

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 - PLR-166157-01

Date:

April 2, 2002

X =

Property =

A =

Year =

D1 =

D2 =

w =

\$y =

\$z =

Dear _____ :

This letter responds to your letter dated November 28, 2001, and subsequent correspondence, submitted on behalf of X, requesting a ruling that rental income 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 has been engaged in the business of farming since it was formed in Year. X was a C corporation and became a S corporation effective D2. X has accumulated earnings and profits. Currently, X owns and leases Property.

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X has w employees, including its officers. A, as X's president, represents that the services X provides with respect to Property include: soil preparation; planting; harvesting; spraying for weed and insect control; fall tillage; rock picking and yard maintenance; drying; storing; advising as to soil management; operating digger and combine; general maintenance; conservation which includes building terraces, waterways and dikes for drainage; and fertilizing.

For its taxable year ending on D1, X accrued approximately \$y in rents and incurred approximately \$z in operating expenses for Property.

Except as provided in § 1362(g), § 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 income.

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 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 Property are not passive investment income under §1362(d)(3)(C)(i).

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any

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other provision of the Code. Specifically, no opinion is expressed regarding X's eligibility to elect to be an S corporation. 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 the purposes of § 469.

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's authorized representative.

Sincerely yours,
Matthew Lay
Senior Technician Reviewer
Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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