

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B02

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Date:

July 14, 2008

Legend

X =

A =

B =

State =

Property1 =

Property2 =

D1 =

Year =

a =

x =

y =

Dear _____ :

This responds to a letter dated January 23, 2008, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling that X's rental income from Property1 and Property2 is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

The information submitted states that X is incorporated in State. The shareholders of X are A and B. X elected to be treated as an S corporation effective D1.

A, the president of X, represents that X owns Property1 and Property2. X's leasing operations involve a employees. A represents that X, through its employees, provides various services to the tenants of Property1 and Property2. These services include, among other things, maintenance and repair of the building structural components and systems; pest control; security; maintenance and repair of exterior parking lots and common areas, including the pool and pool furniture, a picnic area, tennis courts and a game area; maintenance and repair of all appliances, carpet, fans and light fixtures; and landscaping and grounds maintenance. Property2 has a laundry facility, and Property1 has a laundry and dry cleaner on the premises. In addition to the services provided to the tenants, the property manager, on behalf of X, explains and reviews leasing contracts, completes both paper and computer data storage of resident leases and assists in the sub-leasing of apartments. For Year, X received \$x in rents and X paid or incurred \$y expenses (other than depreciation) with respect to Property1 and Property2.

LAW AND ANALYSIS

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

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(3)(A) provides that an election under § 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. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to above.

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)(2) of the Income Tax Regulations 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).

CONCLUSION

Based solely on the facts and the representations submitted we conclude that the rental income that X derives from Property1 and Property2 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. Specifically, we express no opinion on whether X is a small business corporation eligible to make an S election. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of section § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Melissa C. Liquerman
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes