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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-129503-18

Date:
March 15, 2019

TY:

Legend

Taxpayer 1	=
Taxpayer 2	=
State A	=
Station	=
Market	=
<u>X</u> percent	=
Date A	=
Date B	=
<u>\$</u> z	=
Buyer	=

Dear :

This responds to your request for a private letter ruling dated August 31, 2018, regarding the application of § 1033 of the Internal Revenue Code to your transactions. You have requested a ruling that the sale of spectrum-based content distribution rights associated with the Station constituted a sale under a threat of an involuntary conversion for purposes of § 1033.

FACTS

Taxpayer 1, a State A corporation, is a diversified media and entertainment business. Taxpayer 1 is the common parent of an affiliated group of corporations and files a consolidated federal income tax return. Taxpayer 1 uses the accrual method of accounting and files on a December 31 taxable year-end.

Taxpayer 2 is a wholly-owned subsidiary of Taxpayer 1. Taxpayer 2 has elected to be classified as an association taxable as a corporation for U.S. federal income tax purposes. Taxpayer 2 is a member of the affiliated group filing a consolidated federal income tax return, the common parent of which is Taxpayer 1. Taxpayer 2 uses the accrual method of accounting, and files on a December 31 taxable year-end.

For U.S. federal income tax purposes, Taxpayer 2 was treated as the owner of the spectrum-based content distribution rights associated with the Station, a full-power UHF television station in Market. The Station operated pursuant to licenses and permits issued by the FCC, which authorized the Station to deliver video, audio, data, and other content over specific broadcast frequencies.

Pursuant to applicable provisions of the Middle Class Tax Relief and Job Creation Act of 2012 (Spectrum Act)¹, the FCC is implementing a mandate by Congress to repurpose spectrum in the 600 MHz band currently used by television broadcasters to help meet the nation's accelerating needs for mobile broadband and other new bandwidth-intensive technologies. The Spectrum Act required the FCC to undertake two related, but independent, processes to reclaim spectrum currently used for television broadcasting: (i) an "Incentive Auction" and (ii) a "Repacking".

The Incentive Auction is intended to motivate existing television broadcasters to relinquish some or all of their spectrum usage rights to accommodate the requirements of the wireless carriers within the repurposed spectrum. Repacking is an involuntary reassignment of remaining broadcast television stations to a narrower segment of spectrum lower in the band. The purpose of the Repacking is to allow the FCC to assemble a near nation-wide contiguous band of spectrum in the upper 600 MHz band for reallocation to mobile broadband.

The Spectrum Act provided broadcasters with three relinquishment options for participating in the Incentive Auction. First, broadcasters could relinquish their spectrum-based content distribution rights in their entirety and cease broadcasting. Second, broadcasters operating on frequencies in the UHF band could voluntarily agree to relocate to frequencies in the VHF band. Third, broadcasters could relinquish their rights to deliver content over a television broadcast channel and, instead, agree to share a single channel with another broadcaster.

Alternatively, broadcasters could also forgo participation in the Incentive Auction altogether and remain on the air. However, that would mean accepting, as part of the Repacking process, the potential to be reassigned to a different, possibly inferior, less valuable, UHF channel without compensation (other than reimbursement from a limited fund for the cost of moving to the new channel).

¹ Middle Class Tax Relief and Job Creation Act of 2012, Pub. L. No. 112-96 § 6403.

On May 15, 2014, the FCC released a *Report and Order*² adopting rules to implement the Spectrum Act, including the Incentive Auction and Repacking process. Under the rules, the Incentive Auction was to consist of a “reverse” auction and a “forward” auction. The reverse auction would determine the price at which a broadcast station would be willing to relinquish some or all of its spectrum-based content distribution rights. The forward auction would set the price that the wireless carriers would pay for the new licenses for repurposed spectrum. After the auction was completed, broadcasters whose bids were accepted in the auction received their payments from the forward auction proceeds. The FCC will also use proceeds from the forward auction to reimburse certain spectrum relocation costs of broadcasters who do not elect to sell. Any remaining proceeds will be deposited with the federal treasury.

Broadcasters who chose to forego the Incentive Auction and instead remain on the air were subject to Repacking — mandatory relocation to different operating frequencies — at the direction of the FCC. Non-participating stations operating in that portion of the upper 600 MHz band that is being repurposed for mobile broadband licenses were almost certain to be forced to change to a new channel in a lower portion of the existing UHF band. In addition, some non-participating stations not operating in the repurposed band could still have been required to operate on new channels to accommodate other stations being moved to other frequencies.

Although the FCC was obligated to use “all reasonable efforts” in the Repacking process to replicate a station’s coverage area and population served, there was no guarantee that a broadcast station’s coverage area and population served would, in fact, be preserved following the Repacking. In addition, broadcasters forced to change to a new channel through Repacking are incurring significant out-of-pocket costs to obtain new broadcasting facilities and equipment. Taxpayer 2 represents that at the time it decided to sell spectrum-based content distribution rights associated with the Station, it believed that a material portion of its total anticipated out-of-pocket Repacking costs would not be reimbursed by the FCC.

Given the Station’s particular circumstances, Taxpayer 2 believed it was highly likely that the Station’s spectrum-based content distribution rights would be Repacked. On Date A, Taxpayer 2 entered into an agreement with Buyer to sell to Buyer an X portion of the Station’s spectrum-based content distribution rights for \$z. Buyer made payment to Taxpayer 2 on Date B.

REQUESTED RULING

² *Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions*, Report and Order, 29 FCC Rcd.

You have requested a ruling that the sale of spectrum-based content distribution rights associated with the Station pursuant to the actions of the FCC constituted a sale under a threat of an involuntary conversion for purposes of § 1033.

LAW AND ANALYSIS

Section 1033(a)(2)(A) of the Code generally provides that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money and the taxpayer, within the period provided in § 1033(a)(2)(B) and for the purpose of replacing such property, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock.

One of the circumstances in which a § 1033 requisition or condemnation occurs is where a taxpayer's property is subjected to a compensable governmental taking for public use under the Fifth Amendment of the U.S. Constitution. *American Natural Gas Co. v. United States*, 279 F.2d 220 (Ct. Cl. 1960); *Behr-Manning Corp. v. United States*, 196 F. Supp. 129 (D.C. Mass. 1961); Rev. Rul. 69-254, 1969-2 C.B. 162; Rev. Rul. 58-11, 1958-1 C.B. 273. The Fifth Amendment provides, in part, that no "private property be taken for public use without just compensation." However, the meaning of condemnation or requisition for purposes of § 1033 of the Code is not strictly limited to takings within the meaning of the Fifth Amendment.

In Rev. Rul. 82-147, 1982-1 C.B. 190, a federal law prohibited the use of motor boats with motors of greater than 25 horsepower on designated lakes in wilderness areas. It also provided that, if the horsepower restriction made the operation of a resort uneconomical, the owner of the resort could require the government to purchase its resort at its fair market value (determined without regard to the horsepower restrictions). The horsepower restriction made the operation of the taxpayer's resort uneconomical and the taxpayer sold its fishing lodge to the federal government. In holding that the government's purchase of the resort constituted a condemnation within the meaning of § 1033, the Service did not refer to a Fifth Amendment taking, but instead emphasized that the horsepower restriction "in addition to the provision authorizing purchase of a resort at its fair market value without regard to the restriction, effectively constitutes a taking of property upon payment of fair compensation."

In the present case, the FCC's Repacking process is functionally equivalent to a direct physical taking of private property for a public use without the consent of the property owner because it effectively deprived Taxpayer 2 of its assets. Taxpayer 2's choice to sell a portion of the Station's spectrum-based content distribution rights was not a

meaningful choice. Choosing to forego the Incentive Auction would have subjected the spectrum-based content distribution rights sold by Taxpayer 2 to the Repacking process. Due to Taxpayer 2's unique circumstances, it was highly likely that the spectrum-based content distribution rights associated with the Station would have been acquired by the FCC in the Repacking. Indeed, following the Incentive Auction, the spectrum-based content distribution rights associated with the Station were Repacked.

In Rev. Rul. 63-221, 1963-2 C.B. 332, the Service stated that for purposes of § 1033, threat or imminence of condemnation is generally considered to exist where a property owner is informed, either orally or in writing, by a representative of a governmental body that the government entity has decided to acquire his property and the property owner has reasonable grounds to believe, from the information conveyed to him by such representative, that the necessary steps to condemn the property will be instituted if a voluntary sale is not arranged.

In Rev. Rul. 81-180, 1981-2 C.B. 161, the Service considered a situation where a taxpayer learned through newspaper reports that a city intended to acquire its property by condemnation for public use if a sale could not be negotiated. City officials confirmed the accuracy of the reports. The taxpayer sold its property to a third party thereafter, but before the city actually condemned the property. The Service concluded that the sale was made under the "threat or imminence of condemnation" because the property was sold after the taxpayer was given reasonable grounds to believe that its property would be taken.

These authorities indicate that a voluntary sale qualifies as an involuntary conversion under § 1033 if the threat or imminence of condemnation is present at the time of sale. However, the threat need not be a certainty. A threat exists if the taxpayer may reasonably believe from representations of the government and surrounding circumstances that a forced sale is likely to take place.

In this case, the FCC's decision to impose on Taxpayer 2 mandatory modification of its broadcast facilities if it decided not to participate in the Incentive Auction (including forced relocation to a different operating frequency, and the potential to incur service losses, unreimbursed out-of-pocket costs, and reduced value for its remaining assets), creates the reasonable grounds to believe that condemnation is forthcoming. The FCC's threat of Repacking Taxpayer 2's Station to different frequencies and the consequent loss of economic utility of its related property constitute an involuntary conversion.

The FCC has provided Taxpayer 2 with notice, through the Spectrum Act and the *Report and Order*, of its intent to acquire the type of spectrum-based content distribution rights that Taxpayer 2 possessed in the Station. Under its unique circumstances, Taxpayer 2 reasonably believed that if it did not sell spectrum-based content distribution rights associated with the Station, it was highly likely that the FCC would take Taxpayer 2's rights and force the Station to relocate to different channels.

Accordingly, Taxpayer 2's sale of spectrum-based content distribution rights associated with the Station constitutes a disposition under the threat or imminence of condemnation for purpose of § 1033 of the Code.

CONCLUSION

The sale of the spectrum-based content distribution rights associated with the Station constituted a sale under a threat of an involuntary conversion for purposes of § 1033.

CAVEATS

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.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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.

Sincerely,

William A. Jackson
Branch Chief, Branch 5
Office of Chief Counsel
(Income Tax & Accounting)

cc: