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LEGEND

Taxpayer =
Station =
Spectrum =
X Band =
Date 1 =
Year A =
Year B =
$x =
$y =

Dear :

This letter responds to your request for a private letter ruling dated June 19, 2019, regarding the application of § 1033 of the Internal Revenue Code to certain transactions entered into by Taxpayer. Taxpayer has requested a ruling that the series of transactions ("the Transactions"), beginning with the sale of rights to distribute content over Spectrum and ending with the sale of remaining intangible assets, constituted sales under a threat of an involuntary conversion for purposes of § 1033.

FACTS

Taxpayer is a limited liability corporation that files federal income tax returns as a partnership. Taxpayer is a television and broadcasting company that previously operated Station. Taxpayer uses the accrual method of accounting and files on a Date 1 taxable year end.

Taxpayer owned an FCC license to broadcast as well as spectrum-based content distribution rights. These FCC-issued licenses and permits authorized Station to deliver video, audio, data, and other content over its specific broadcast frequencies which were in the X Band.

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 requires 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". On May 15, 2014, the FCC issued a Report and Order[2] adopting rules to implement the Spectrum Act, including the Incentive Auction and Repacking process.

The Incentive Auction was intended to motivate existing television broadcasters to voluntarily relinquish some or all of their spectrum usage rights to accommodate the requirements of the wireless carriers within the repurposed spectrum. Repacking, on the other hand, 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 forgo participation in the Incentive Auction altogether and remain on the air. However, such broadcasters would be subject to the Repacking process—mandatory relocation to different operating frequencies—and the potential for the FCC to reassign them to a different, possibly inferior and less valuable, channel without compensation (other than reimbursement from a limited fund for the cost of moving to the new channel).

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[1] Middle Class Tax Relief and Job Creation Act of 2012, Pub. L. No. 112-96 § 6403.
[2] *Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions*, Report and Order, 29 FCC Rcd. 6567 (2014).

Although the FCC is obligated to use "all reasonable efforts" in the Repacking process to replicate a station's coverage area and population served, there is no guarantee that a broadcast station's coverage area and population served would, in fact, be preserved following the Repacking. Furthermore, Taxpayer represents that the FCC is not required to account for all of the real and substantial technical, commercial, and economic differences between the current value of its higher quality band spectrum and the future value of residual assigned spectrum.

Based on the design of the Incentive Auction and the FCC's implementing rules, unless Taxpayer relinquished its rights to broadcast over Spectrum in the Incentive Auction, Taxpayer would likely have been "repacked" to different frequencies which would have forced it to operate with different facilities, on different and less valuable frequencies, and with possibly reduced protected service areas, all of which would harm Taxpayer's future revenue potential and economic value.

Instead, Taxpayer engaged in the Transactions to dispose of its television broadcast business operations. The Transactions began with the sale of Taxpayer's licensed spectrum in the Incentive Auction. In Year A, Taxpayer received $x from the Incentive Auction.

Taxpayer continued to liquidate its television broadcast business operations which included abandoning or disposing of its remaining tangible personalty and intangible assets associated with its television broadcast business operations. The liquidation culminated with the sale of Taxpayer's network affiliation rights and remaining FCC license to broadcast to an unrelated third party in Year B. In total, the Transactions generated gross proceeds of $y for Taxpayer. Taxpayer represents that all of the assets sold in the Transactions were directly related to Taxpayer's television broadcasting business.

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. For purposes of § 1033(a)(2)(A) —

> (i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and
>
> (ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of § 1033(b), the unadjusted basis of such property or stock would be its cost within the meaning of § 1012.

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 United States 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." The meaning of condemnation or requisition for purposes of § 1033 is not, however, 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 deprives Taxpayer of its assets. Taxpayer's choice to participate in the Incentive Auction was not a meaningful choice because choosing to forego the Incentive Auction would have subjected Taxpayer to the repacking process. Due to Taxpayer's unique circumstances, if Taxpayer did not participate in the Incentive Auction then Taxpayer would likely have been repacked into a different channel without compensation other than reimbursement from a limited fund for the cost of moving to the new channel.

Rev. Rul. 63-221, 1963-2 C.B. 332, provides that for purposes of § 1033, threat or imminence of condemnation is generally considered to exist if 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, 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. 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.

The FCC provided Taxpayer 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 possessed. Based upon the information and representations provided, it was reasonable to believe that if Taxpayer did not participate in the Incentive Auction it was likely that the FCC would take Taxpayer's rights to distribute content over Spectrum and then force Taxpayer to relocate its Station to a different frequency.

CONCLUSION

The series of transactions that began with the Year A sale of rights to distribute content over Spectrum and concluded with the Year B sale of remaining intangible assets constituted sales under a threat of 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,

Ronald J. Goldstein
Senior Technician Reviewer, Branch 4
(Income Tax & Accounting)

cc: