

Internal Revenue Service

Number: **200536004**

Release Date: 9/9/2005

Index Number: 1362.02-03

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-107790-05

Date:

June 01, 2005

Legend:

X =

State =

Date 1 =

\$A =

\$B =

Year 1 =

Dear :

This letter is in response to your letter, on behalf of X, dated January 18, 2005, seeking a written determination that rental income received from commercial properties is not passive investment income under section 1632(d) of the Internal Revenue Code.

Facts

Based on the facts submitted and representations within, we understand the facts to be as follows. X, incorporated in accordance with the laws of State, has been an S corporation since Date 1. X owns commercial real estate property which it leases.

X provides various services with respect to the leasing of the property. These services include the payment of all real estate taxes, reviewing all property tax assessments; maintaining general liability insurance, reviewing and negotiating all

insurance policies; coordinating all general property maintenance, maintaining landscaping, parking lots, HVAC systems, roofs, foundations, exterior walls, fire sprinkler systems, fire alarm systems, exterior lighting, plumbing and electrical systems to each building, and conducting pest control. In addition, X advertises available space, maintains informational brochures and a web site, screens all potential tenants, negotiates all leases, collects all rents, establishes and enforces rules for common areas, maintains complete records of tenants. Finally, X also evaluates the need for improvements, designs such improvements, oversees construction and repairs, and performs basic repairs and maintenance itself.

For the first nine months of Year 1, X accrued \$A in rents and paid or incurred \$B in relevant expenses.

Law and Analysis

Except as provided in section 1362(g), section 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of section 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earning and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts 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) defines “rent” 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 the term “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 types and amounts of costs and expenses incurred (other than depreciation).

Conclusion

Based solely on the facts as presented in the ruling request, and viewed in light of the applicable law and regulations, we conclude that X provides significant services and incurs substantial costs in its business. Accordingly, we conclude that the rents X receives from its rental property will not be passive investment income under section 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X satisfies the S corporation eligibility requirements of section 1361. Further, the passive investment income rules of section 1362 are completely independent of the passive activity rules of section 469; unless an exception under section 469 applies, the rental activity remains passive for purposes of section 469.

This ruling is directed only to the taxpayer(s) 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 will be sent to the taxpayer's representative.

Sincerely,

/s/ David R. Haglund

David R. Haglund
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes

cc: