

Internal Revenue Service

Department of the Treasury

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December 13, 1999

X =

D1 =

D2 =

D3 =

D4 =

a =

b =

c =

d =

Properties =

Dear :

This letter responds to a letter dated July 29, 1999, and subsequent correspondence submitted by X's authorized representative on behalf of X, requesting a ruling that X's receipts from leasing certain commercial properties will not constitute passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 and elected under § 1362(a) to be an S corporation effective D2. X has accumulated earnings and profits.

X leases commercial rental properties (Properties) to various tenants under both gross and net leases. Through X's employee, as well as independent contractors, X provides various services to its tenants. Services provided in the last year

include, but are not limited to, the following: supervision of all development and construction on Properties, handling complaints from tenants; maintenance and repairs on the roofs, canopies, external walls, concrete floors, structural foundation, gutters, downspouts, plumbing, parking lots, light fixtures in the parking lots, sidewalks, curbs, and air conditioning and heating; removal of snow from common areas; landscaping and maintenance of grounds; and regular monitoring and inspection of Properties. In addition to the services provided to tenants, X handles the usual marketing, leasing, and administrative functions involved in managing real estate, including, but not limited to, screening prospective tenants, negotiating leases, exhibiting space, and handling necessary evictions.

In X's taxable year ending D3, X received approximately \$a in rents and paid approximately \$b in operating expenses, not including depreciation. In X's taxable year ending D4, X received approximately \$c in rents and paid approximately \$d in operating expenses, not including depreciation.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided in § 1362(d)(3)(C), 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 the term "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 the term "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 and representations submitted, we conclude that X's receipts from leasing Properties will not be passive investment income under § 1362(d)(3)(C)(i).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding X'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.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely yours,

H. GRACE KIM  
Assistant to the Chief  
Branch 2  
Office of the Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes