TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200219037

Date: OCT 15 2001

SIN: .0501.04-01
-0512.01-01

NO THIRD PARTY CONTACTS

T:EO:B2

Employer Identification Number:

Legend:
M =
N =
C =
A =
B =
D =

Dear Sir or Madam:

We have considered your Form 1024, Application for Exemption under Section 501(c)(4) of the Internal Revenue Code along with the private letter rulings you requested on September 28, 2000. We sought assistance from Chief Counsel, Corporate Division, regarding your request for a ruling that your conversion from a taxable corporation to a tax-exempt organization will not cause recognition of gain or loss under section 1.337(d)-4 of the Income Tax Regulations and have incorporated that assistance herein.

You were created in A as a result of the consolidation of M and N, two pre-existing corporations. Both of these corporations had been in existence prior to 1997. M was recognized as tax-exempt under section 501(c)(4) of the Code until B, at which time the IRS retroactively revoked its exemption. You, as the successor of M, have been treated as a taxable corporation since A and have filed a Form 1120 annually.

Your purposes, as set forth in M's initial charter and carried forward in your Articles of Incorporation, include:

- the promotion and development of the use, understanding and appreciation of the language, literature, drama, music, art, history, philosophies, values and other elements of the C culture;
- the enhancement and extension of the principles of democracy which foster freedom of the

individual with equal rights for all, regardless of race, color, sex or creed and the support of all lawful efforts to achieve for labor improved standards of living and general economic security and the opposition to any use of force and violence against such aims, when exerted by totalitarian or dictatorship governments and groups of all kinds, whether communists, fascist and otherwise;

- the education and development of all cultural minorities within a democratic society by all lawful and democratic means in order to effect the preservation and enhancement of their respective mores, values and cultures;
- all to be carried out in furtherance of an ethical and viable pluralistic civilization based upon a concern for the public welfare and encompassing the philosophy of humanism and the fundamental rights of man and social justice;
- and the promotion and diffusion, especially among the C people in the United States, of a general knowledge of literature, economic, social, political and historical science and other useful information by any and all available media of communication and the assistance including financially, of other progressive civic, scientific, economic, philanthropic and similar movements and organizations in the public social welfare.

Since A, you have continued to publish newspapers (Papers) in several languages. You have also owned and operated a popular radio station (Station). The Papers have historically played – and continue to play – an important role in the lives of the American C people and new C immigrants. You have indicated that the publishing function has consistently operated at a substantial loss. The Station, in contrast, has evolved from its roots as a forum for progressive ideas and programs aimed at various immigrant and ethnic cultures and is currently operated in a manner similar to other commercial radio stations. The revenues generated by the Station have been used to subsidize the Papers. In order to concentrate on the publication of the Papers and other social welfare activities consistent with your mission, you decided to discontinue the operation of the Station and to re-apply for exemption as an organization described in section 501(c)(4) of the Code. You did not have to amend your charter nor transfer assets to another entity. However, to obtain tax exemption, you had to discontinue operating the Station by either leasing its airtime to a station operator or selling the Station.

On D, you entered into a local marketing agreement ("LMA") with Programmer that provides both a license for Programmer to use the airtime on the Station for two years in exchange for a royalty and an option (Option) that allows Programmer to negotiate the Programmer's purchase of the Station's operating assets from you for a fixed purchase price at any time during the two-year term. The LMA will not take effect until after the tax rulings requested in this case are issued and certain regulatory approvals are obtained. Programmer agreed to pay a premium for the Option, which if the LMA goes into effect, you will retain whether or not Programmer exercises the Option. The LMA states that, upon exercise of the Option, the parties must negotiate, in good faith, the sale of the Station. The LMA specifies several terms, in addition to the price, that would govern such purchase. If the Option is exercised but an agreement is not reached, Programmer can extend the license for five years in exchange for an additional royalty. In the event you default under the LMA, Programmer has a right of specific performance.

You have also represented that:

(a) To the best of your knowledge and belief, the exercise price of the Option represents the fair market value of the Station.

(b) To the best of your knowledge and belief, the royalty payments specified in the LMA represent the fair market value of the right to use the airtime of the Station under the terms of that Agreement.

Under the LMA, the Programmer will develop the programming to be broadcast and collect all commercial advertising and revenues for its own account. You will continue to retain legal and beneficial ownership of the Station during the term of the LMA, but will not be involved in the management of the Programmer or in the formulation of its programs. You state that your activities will be limited solely to those necessary to comply with FCC rules and regulations and the terms of your FCC license. You will perform the following activities:

- employ a General Manager (GM) to report to and carry out your obligations under the FCC license. The GM will not provide services to the Lessee and will have no employment, consulting, or other material relationship to the Lessee;
- employ at least one full time employee to assist the GM in performing your obligations under the FCC license. This includes maintaining the Station's transmission facilities;
- retain ultimate control over the operation of the Station in accordance with the FCC license;
- maintain a main studio consistent with the license requirements at which the GM and employee of the Station will be available during normal business hours;
- comply with the FCC requirements with respect to the ascertainment of community problems, needs and interests and the broadcast of programming responsive thereto: and timely prepare and place in the Station's public inspection files appropriate documentation thereof;
- and comply with all FCC requirements that are applicable to the operation of the Station.

The Programmer will be responsible for the programming and utilization of air time, while you remain responsible for ensuring the Programmer's performance under the LMA and that its use of the air time is consistent with the license requirements. To fulfill the public programming requirement, you will retain the use of one hour of broadcast time per week for non-commercial programming.

You have asked that we issue the following rulings:

1. That payments from the Programmer of the Station that are attributable to the licensing of the Station's broadcast rights will be treated as royalties under section 512(b)(2) of the Code and neither such payments nor any deductions directly connected with such payments will be taken into account in determining your unrelated business taxable income (UBTI).

2. That gain or loss from the sale of the Station after you have been recognized as exempt under section 501(c)(4) of the Code will be treated as gain or loss described in section 512(b)(5) and not taken into account in determining UBTI.

3. When you converted from a taxable corporation to an exempt entity, you fell within section 1.337(d)-4(a)(3)(i)(B) of the regulations so that you will not be treated as if you transferred all of your assets in a taxable transaction.

On D, based on your Form 1024 and subsequent submissions, the Internal Revenue Service recognized you as exempt under section 501(c)(4) of the Code, effective that date. The basis for this recognition is that you will no longer be operating the commercial radio station. Your primary remaining activity will be the non-commercial publication and distribution of the Papers. You have represented that the Papers will continue to have an ethnic and cultural focus and will continue to fulfill an important role in the lives of the American C people and new C immigrants. In addition to the non-commercial publication of the Papers, you will expand your other social welfare activities, including education and outreach to the various communities served by the Papers and educational forums on topics of general interest in the field of C studies. You will continue to collaborate with and provide support to other nonprofit tax-exempt organizations active in preserving and maintaining the C language and culture, and the cultures of immigrant C populations.

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as gross income derived by an organization from an unrelated trade or business regularly carried on by it, less the deductions directly attributable to such business activity.

Section 512(b)(2) of the Code provides that one of the modifications to be taken into account in determining unrelated business taxable income is that "all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income" shall be excluded. However, if royalty income is derived from debt-financed property (section 514) or controlled organizations (section 512(b)(12), it is included in computing UBTI to the extent provided in those sections.

Section 1.512(b)-l of the Income Tax Regulations provides that whether a particular item of income falls within any of the modifications provided in section 512(b) shall be determined by all of the facts and circumstances of each case.

A royalty is generally defined as a payment for a licensee's valuable right to use the property of another without requiring any significant action on the part of the party offering the use of the right. Rev. Rul. 81-178, 1981-2 C.B. 135, supports this view and defines a royalty as any payment received in consideration for the use of a valuable intangible property right, whether or not payment is based on the use made of such property. For example, the Rev. Rul. lists items such as trademarks, trade names, service marks, and members, names, photos, and facsimile signatures as the type of intangibles that payments for the use of which would constitute royalties. Payments for personal services provided in connection with the granting of

such rights are not royalties under section 512(b)(2) of the Code. Such income and related expenses, must be taken into account in computing the organization's unrelated business taxable income under section 512.

Under the LMA effective D, the Programmer has full availability of the Station's air time (except for one hour per week). The Programmer is responsible for the operation and maintenance of the Station. Your responsibilities are limited to ensuring compliance with your obligations under the FCC Requirements and your FCC license. In this regard, your rights under the LMA are similar to those retained by the organization described in Rev. Rul. 81-178, Situation 1, which involved the maintenance of certain quality control rights and the ability to approve the quality and style of the licensed property.

The right granted to the Programmer under the LMA to use your radio broadcast capacity is intangible property. We conclude, therefore, that the payments you received for the rights granted the Programmer are royalties within the meaning of section 512(b)(2) of the Code. You have represented that this income is not from debt-financed property and the Programmer is not a controlled organization. Accordingly, such payments and directly connected deductions should not be taken into account in determining your UBTI.

Section 512(b)(5) of the Code provides that in computing the UBTI of an exempt organization, there shall be excluded all gains or losses from the sale, exchange or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of business.

You have represented that following the recognition of your exempt status, you expect to sell the Station, either pursuant to the purchase option contained in the LMA, or in a separate transaction unrelated to the LMA. A sale of the Station would include the following assets and properties: your FCC license; your interest in the transmitter site and the transmitter towers; and Station and broadcast equipment. None of these properties would be categorized as stock in trade or other property includible in inventory or property held primarily for sale to customers in the ordinary course of business. The Station would be treated as a capital asset under section 1221, property used in a trade or business under section 1231(b), or other property that is not either inventory type property or property held for sale to customers in the ordinary course of business.

Section 1.512(b)(1)(d) of the regulations provides that the exclusion from the computation of UBTI does not apply to the gain derived from the sale or other disposition of debt-financed property. You have represented that your indebtedness consists of accounts payable to trade creditors and accrued expenses attributable to the day-to-day operations of your current business. No indebtedness is acquisition indebtedness as defined in section 514(c) nor does any property you hold that is subject to sale under the LMA constitute debt-financed property as defined in section 514(b). Accordingly, we rule that any gain or loss from your sale of the Station will be treated as gain or loss described in section 512(b)(5) of the Code and will not be

taken into account in determining your UBTI under section 512(a).

Section 337(d) authorizes regulations to prevent avoidance of the repeal of the General Utilities doctrine, including prevention of the circumvention of those provisions through the use of a tax-exempt entity. Under section 1.337(d)-4(a)(1) of the regulations, if a taxable corporation transfers all or substantially all of its assets to a tax-exempt entity, the taxable corporation generally must recognize gain or loss as if the assets transferred were sold at their fair market values. Under section 1.337(d)-4(a)(2), a taxable corporation's change in status to a tax-exempt entity generally will be treated as if it transferred all its assets to a tax-exempt entity in a transaction subject to gain or loss recognition.

Section 1.337(d)-4(a)(3)(i)(B) of the regulations provides that section 1.337(d)-4(a)(2) does not apply to a corporation that was previously tax-exempt under section 501(a) or that applied for but did not receive recognition of exemption under section 501(a) before January 15, 1997, if such corporation is tax-exempt under section 501(a) within three years from January 28, 1999.

Based solely on the information submitted, we rule that you are a corporation described in section 1.337(d)-4(a)(3)(i)(B), because you were previously exempt and re-obtained tax-exempt status within three years from January 28, 1999. Accordingly, your sale of the Station after that date will not be treated as if you transferred all of your assets in a taxable transaction pursuant to sections 1.337(d)-4(a)(1)) and 1.337(d)-4(a)(2).

We express no opinion as to whether (a) if the Option is exercised by Programmer and the Station is sold, your receipt of the proceeds from the sale of the radio station will be treated as gain or loss before your change in status to a tax-exempt entity, and (b) whether or not the option is exercised, whether the premium paid for the option by Programmer, upon the exercise, lapse, or disposition of the option, will be treated as income, gain or loss before your change in status to a tax-exempt entity. In addition, we express no opinion on the tax treatment of your change in status to a tax-exempt entity, the airtime license for the Station, or the possible sale of the Station under other provisions of the Code or regulations (including provisions relating to depreciation recapture or investment credit recapture) or the tax treatment of any condition existing at the time of, or effect resulting from, the transaction not specifically covered by the above ruling.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

200219037

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4