

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PSI:3 PLR-117108-00**

Date:

**January 4, 2001**

Company:

Type A Sites:

Type B Sites:

Properties:

Shareholders:

State:

City:

PLR-117108-00

a:

b:

c:

d:

e:

f:

g:

h:

i:

j:

k:

m:

Dear

This letter responds to a letter from your authorized representative dated August 25, 2000, as well as 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.

#### FACTS

Company was incorporated under the laws of State on a and intends to elect under § 1362(a) to be an S corporation effective b. It anticipates having accumulated earnings and profits as of the effective date of its S election. Company's shareholders are listed in the legend.

Company engages in the business of leasing commercial real estate in and around City. This real estate is composed primarily of Type A Sites (the Properties) but also includes Type B Sites. Company owns c of the d Properties, while leasing the remainder for sublease to tenants.

PLR-117108-00

The Properties are subject to substantial environmental regulation, requiring close Company oversight of each Property's operations, as well as careful review and supervision of all repairs and capital improvements. Close oversight of each tenant's business operations is necessary also because a significant portion of Company's income is directly dependent on the efficient operation of the Properties. Company employs e persons, f of whom travel to the Properties on a regular basis for property inspection, repair and construction supervision, and consultation with tenants and tenants' employees. Each tenant is responsible under the lease for repair costs. However, Company often pays for certain repairs because many of the tenants are not financially capable of covering these expenses. Company handles the usual leasing and administrative functions involved in leasing and managing real estate.

Company received or accrued approximately g in rents and paid or incurred approximately h in relevant expenses for i on the Properties. The comparable figures for j are k and m.

#### 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

PLR-117108-00

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).

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.

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,  
MARY BETH COLLINS  
Assistant to the Chief, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes