

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
March 21, 2000

LEGEND

Company =

Property =

d1 =

d2 =

State =

y =

z =

Dear

This responds to your letter dated November 24, 1999, on behalf of Company, requesting a ruling that the income that Company receives from Property will not be passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

According to the information submitted, Company, a C corporation with accumulated earnings and profits, was incorporated on d1 in State. Company intends to elect under § 1362(a) to be an S corporation.

Company is engaged in a number of businesses, including owning and leasing Property. Property is leased to a tenant for extracting sand, gravel, rocks, and clay by-products (collectively the materials), to be processed and used in the construction industry. Property includes an office, as well as equipment and facilities designed for

the facilitation of mining and material processing. Pursuant to a lease, the tenant pays Company a monthly fee for use of Property and the related facilities.

Although the tenant performs the actual extraction and processing, Company provides services to the tenant, either directly or through independent contractors, such as: technical assistance concerning the installation, use, and inspection of extraction equipment; technical assistance concerning liquid and solid waste disposal; maintenance and renewal of state and local permits; landscaping; and government and community relations. For the fiscal year ending d2, Company received or accrued y in rents and paid or incurred z in relevant expenses on Property.

LAW AND ANALYSIS

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 provides that the term "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, 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).

CONCLUSIONS

After applying the relevant law to the facts submitted and the representations made, we conclude that the rent Company receives from Property is not passive investment income under § 1362(d)(3)(C)(i). This ruling does not apply to any licensing fee the tenant may pay for extracting the materials.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding whether Company is eligible to be 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.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to the taxpayer.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

Sincerely yours,

Shannon Cohen
Acting Assistant to the Chief, Branch 3
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes