

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 PLR-121165-98

Date:

March 24, 1999

Company:

Manager:

Shareholders:

Property:

State:

a:

b:

c:

d:

e:

f:

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Dear

This letter responds to your letter dated November 17, 1998, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i). Company represents the following facts.

Company was incorporated in State on a. Company and its shareholders intend to elect under § 1362(a) to be an S corporation effective b.

Company leases the Property to various commercial tenants under long-term contracts.

Company's shareholder-officers devote their full time to the rental activities of Company and other related corporations. Manager, with the same owners as Company and with c full-time, non-owner employees, provides management and maintenance services to Company and other related corporations. Through Manager, as well as a variety of independent contractors, Company provides various services in its real estate leasing and management business. These services include, but are not limited to, the maintenance of the buildings' structural components and systems, such as exteriors, roofs, heating and air conditioning, plumbing, sprinklers, and fire alarms; routine cleaning and repairs; maintenance of outside lighting, sidewalks, and parking lots; landscaping; snow removal; and supervision of tenant improvements. In addition to the services provided to tenants, Company handles the usual marketing, leasing, and administrative functions involved in managing real estate.

Company received or accrued approximately d in rents and paid or incurred approximately e in relevant expenses for f on the Property.

Section 1362 (a) (1) provides that, except as provided in § 1362 (g), 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

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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 solely on the facts as presented in this ruling request, and viewed in light of the applicable law and regulations, we conclude that the rents Company receives from the Property will not be passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's eligibility to elect S corporation status. 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.

In accordance with the power of attorney on file with this office, we are sending you the original of this letter and copies to Company and to the second authorized representative.

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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,

DONNA M. YOUNG  
Senior Technician Reviewer,  
Branch 3  
Office of the Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

encl: copy for § 6110 purposes