

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:P&SI:1-PLR-107556-99  
Date:  
June 7, 1999

### Legend

Company =

Subsidiary 1 =

Subsidiary 2 =

Trust =

m =

n =

o =

p =

q =

r =

Year =

This letter responds to your letter dated April 15, 1999, together with subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from certain properties is not passive investment income within the meaning of section 1362(d)(3)(C)(i) of the Code.

### Facts

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Trust is the sole shareholder in Company. Company and Trust intend to elect under section 1362(a) for Company to be an S corporation. The trustee for Trust intends to file an election for Trust to be treated as an electing small business trust (ESBT) under section 1361(e)(3) (see section 641(c) for rules relating to the taxation of electing small business trusts). Company also intends to elect under section 1361(b)(3)(B)(ii) to treat Subsidiary 1 and Subsidiary 2 (Subsidiaries) as qualified subchapter S subsidiaries (QSubs) (see section 1361(b)(3)(A) for the effect of a QSub election).

Company conducts all of the following activities through Subsidiary 1. Company has a seasonal marina operation, automobile parking facilities, and a seaplane base (the Properties). Company has m employees. Company has two offices: a general office open five days per week throughout the year, and a dock master's office open seven days a week for most of the year.

The marina has a total of n slips, o of which are rented to slipholders for the whole season, and p of which are rented on a transient basis. Company provides the following services for slipholders: ship to shore radio contact, mooring service through which the marine staff ensures that all boats are secure, reservation services for the use of the transient slips, referral services for slipholders who need boat repairs, water and electric hookups, discounted rate automobile parking and dock carts. Company also provides (1) 24 hour security services to slipholders through a combination of employees and an independent contractor, and (2) a tow service through an independent contractor. For an additional charge, Company provides slipholders with fuel, oil, and ice. Company makes its dock available for sea planes, and makes available, for a fee, office space to a seaplane tour company. Company employees also perform various maintenance functions related to the marina.

Company's parking operations include both indoor and outdoor facilities. Indoor spaces are rented on a monthly basis, and outdoor spaces are rented on a monthly and transient basis. Customers park their own vehicles in both indoor and outdoor facilities. Company maintains the parking facilities, including resurfacing, restriping, and sweeping. Company maintains security fences and provides security guards. Company also maintains all customary and necessary insurance, such as property insurance and liability insurance. Company advertises vacant parking spaces.

Company performs a variety of functions with respect to all of activities, such as billing and collection activities, accounting, payment of bills and payroll, and filing federal, state, and local tax returns.

Company received or accrued approximately q in rents and paid or incurred approximately r in relevant expenses with respect to the Properties for Year.

### Law and Analysis

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Except as provided in section 1362(g), section 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of section 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under section 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 subparagraph (C), section 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, 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).

### Conclusion

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 Properties are not passive investment income under section 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 under section 1361 to be an S corporation, the eligibility of Subsidiaries to be QSubs, or the eligibility of Trust to be an ESBT. Further, the passive investment income rules of section 1362 are completely independent of the passive activity rules of section 469; unless an exception under section 469 applies, the rental activity remains passive for purposes of section 469.

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

This ruling is directed only to the taxpayer who requested it. According to section 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

Signed/Daniel J. Coburn  
Daniel J. Coburn  
Assistant Branch Chief, Branch 1  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for section 6110 purposes