

**Internal Revenue Service**

Department of the Treasury

Number: **200150013**  
Release Date: 12/14/2001  
Index Number: 1362.02-03

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B1 PLR-115281-01

Date:

Sept 11, 2001

**Legend:**

X =

Y =

State =

Property =

D1 =

Year =

\$a =

\$b =

This responds to the letter dated March 4, 2001, together with subsequent correspondence, submitted on behalf of X, requesting a ruling that X's income from Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

**FACTS**

X, a State corporation, elected to be treated as an S corporation for its taxable year beginning D1. X owns 100 percent of the outstanding stock of Y, a qualified subchapter S subsidiary. Y owns Property.

X, through its on-site management office, and through independent contractors, provides various services to the Property. X's responsibilities include, but are not limited to; maintenance and repair of building structural components and systems, including foundations, roofs, and plumbing and electrical systems, parking lot, sidewalk, common area, and building exterior maintenance, trash and snow removal, and landscaping. In addition to the services provided to tenants, X handles the usual administrative functions involved in managing real estate.

PLR-115281-01

In Year, X received or accrued approximately \$a in gross rental income and paid approximately \$b in relevant expenses, other than depreciation.

### **LAW AND ANALYSIS**

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 a subchapter S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) terminates whenever the corporation has accumulated earnings and profits at the close of each of three consecutive years, and 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).

### **CONCLUSION**

After applying the law to the facts submitted and representations made, we conclude that the rental income X receives from Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, no opinion is expressed regarding whether X otherwise satisfies the S corporation eligibility requirements under § 1361, or whether Y otherwise satisfies the qualified subchapter S eligibility requirements under § 1361.

PLR-115281-01

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,  
David H. Haglund  
Senior Technician Reviewer, Branch 1  
Associate Chief Counsel  
(Passthroughs and Special Industries)

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