

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

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### Legend

X:

Grantor Trust:

Irrevocable Trust:

Properties:

a:

b:

c:

d:

e:

f:

g:

Y1:

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Dear \_\_\_\_\_ :

This letter responds to a letter dated \_\_\_\_\_, written by X's authorized representative on behalf of X, requesting a ruling that X's rental income from Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X is a C corporation whose preferred and common stock are held by Grantor Trust and Irrevocable Trust respectively. X requests this ruling in anticipation of making an election to be treated as an S corporation.

X is in the business of owning, renting, and managing Properties. Properties are divided into a commercial rental units. X, directly and through contractors, provides various services in operating Properties. Services provided with respect to Properties include, but are not limited to, sweeping the parking lots weekly, resurfacing and repainting the parking lots as needed, removing snow and ice from the parking lots and sidewalks as needed, repairing mechanical defects in the plumbing and electrical systems, maintaining and repairing roofs, maintaining and repairing sidewalks, periodic inspections for property damage, and any other exterior structural repairs. On the properties which have landscaping or grass, X mows the grass, plants and maintains landscaping, and provides outdoor pest control. X is also responsible for the repair and maintenance of outdoor light systems on Properties. Furthermore, X operates a business office on weekdays and provides a 24-hour emergency repair service to its clients. On approximately b of the units, X repairs mechanical defects on heating, ventilation and air conditioning (HVAC). On the remaining units, X is responsible for all repairs to HVAC systems that exceed \$c.

In addition to the services provided to tenants, an employee of X handles the usual marketing, leasing, and administrative functions involved in leasing commercial real estate. X's president decides whether to buy or sell Properties and whether to make improvements to Properties. In addition, X provides liability and casualty insurance on all but d of Properties and pays the property taxes on all but e of Properties.

In the Y1 fiscal year, X received approximately \$f in gross rental income and paid approximately \$g in relevant expenses other than depreciation.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under section 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A) provides that an election under section 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

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Section 1362(d)(3)(C)(i) provides that except as otherwise provided, 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 defines "rents" as amounts received for the use of, or 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, 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).

Based solely on the facts and the representations submitted, we conclude that the rental income that X derives from Properties is income from the active trade or business of renting property and is not passive investment income as described in 1362(d)(3)(C)(i).

Except as specifically set forth above, we express no opinion as to the federal tax consequences of the transaction described above under any other provision of the Code. Further, we express no opinion on whether X is a small business corporation eligible to make an S election under section 1361(b)(3) of the Code.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X.

Sincerely yours,  
J. Thomas Hines  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2

Copy of this letter  
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