

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-112529-02

Date:

December 12, 2002

Legend

Company:

Corp:

Entity 1:

Entity 2:

Entity 3:

Entity 4:

Entity 5:

Entity 6:

Entity 7:

Entity 8:

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Entity 9:

Entity 10:

Entity 11:

Entity 12:

Entity 13:

Entity 14:

Entity 15:

Entity 16:

Entity 17:

Entity 18:

Entity 19:

Entity 20:

Property 1:

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Property 2:

Property 3:

Property 4:

Property 5:

Property 6:

Property 7:

Property 8:

Property 9:

Property 10:

Property 11:

Property 12:

Property 13:

Property 14:

Property 15:

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Property 16:

Property 17:

Property 18:

Property 19:

Property 20:

Property 21:

Property 22:

State:

a:

b:

c:

d:

e:

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f:

g:

h:

Dear _____ :

This letter responds to your letter dated January 31, 2002, as well as subsequent correspondence, requesting a ruling that the rental income received by Company from the Properties will not be passive investment income under § 1362(d)(3)(C)(i) of the Internal Revenue Code. Company represents the following facts.

FACTS

Company, a State corporation, elected under § 1362(a) to be an S corporation effective a. It has subchapter C earnings and profits.

The Properties, owned by the Entities, are managed and operated through the activities of the Entities' employees and under contract arrangements with either Corp (Company's former parent), which maintains a staff of employees who service these management contract arrangements, or with unrelated management companies. Company is a general partner or managing member in Entities 1, 2, 5, 6, 8, 9, 10, 11, 13, 15, 16, and 17 (the qualifying entities).

Company, through the approximately b employees of the qualifying entities, as well as through the contract arrangements mentioned above, provides various services to Properties 1, 2, 5, 6, 8, 9, 10, 11, 13, 15, 16, and 17 (the qualifying properties) in its real estate leasing and management business. These services include property inspection, common area maintenance, unit maintenance (for the apartments), maintenance and repair of building structural components, repair work contracting and subcontracting, direct response and assistance to tenants, provision of hospitality suites for the guests of tenants, provision of utilities, planning and construction services, grounds maintenance and landscaping, and exterior sign maintenance. These services are in addition to the usual marketing, leasing, and administrative functions involved in the leasing and managing of real estate.

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The qualifying properties generated a total of approximately c in rents and a total of approximately d in relevant expenses for e. The comparable figures for f are g and h. Company's distributive shares of the income and expenses of the qualifying properties are determined by its ownership interests as reflected in the legend.

LAW AND ANALYSIS

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 investment 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 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 on the facts and representations submitted by Company, we conclude that its share of the rents Company receives from the qualifying properties are not passive investment income under § 1362(d)(3)(C)(i).

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Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to elect to be treated as 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 purposes of § 469.

Under a power of attorney on file with this office, we are sending the original of this letter to you and copies to the taxpayer and the taxpayer's other 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,

/s/

CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes