

**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-109153-00  
Date:  
August 1, 2000

Company:

Partnerships:

Properties:

Shareholders:

State:

a:

b:

c:

d:

e:

f:

Dear \_\_\_\_\_ :

This letter responds to a letter from your authorized representative dated April 19, 2000, and 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 was incorporated in State on a and intends to elect under § 1362(a) to be an S corporation. It has C corporation earnings and profits. The Shareholders are

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equal owners of Company.

Company is engaged in the business of owning, operating, leasing, and managing commercial rental real estate (office and industrial buildings). These activities are conducted primarily through the Partnerships. Company also manages commercial and residential properties owned by affiliated entities.

Company has b employees. Through c of these employees, as well as the Shareholders and third-party contractors, Company provides various services to the Properties in its real estate leasing and management business. These services include maintenance and repair of building exteriors, including window washing, painting, and roofing; grounds maintenance and landscaping; parking lot and driveway maintenance and repair; maintenance and repair of exterior lighting; assistance to tenants with subletting, space utilization, and other issues; and, with respect to the office properties, provision of janitorial services, utilities, and off-hour security personnel. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing real estate.

Either directly or as part of its distributive share from the Partnerships, Company received or accrued approximately d in rents and paid or incurred approximately e in relevant expenses for f 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) 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

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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 Company in this ruling request, we conclude that the rents Company received from the Properties, either directly or as part of its distributive share from the Partnerships, are not passive investment income under § 1362(d)(3)(C)(i).

The ruling in this letter is based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

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 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 a copy of this letter to your authorized representative.

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,  
ROBERT HONIGMAN  
Acting Assistant to the Chief, Branch 3  
Office of Assistant Chief Counsel  
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes