

**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-149984-04

Date:

January 18, 2005

Company:

Corp A:

Corp B:

Corp C:

Shareholders:

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a:

b:

c:

d:

e:

f:

g:

h:

i:

k:

m:

n:

p:

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

This letter responds to a letter from your authorized representative dated September 17, 2004, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from its leasing activities is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

## FACTS

Company was incorporated on a and intends to elect under ' 1362(a) to be an S corporation effective b. It anticipates electing under § 1361(b)(3)(B) to treat all of its wholly-owned subsidiaries as qualified subchapter S subsidiaries (QSubs), also effective b. It has subchapter C earnings and profits.

Company and its subsidiaries sell and lease information technology equipment, software, and other related products and services. This ruling letter covers Company's leasing activities, which consist in part, and on occasion, of the sale of the equipment at the end of the lease term.

Corp A is a wholly-owned subsidiary of Company. Corp B and Corp C are wholly-owned subsidiaries of Corp A. Company conducts its equipment leasing primarily through Corp B, which uses its own employees and those of Corp A and Corp C (totaling c full-time employees and d part-time employees) to carry on the leasing activities. Corp B pays Corps A and C fees in compensation for services rendered in connection with these activities.

Company helps each customer assess, design, select, and implement its information technology infrastructure. For a customer who decides to finance its equipment acquisition through a lease, Company works to structure the lease to best suit its needs. It consults with the customer during the term of each lease and restructures the lease as necessary. At the end of the lease term, Company reviews available options with the customer, and it remarkets or disposes of the equipment upon receipt.

Company received or accrued approximately e in lease payments and paid or incurred approximately f in relevant leasing expenses for g. The comparable figures for h are i and k, respectively, and for m, n and p, 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 its leasing activities 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 or to treat its subsidiaries as QSubs. 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 your 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/

MARY BETH COLLINS  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosures: copy for ' 6110 purposes

cc: