

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
**CC:PSI:3 PLR-164349-02**  
Date:  
**March 3, 2003**

Company:

Properties:

State:

a:

b:

c:

d:

e:

f:

g:

h:

i:

j:

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Dear

This letter responds to your letter dated November 20, 2002, 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.

### FACTS

Company was organized as a business trust under the laws of State on a and anticipates electing under § 1362(a) to be an S corporation effective b. Company has accumulated earnings and profits.

Company owns, leases, and manages commercial real estate (the Properties) from an on-site office. Through its c officers and d staff members, and with the assistance of property managers and independent contractors, Company provides various services in its real estate leasing and management business. These services include daily property visits; maintenance and repair of common areas, building exteriors and roofing, HVAC and electrical systems, and sidewalks; maintenance of fire and life safety systems; janitorial services for all interior common spaces, such as lobbies, elevators, and hallways; exterior window washing; rubbish removal; snow removal; extermination services; key and lock services; utilities; lobby security; consultation on, and supervision of, tenant improvements; and a 24-hour "on-call" service. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing rental real estate.

Company received or accrued approximately e in rents and paid or incurred approximately f in relevant expenses for g on the Properties. The rental income and expense figures for h are i and j, respectively.

### 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 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.

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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

Based solely on the facts and representations submitted, 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, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to elect to be treated as 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.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to Company.

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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,

*/s/*

MARY BETH COLLINS  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes