

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-114490-04

Date:

August 10, 2004

Company:

Property:

State:

Business:

Tenant:

a:

b:

c:

d:

e:

f:

g:

h:

i:

k:

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m:n:p:

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

This letter responds to a letter from your authorized representative dated March 8, 2004, as well as subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income received by Company from the Property is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code. This ruling would effectively update PLR 200024044 (June 16, 2000) to reflect a revised lease.

#### FACTS

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

In addition to owning and operating a Business, Company owns and leases the Property. The Property contains various minerals and is improved with an office and facilities for processing the minerals into products that are sold to third parties for use in the construction industry.

In exchange for monthly payments calculated as a percentage of Tenant's income from its products, Tenant has the right under the revised lease to extract minerals from the Property, to use the Property and the processing facilities and equipment, and to receive services from Company in connection with the use of the facilities and equipment.

Through c of its d full-time employees, as well as independent contractors, Company provides various services under the lease agreement. These services include permit and environmental compliance services; technical assistance on equipment selection and installation; annual equipment inspections and advice on equipment maintenance; technical assistance on waste handling and disposal; storage and disposal of certain mineral by-products; resolution of issues with neighbors; and landscaping. Company maintains an on-site office for the use of its vice president, who devotes approximately 20 percent of his work day to fulfilling Company's obligations under the lease agreement.

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Company received or accrued approximately e in lease payments and paid or incurred approximately f in relevant expenses for g on the Property. The comparable figures for h are i and k, respectively, and those figures for m are n and p, respectively.

### 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 payments Company receives under the Property lease that constitute rents are 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 Code. Specifically, we express or imply no opinion regarding Company's eligibility to be

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an S corporation. Further, the passive investment income rules of § 1362 are 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,

*/s/*

JAMES A. QUINN  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

enclosures: copy for § 6110 purposes

cc: