

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 - PLR-107066-00

Date:

September 7, 2000

X =

Properties =

City =

D1 =

D2 =

\$x =

\$y =

Dear :

This letter responds to a letter dated March 20, 2000, and subsequent correspondence written by your authorized representative on behalf of X, requesting a ruling that X's rental income from the Properties is not passive investment income within the meaning of section 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X is a closely held C corporation with accumulated earnings and profits. X anticipates making an election to be treated as an S corporation on D1.

X is in the business of owning, renting, and managing the

Properties. The Properties are commercial retail stores and offices located in City. X, directly and through contractors, provides various services in operating the Properties. Services provided in the last year include the following: security for tenants and tourists; maintenance of the Properties' exterior walls, roofs, heating, electricity, and plumbing; gardening and landscaping; maintenance of the sidewalk, curbing and trash removal; and 24 hour emergency repair service.

In addition to the services provided to tenants, X handles the usual marketing, leasing, and administrative functions involved in managing real estate including posting "For Rent" signs in vacant store windows, negotiating and preparing tenant leases, directly leasing its Properties to tenants, collecting rents from its tenants, paying all of the Properties operating expenses, and obtaining insurance coverage.

In the fiscal year ending D2, X received approximately \$x in rents and paid approximately \$y in relevant expenses.

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)(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.

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 § 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.

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

Sincerely yours,

J. THOMAS HINES  
Acting Branch Chief  
Branch 2  
Office of the Associate  
Chief Counsel  
(Passthroughs and  
Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes