

**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-104531-00  
Date:  
June 8, 2000

Company:

Properties:

State:

Shareholders:

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Subs:

LLCs:

Agent A:

Agent B:

a:

b:

c:

d:

e:

f:

Dear

This letter responds to your letter dated February 25, 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 elected under § 1362(a) to be an S corporation effective b. It has C corporation earnings and profits. Company's shareholders are listed in the legend.

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Company is engaged in the business of owning, leasing, and operating residential and commercial real estate (apartment buildings, office buildings, and garages). These activities are conducted through several wholly-owned corporate subsidiaries (the Subs) and wholly-owned limited liability companies (the LLCs). Company elected under § 1361(b)(3)(B)(ii) to treat the Subs as qualified subchapter S subsidiaries effective b. The LLCs are disregarded as separate entities under § 301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations.

Company has c full time employees stationed at all but one of the Properties. Through these employees, as well as two property managers (Agents A and B) and numerous contractors, Company provides various services to the Properties in its real estate leasing and management business. These services include regular property inspection; common area maintenance; maintenance and repair of building structural components and systems; grounds maintenance and landscaping; sidewalk maintenance and repair, including cleaning and snow removal; painting and other interior refurbishing; utilities; rubbish removal; pest control; building security; emergency services; tenant-directed alterations or alteration assistance; and handling of tenant requests and complaints. 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.

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

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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 Company 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).

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

enclosure: copy for § 6110 purposes