric, and cable TV lines and equipment; property signs and markers; and landscaping. Company provides security and on-call emergency services. 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 a in rents and paid or incurred approximately b in relevant expenses for c on the Properties. The comparable figures for d are e and f, 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.

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

PLR-132453-04

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 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,

JEANNE SULLIVAN
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: copy for § 6110 purposes

cc: