

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-112586-00
Date:
October 5, 2000

Company:

State:

a:

b:

Dear

This letter responds to a letter from your authorized representative dated June 15, 2000, submitted on behalf of Company, requesting a ruling under §§ 1362(d)(3) and 1375(a) of the Internal Revenue Code. Company represents the following facts.

Company was incorporated on a under the laws of State and elected under § 1362(a) to be an S corporation effective b. It has accumulated earnings and profits.

Company intends to acquire a membership interest in a limited liability company (LLC) in exchange for certain Company assets. The LLC, which will engage in commercial general contracting, will be taxed as a partnership for federal income tax purposes. Company's income will consist primarily of its distributive share of the income from the active trade or business of the LLC.

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 these 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 1375(a) provides that a tax is imposed on the income of an S corporation for any tax year in which the corporation has accumulated earnings and

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profits at the close of that year and gross receipts more than 25 percent of which are passive investment income.

Section 702(a)(7) provides that, in determining income tax liability, each partner shall take into account separately his distributive share of the partnership's items of income, gain, loss, deduction, and credit to the extent provided by regulations.

Section 1.702-1(a)(8)(ii) of the Income Tax Regulations provides that each partner must take into account separately his distributive share of any partnership item that would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

Section 702(b) provides that the character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under § 702(a)(1) through (7) shall be determined as if the item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Rev. Rul. 71-455, 1971-2 C.B. 318, concerns an S corporation that operates a business in a joint venture with another corporation. In the tax year at issue, the total business expenses of the joint venture exceeded its gross receipts. The revenue ruling holds that, in computing "gross receipts" for purposes of applying the passive investment income test, the S corporation should include its distributive share of the joint venture's gross receipts and not its share of the venture's loss.

Company's distributive shares of gross receipts from the LLC, if separately taken into account, might affect its federal income tax liability. Under § 1362(d)(3), the status of Company as an S corporation could depend upon the character of its distributive shares of gross receipts from the LLC. Thus, pursuant to § 1.702-1(a)(8)(ii), Company must take into account separately its distributive shares of the gross receipts from the LLC. The character of these partnership receipts for Company will be the same as the character of the partnership receipts for the LLC, in accordance with § 702(b).

Based solely on the facts as represented by Company, we conclude that Company's distributive share of the LLC's gross receipts attributable to the active trade or business of commercial general contracting will not constitute passive investment income as defined by § 1362(d)(3)(C).

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

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concerning the federal income tax consequences of the facts of this case under any other provisions of the Code. Specifically, no opinion is expressed regarding Company's eligibility to be an S corporation.

In accordance with the 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,
ROBERT HONIGMAN
Acting Assistant to the Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes