

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Telephone Number:

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Date:

May 5, 2000

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Dear :

This letter responds to a December 16, 1999 ruling request submitted on behalf of X by X's authorized representative requesting a ruling that X's rental income will not constitute "passive investment income" within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X incorporated on January 1, 1963. X is currently a C corporation and proposes to elect to be taxed as an S corporation. X is engaged in the business of owning, managing, and leasing thirty-two residential multi-unit apartment buildings and houses (Properties) in State. Thirteen are apartment buildings containing 504 rentable units and 19 are residential rental houses which are being rented or are available for rent.

X employs six employees in its corporate office and 26 employees in its property management division. X's vice president runs the property management division. X also employs a property manager who coordinates and turns over daily maintenance, performs market analysis, handles resident manager

issues, and trains employees. Each apartment has a resident manager who is employed by X. The resident managers assist the property manager on diverse matters, including but not limited to, maintenance, rent collection, and tenant selection. X employs maintenance workers who service appliances, repair or replace electrical fixtures, repair plumbing, and provide gardening services.

X's gross rental income for 1998 was \$n and its related expenses (excluding depreciation) was \$o.

Properties are not rented under net lease arrangements. X pays all the expenses relating to Properties except for utilities (water, sewer, garbage, electricity, and heating) in the case of houses, and except for electricity in the case of apartments. A as X's president represents that X provides services and incurs substantial costs in the operation of its rental business.

Section 1362(d)(3)(C)(i) of the Code 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 the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) of the regulations provides that "rents" does not include rents derived in the active trade or business of renting property. Rents 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 information submitted and the representations made, we conclude that X's receipts from renting Properties are not passive investment income under § 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 concerning the validity of X's election under § 1362(a) to be an S corporation, or X's qualification to be a small business corporation eligible to make an S election.

This ruling is directed only to the taxpayer who requested 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, a copy of this letter is being sent to X's authorized representative.

Sincerely yours,

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

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