

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:Br.1-PLR-106846-99

Date:

April 28, 1999

Legend

X =

STATE =

D1 =

D2 =

D3 =

D4 =

D5 =

a =

b =

c =

d =

This responds to your letter dated March 23, 1999, submitted on behalf of X, requesting a ruling that the rental income received by X from renting commercial real estate (the "Properties") is not passive investment income within the meaning of § 1362(d)(3)(C)(i).

### FACTS

X incorporated under STATE law on D1 and elected under § 1362(a) to be taxed as a subchapter S corporation effective D2. X has C corporation earnings and profits.

X had a separate operating division, which was sold on D3. Since the sale of the operating division, X has operated exclusively as a lessor of the Properties to commercial tenants.

Through X's employee, as well as through independent contractors, X provides various services to the Properties. Services provided in the last year include property inspection; grounds maintenance and general upkeep; and cleaning and trash removal. X is also responsible for the maintenance and repair of the buildings, their structural components, and operating systems. In addition to the services provided to tenants, X handles the usual leasing and administrative functions involved in overseeing the management of real estate.

X received or accrued approximately a in rents and paid or incurred approximately b in relevant expenses in D4 on the Properties. In D5, X received or accrued approximately c in rents and paid or incurred approximately d 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 a subchapter 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

PLR-106846-99

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

After applying the applicable law and regulations to the facts as presented in this ruling request, we conclude that the rents X receives from the Properties are not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding X's election to be taxed as a subchapter 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.

The rulings contained in this letter are based upon 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 rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

PLR-106846-99

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X.

Sincerely,

**Signed/David R. Haglund**

David R. Haglund, Senior Technician Reviewer  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
copy of letter  
copy for § 6110 purposes