

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-143073-10

Date:

March 14, 2011

X =

A =

B =

C =

D =

E =

State =

Date =

1

Date =

2

Year =

1

Year =

2

n1 =

n2 =

n3 =

n4 =

Dear _____ :

This letter responds to a letter dated October 8, 2010, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting a ruling that rental income received by X from certain rental real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on Date 1 and elected under § 1362(a) to be an S corporation effective Date 2. X owns, leases, and manages certain commercial real estate properties: A, B, C, D, and E (collectively, the "Properties"). X has accumulated earnings and profits.

X, through its shareholders, provides certain services with respect to the leasing of Properties. These services involve inspecting, maintaining, and repairing the buildings, including the roofs, external walls, windows, floors, foundations, guttering and downspouts, plumbing, sidewalks, curbs, drainage ditches, air conditioning and heating units, security and fire alarm systems, providing waste disposal, and performing safety inspections. X negotiates leases, collects rents, monitors compliance with lease terms, and addresses tenant complaints and requests.

For the tax years ending in Year 1 and Year 2, X collected approximately \$n1 and \$n2, respectively, in gross rents and paid or incurred approximately \$n3 and \$n4, respectively, in relevant operating expenses excluding depreciation.

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)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earnings 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. The termination is effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i). Section 1362(d)(3)(A)(ii).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

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 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).

Based solely on the facts and representations submitted, we conclude that the rental income X receives from its operations describe above is not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion on whether X is a small business corporation under § 1361(b). Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

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 powers of attorney on file with this office, we are sending copies of this letter to your authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes