

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Telephone Number:

Refer Reply To:

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Date:

May 19, 2000

X =

A =

D1 =

D2 =

x =

y =

z =

Dear :

This letter responds to your letter dated January 11, 2000, submitted on behalf of X, requesting a ruling that rents received by X 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 filed an election to be an S corporation on D1. X has accumulated earnings and profits. Currently, X conducts real estate leasing and management of two commercial and residential buildings (Properties) as its sole business.

A, as X's president, represents that X performs significant services and incurs substantial costs in the operation of its leasing and management business. X's activities are conducted by A and an additional employee. A represents that X provides the following services: assistance in the remodeling for new tenants; assistance to architects, builders, and other professionals on remodeling projects; recommending architects, contractors, and other vendors; maintenance services for common areas, center sign and parking facilities; handling emergency maintenance services on a 24-hour basis; providing advertising through message board and special promotions; providing emergency contact sources and access for all public safety purposes; arranging garbage pickup and recycling services; paying expenses for insurance, real estate taxes, repairs and maintenance; resolving tenant complaints; negotiating and preparing documents for all leases and lease renewals; inspecting properties on a

daily and weekly basis; maintaining the common area; maintaining all records pertaining to rental receipts and property operating costs and preparing monthly tenant reports; periodically inspecting for water leaks and other damage, making repairs to, and otherwise maintaining roof of buildings; periodically inspecting, repairing, and maintaining foundations and exterior walls, including painting of exterior wall and trim when necessary; periodically inspecting, repairing, and maintaining the plumbing, electrical, heating, air conditioning, and HVAC systems; periodically inspecting and maintaining the fire alarm and sprinkler systems; inspecting and maintaining the landscaping, cutting lawns, trimming shrubs, and carrying out other necessary ground and yard maintenance for a good appearance; maintaining and keeping the parking and pavement spaces in good repair; providing routine cleaning and upkeep of the parking area, grounds, and landscaped areas; maintaining fire and extended coverage insurance on the premises; making periodic inspection of the exterior portions of buildings looking for decay, dry rot, insect, termite, and other pest damage.

For its taxable year ending on D2, X received gross rental income of \$x and incurred \$y in operating expenses (not including depreciation of \$z) for Properties. X incurs the following costs in connection with the business of renting and managing the property: the payment of real estate taxes; the payment of insurance of all of its buildings; the payment of salary and fringe benefits for employees; the payment for maintenance and repairs; the payment for repairs and or replacement of building foundations, exterior walls, and roof.

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) 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 the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts and representations submitted, we conclude that X's receipts from leasing Properties are not passive investment income under § 1362(d)(3)(C)(i).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b) of the Code.

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 a power of attorney on file with this office, a copy of this letter is being sent to X.

Sincerely yours,  
H. GRACE KIM  
Assistant to the Chief, Branch 2  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

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