

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

CC:PSI:3 – PLR-106101-04

Date:

June 08, 2004

Company:

Trust shares:

Properties: 1:

2:

State:

a:

b:

c:

d:

e:

f:

g:

h:

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i:

Dear :

This letter responds to your letter dated January 12, 2004, 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 incorporated under the laws of State in a, and elected under § 1362(a) to be an S corporation effective b. Company has accumulated earnings and profits.

All of Company's issued and outstanding stock is owned by the Trust shares. Company represents that these Trust shares meet the requirements for a qualified subchapter S trust (QSST).

Company owns, leases, and manages residential real estate.

Company employs c persons, of whom one works full time. Through these employees, as well as an hourly maintenance man and third-party contractors, Company provides various services to the Properties in its real estate leasing and management business. These services include visual property inspection at least twice a week; maintenance of common areas, including grounds and landscaping; maintenance of a swimming pool at Property 1; maintenance and repair of building structural parts and systems (roofs, walls, heating, air conditioning, and plumbing); provision of water to Property 1; maintenance and repair of appliances and fixtures; cleaning and refurbishing of units between tenants; painting; trash removal; snow plowing; pest control; and a 24-hour call answering service. In addition to the services provided to tenants, Company handles the usual leasing and administrative functions involved in managing real estate.

Company received or accrued approximately d in rents and paid or incurred approximately e in relevant expenses for f on the Properties. The rental income and expense figures for g are h and i, respectively (a third rental property was sold at the end of this year).

### LAW AND ANALYSIS

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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).

## 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 the validity of Company's election to be an S corporation or the Trust shares' eligibility to be QSSTs. Further, the passive investment income rules of § 1362 are 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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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.

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/*

JEANNE SULLIVAN  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes

cc: