

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 PLR-100358-99

Date:

June 9, 1999

Company:

Sub A:

Sub B:

Sub C:

Shareholders:

Properties:

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Partnership A:

Partnership B:

Partnership C:

Partnership D:

Partner A:

Partner B:

State:

a:

b:

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c:

d:

e:

f:

g:

h:

i:

Dear

This letter responds to a letter from your authorized representative dated December 21, 1998, 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.

Company, incorporated in State on a, elected under § 1362(a) to be an S corporation effective b. Effective the same date, Company elected under § 1361(b)(3)(B) to treat Subs A, B, and C as qualified subchapter S subsidiaries (QSubs).

Prior to the QSub elections, Subs A and B were wholly owned subsidiaries of the Company, and Sub C was a wholly owned subsidiary of Sub B.

Sub A develops, leases, and manages industrial (mostly warehouse) buildings.

Sub A, with a core staff of c full-time employees, provides management and leasing services for properties owned by Company and all its subsidiaries, including direct oversight of numerous subcontractors.

Sub A owns Properties 1-10. Through its own employees, as well as a variety of independent contractors, Sub A provides various services with respect to these Properties. The services provided include maintenance and repair of building roofs, foundations, and exterior walls; maintenance and repair of

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pavement and parking spaces; general maintenance as required or requested by tenants, such as snow removal, mowing, etc.; and periodic inspection of exterior portions of the Properties for decay, dry rot, and pest damage. In addition to the services provided to tenants, Sub A handles the usual marketing, leasing, and administrative functions involved in leasing and managing the Properties.

Sub B develops, leases, and manages commercial office buildings.

Sub B owns Properties 11 and 14-19 outright. Partnership A owns Property 12, Partnership B owns Property 13, Partnership C owns Property 20, and Partnership D owns Properties 21 and 22.

Sub B is the general partner of Partnerships A and B. Sub C is the general partner of Partnerships C and D.

Sub A, with the same owners as Sub B, having c full-time employees, provides management and leasing services to Sub B, Sub C, and Partnerships A, B, C, and D. Through Sub A, Subs B and C provide various services with respect to Properties 11-22. These services include regular inspection, maintenance, and repair of building exteriors, including signs; maintenance of plumbing, electrical, heating, ventilation, and air conditioning systems; complete landscaping and grounds maintenance, including routine cleaning; maintenance, repair, and routine cleaning of pavement and parking spaces; janitorial and cleaning services; garbage collection and snow removal; and the provision of security guards.

For d, Company directly or indirectly received or accrued approximately e in rents and paid or incurred approximately f in relevant expenses on the Properties. The comparable figures for g are h and i.

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 subparagraph (C), § 1362(d)(3)(C)(i) provides that the term "passive investment

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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, but not limited to, 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 as presented in this ruling request, and viewed in light of the applicable law and regulations, we conclude that the rents Company receives from the Properties will not be passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's eligibility under § 1361 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.

In accordance with the power of attorney on file with this office, we are sending you the original of this letter and a copy to your authorized representative.

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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,

WILLIAM P. O'SHEA  
Chief, Branch 3  
Office of Assistant  
Chief Counsel  
(Passthroughs and  
Special Industries)

encl: copy for § 6110 purposes

cc: