

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 – PLR-165092-03

Date:

March 04, 2004

Company:

Corp:

Shareholders:

Property

State:

a:

b:

c:

d:

e:

f:

g:

h:

i:

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k:m:

Dear \_\_\_\_\_,

This letter responds to a letter from the taxpayer signed November 3, 2003, as well as subsequent correspondence, requesting a ruling that the rental income received by Company from the Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

Company was incorporated under the laws of State in a and elected under § 1362(a) to be an S corporation effective b. It owns, leases, and manages the Property.

Company shares with Corp, a sister company with similar property, two full-time employees and one part-time employee. One of the full-time employees lives on-site. Through these employees, as well as through independent contractors, Company provides various services to the Property in its real estate leasing and management activities. These services include regular property inspection; maintenance and repair of the roofs, foundations, and exterior walls of the common buildings; maintenance and repair of the plumbing, electrical, heating, and air conditioning systems in the common buildings; maintenance and repair of the laundry room equipment; grounds maintenance and landscaping; maintenance of the parking and pavement spaces; maintenance of a private road through the property, including snow removal; maintenance of the property's private water and sewer system; and the provision of 24-hour-a-day on-call service for tenants. 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 c in rents and paid or incurred approximately d in relevant expenses for e on the Property. The rental income and expense figures for f are g and h, respectively. The rental income and expense figures for i are k and m.

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.

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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).

Based solely on the facts and representations submitted, we conclude that the rents Company receives from the Property 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 be an S corporation. 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.

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/*

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

enclosures: copy for § 6110 purposes

cc: