

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:3 PLR-124966-00  
Date:  
March 8, 2001

Company:

Manager:

Property:

Shareholders:

a:

b:

c:

d:

e:

f:

Dear

This letter responds to a letter from your authorized representative dated October 31, 2000, as well as subsequent correspondence, submitted on behalf of Company, 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. Company represents the following facts.

Company is a C corporation with accumulated earnings and profits. It intends to elect under § 1362(a) to be an S corporation.

Company's assets include the Property. Manager, a related corporation, manages the Property on a day-to-day basis. Company makes all the major property

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management decisions, including those on building repairs and improvements, lease negotiations, and expenses.

Company, through Manager, provides various services in its real estate leasing business. These services include the usual leasing and administrative functions; maintenance and repair of building exterior structure, including the roof; maintenance of exterior lighting; parking lot and sidewalk repair; loading dock maintenance; grounds maintenance; and 24-hour-a-day staff availability for tenant requests and inquiries.

Company received or accrued approximately a in rents and paid or incurred approximately b in relevant expenses for c on the Property. The comparable figures for d are e and f.

In general, § 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.

Section 1362(d)(3)(C)(i) provides that the term "passive investment income" generally 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 as represented by Company in this ruling request, we conclude that the rents Company receives from the Property are not passive investment

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income under § 1362(d)(3)(C)(i).

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 Company's eligibility to elect S corporation status. 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.

In accordance with the 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,  
DONNA M. YOUNG  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes