

**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-110715-05

Date:

April 11, 2006

Company:

Property:

Shareholders:

State:

a:

b:

c:

d:

e:

f:

g:

h:

i:

j:

k:

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m:n:o:

Dear :

This letter responds to a letter dated February 15, 2005, from your authorized representative, 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.

#### FACTS

Company was incorporated under the laws of State on a and elected under § 1362(a) to be an S corporation effective b. Company is primarily engaged in leasing and operating the Property. With approximately c tenants, the Property consists of retail shopping, entertainment, restaurant, and commercial office space. Company also operates certain small retail and service businesses within the Property, is engaged in extensive real estate development. It has subchapter C earnings and profits.

Company represents that it is directly and actively involved in the day-to-day operations of the Property. Company directly employs approximately d persons (all but 3 of whom work full-time) and employs the services of another approximately e full-time equivalent persons through various service agencies. Through these employees and contractors, Company provides various services to the Property in its real estate leasing and management business. The services provided include maintaining common areas, including restrooms; bussing tables and cleaning food trays; providing electricity, water, heating, and air conditioning (depending on the specific lease terms); maintaining property exteriors and structural components, including roofs; maintaining building systems that pass through, or are outside of, leased premises (plumbing, electrical, sewage, and HVAC); operating and maintaining the parking garage and lots; constructing tenant modifications; monitoring and coordinating safety measures; landscaping and grounds maintenance; carpentry repairs and modifications; trash collection and disposal; pest control; security services; customer service for visitors; coordination of promotional activities; and common marketing. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing real estate.

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Company received or accrued approximately f in rents and paid or incurred approximately g in relevant expenses for h on the Property. The comparable figures for i are j and k, respectively, and for m, n and o, 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).

Based solely on the facts submitted and representations made, we conclude that the rents Company receives from the Property 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

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Code. Specifically, we express or imply no opinion regarding Company's eligibility to be treated as an S corporation. Further, the passive investment income rules of § 1362 are completely 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,

/s/

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

Enclosure: Copy for § 6110 purposes  
cc: