

**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-102740-00  
Date:  
May 16, 2000

Company:

Entity:

Properties:

City:

a:

b:

c:

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d:

e:

f:

g:

Dear

This letter responds to your letter dated January 26, 2000, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Properties is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code. Company represents the following facts.

Company, in existence since a, was originally an Entity. It stopped doing business as an Entity on b and became a real estate development and management company. Company intends to elect under § 1362(a) to be an S corporation.

Company owns, leases, and manages the Properties, all of which were developed and constructed by Company. It leases the Properties, located in City, to various residential and commercial tenants. Company maintains a centrally-located office that is within walking distance of the vast majority of the Properties.

Company has c employees, d of which are full-time and d of which share responsibilities with a related, family-owned real estate development and leasing business. Through these employees, as well as a variety of independent contractors, Company provides various services in its real estate leasing and management business (provided to most but not all properties). These services include regular property

inspection; maintenance and repair of building structures and systems, such as roofs, heating and air conditioning, and plumbing; repair and replacement of appliances (residential properties); tenant buildout (commercial properties); carpet cleaning and replacement; painting; grounds care and landscaping; parking lot maintenance; snow removal; rubbish removal (commercial properties); pest control; and 24-hour on-call service for emergencies and tenant problems. In addition to the services provided to tenants, Company handles the usual marketing, leasing, and administrative functions involved in leasing and managing real estate.

Company received or accrued approximately e in rents and paid or incurred

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approximately  $f$  in relevant expenses for  $g$  on the Properties.

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.

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 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 represented by the taxpayers in this ruling request, we conclude that the rents Company receives from the Properties 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 income 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 a copy of this letter to Company.

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

Sincerely,  
JONI LARSON  
Acting Assistant to the Chief, Branch 3  
Office of Assistant Chief Counsel  
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes