

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 PLR-119497-98

Date:

February 2, 1999

Company:

Shareholders:

Corporation:

Property:

a:

b:

c:

d:

e:

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f:

g:

h:

i:

Dear

This letter responds to your letter dated June 1, 1998, as well as subsequent correspondence, 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 on a to construct, own, and operate Property, a residential apartment complex. Company and Shareholders intend to elect under § 1362(a) to be an S corporation.

Company has b employees. In addition, it retains Corporation, a related property management company with c employees, to provide some of the managerial and administrative services. Through the employees of these two firms, 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, regular property inspection; property maintenance and repair; janitorial services; grounds care and landscaping; snow and rubbish removal; and 24-hour emergency services. In addition to the services provided to tenants, Company, mainly through its managing agent, handles the usual marketing, leasing, and administrative functions involved in leasing and managing real estate.

No unit is rented on a net lease basis. Company received or accrued d in rents and paid or incurred e in relevant expenses on Property for f. The comparable figures for g are h and i.

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.

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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 subparagraph (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, 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 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 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 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 § 1361 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 purposes of § 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 and a copy to Company.

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