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Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:3 – PLR-158005-05

Date:
May 26, 2006

Company:

Shareholders:

Properties:

State:

a:b:C:d:e:

f.

g:

PLR-158005-05

h:i:k:m:n:

Dear _____ :

This letter responds to a letter from your authorized representative, dated November 10, 2005, as well as subsequent correspondence, 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) of the Internal Revenue Code.

Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b. It owns, leases, and manages the Properties.

Through c full-time employees, as well as independent contractors, Company provides various services to the Properties in its real estate leasing and management activities. These services include provision and maintenance of common areas and facilities (including a recreation building and its furnishings, a canopied picnic area, various game courts, a pool, laundry facilities, and common area lighting); maintenance of roads and sidewalks (including street signs and lighting); insect and rodent control; trash and debris pickup; sewage disposal (including maintenance of associated lines); provision of water to common areas (including maintenance of water mains); and grounds maintenance (including grass cutting and fertilizing, tree trimming, and the installation and maintenance of lawn sprinklers). Company assists its tenants in various ways, such as in applying for monetary assistance or in cleaning up and repairing storm damage, and its employees are on call 24 hours a day for emergencies. 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 rental income and expense figures for g are h and i, respectively. The rental income and expense figures 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).

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 the validity of Company's election 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.

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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