

**Internal Revenue Service**

Number: **200414038**

Release Date: 4/2/04

Index Number: 1362.02-03

Department of the Treasury  
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 – PLR-150772-03

Date:

December 23, 2003

Company:

State:

N:

O:

P:

Q:

R:

S:

I:

U:

PLR-150772-03

V:

W:

X:

Y:

Z:

Property 1:

Property 2:

Property 3:

Property 4:

Property 5:

Property 6:

Property 7:

Property 8:

Property 9:

Property 10:

Property 11:

Property 12:

Property 13:

Property 14:

PLR-150772-03

Property 15:

Property 16:

Property 17:

Property 18:

Property 19:

Property 20:

Property 21:

Property 22:

Property 23:

Property 24:

Property 25:

Property 26:

Property 27:

Property 28:

Property 29:

Property 30:

Property 31:

Property 32:

Property 33:

Property 34:

Property 35:

PLR-150772-03

Property 36:

Property 37:

a:

b:

c:

d:

e:

d1:

d2:

d3:

d4:

m:

n:

o:

p:

q:

r:

s:

Dear \_\_\_\_\_ :

This letter responds to a letter from your authorized representative dated August 15, 2003, as well as subsequent correspondence, submitted on behalf of Company,

PLR-150772-03

requesting a ruling that the rental income received by Company from Property 1 through Property 36 (the Properties) is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

## FACTS

Company, a business trust organized under the laws of State on d1, intends to elect under § 1362(a) to be an S corporation effective d2. It has C corporation accumulated earnings and profits.

Company is in the business of owning, operating, and managing commercial and residential real estate. As part of this business, Company is a partner or member in the following entities (the Passthrough Entities). Company has an m percent partnership interest in general partnership N, an n percent interest in general partnerships O and R, an o percent interest in general partnerships P and Q, and a p percent interest in general partnerships T, U, and V. R has an n percent partnership interest in S. Company also is a q percent owner of W, an r percent owner of X, and an s percent owner of Z, which are limited liability companies. For federal income tax purposes, W and Z are treated as partnerships and X is treated as a disregarded entity. Company participates in the management of the business of W, X, and Z. X has an s percent partnership interest in general partnership Y.

Company owns Property 1 through Property 3 directly. N owns Property 4 and Property 5, O owns Property 6, P owns Property 7, and Q owns Property 8. R owns Property 9 through Property 22. S owns Property 23, T owns Property 24, U owns Property 25, V owns Property 26, and W owns Property 27. Y owns Property 28 through Property 36. Z owns Property 37.

Through its Trustees and a part-time employees, as well as a contracted management company, Company provides various services to the Properties in its real estate leasing and management business. These services include: acting as an intermediary with tenants and contractors/vendors; inspecting building cleanliness, general condition and mechanical systems weekly; being on call 24 hours a day; providing janitorial services; landscaping; repair and maintenance, including building structures and systems; trash removal; providing security services; snow removal; and providing certain utilities. 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 b in rents and paid or incurred c in relevant expenses for taxable year ending d3. For taxable year ending d4, Company

PLR-150772-03

received or accrued approximately d in rents and paid or incurred e in relevant expenses.

### 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.

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 rental income Company receives from the Properties, either directly or as part of its distributive share of income from the Passthrough Entities, is 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

PLR-150772-03

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 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 a copy of this letter to your authorized representative.

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 yours,

Mary Beth Collins  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure: copy for § 6110 purposes

CC: