

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
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Date:
July 08, 2008

Legend:

X =

Year 1 =

Year 2 =

State =

Date 1 =

Business =

\$M =

\$N =

Dear _____ :

This letter is in response to your letter, on behalf of X, dated January 3, 2008, requesting a ruling that X's income from Business is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code, and that the activity of Business is not a rental activity within the meaning in § 469(c)(2).

Facts

The information submitted states that X was incorporated in Year 1 in accordance with the laws of State. X elected to be an S corporation on Date 1.

X is engaged in Business, an activity in which X receives payments principally for the use of tangible property. X, through its employees, provides certain services with respect to Business. These services involve pick up and delivery of equipment, loading and unloading of equipment, equipment maintenance, replacement and repair (both at X's place of business, and those of its customers), customer training and demonstration, and safety and maintenance inspections of equipment.

In Year 2, X received approximately \$M in relevant gross income and incurred approximately \$N in relevant operating expenses.

Law and Analysis

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 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. 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 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).

Section 469(a) provides for the disallowance of passive activity losses. Section 469(d)(1) defines a passive activity loss as the amount by which the aggregate losses from all passive activities for the taxable year exceed the aggregate income from all passive activities for that year.

Section 469(c)(2) provides that except as provided in § 469(c)(7), the term "passive activity" includes any rental activity. Section 469(j)(8) provides that the term "rental activity" means any activity where payments are principally for the use of tangible property. Similarly, § 1.469-1T(e)(1)(ii) generally includes a rental activity in the definition of a passive activity.

Section 1.469-1T(e)(3)(i) provides that an activity generally is a rental activity for a taxable year if the gross income attributable to the conduct of the activity for the year represents amounts paid or to be paid principally for the use of tangible property. In addition, an activity may be a rental activity if tangible property in the activity is held for rent and the expected gross income from the activity will represent payments principally for the use of such property.

Section 1.469-1T(e)(3)(ii)(B) provides that an activity involving the use of tangible property is not a rental activity if the average period of customer use for such property is 30 days or less, and significant personal services (within the meaning in § 1.469-1T(e)(iv)) are provided by or on behalf of the owner of the property in connection with making the property available for use by customers.

Section 1.469-1T(e)(iv)(A) generally provides that personal services include only services performed by individuals, and do not include excluded services (within the meaning in section 1.469-1T(e)(3)(iv)(B)). In determining whether personal services provided in connection with making property available for use by customers are significant, all of the relevant facts and circumstances shall be taken into account. Relevant facts and circumstances include the frequency with which such services are provided, the type and amount of labor required to perform such services, and the value of such services relative to the amount charged for the use of the property. Section 1.469-1T(e)(iv)(B) provides that the term "excluded services" means, with respect to any property made available for use by customers, (1) services necessary to permit the lawful use of the property, and (2) services performed in connection with the construction of improvements to the property, or in connection with the performance of

repairs that extend the property's useful life for a period substantially longer than the average period for which such property is used by customers; and (3) services, provided in connection with the use of any improved real property, that are similar to those commonly provided in connection with long-term rentals of high-grade commercial or residential real property (e.g., cleaning and maintenance of common areas, routine repairs, trash collection, elevator service, and security at entrances or perimeters).

Conclusion

Based solely on the facts and representations submitted, we conclude that the income that X derives from Business is not passive investment income as described in §1362(d)(3)(C)(i). Additionally, we conclude that the activity of Business is not a rental activity within the meaning in § 469(c)(2).

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 is a small business corporation eligible to make an S corporation election. Further, no opinion is expressed whether any taxpayer materially participates in the activity of Business 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.

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,

Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes

cc: