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Maximizing the Benefits of Tax Certificates in Broadcast and Cable Ventures

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Introduction

The Federal Communications Commission (FCC or Commission) issues tax certificates pursuant to section 1071 of the Internal Revenue Code in connection with certain sales or exchanges of broadcast or cable television properties to promote its ownership policies. Since 1978, the Commission has issued tax certificates to encourage minority ownership.

This Article explains how the Commission's tax certificates work. It discusses how the Commission determines that a minority company qualifies for a tax certificate, how a seller uses the tax certificate to derive tax deferral benefits, the requirements concerning reinvestment proceeds, and the effect of depreciation recapture and the investment tax credit recapture on the seller's use of the tax certificate.

During the past two years, broadcast and cable acquisitions involving minority tax certificates totaled well over one billion dollars.[1] The increasing popularity of tax certificates is the result of the valuable tax benefits that can be enjoyed by all parties to the transaction.

I
The Tax Certificate Policy

The Commission's tax certificate policy is based on section 1071 of the Internal Revenue Code. Congress enacted section 1071 in 1943 in response to the FCC's adoption that same year of the so-called "multiple ownership rules." These rules limit the number of broadcast stations that a single company may own in a single market and nationwide.[2] Section 1071 was originally designed to lessen the hardship imposed on broadcasters who were forced to divest stations under the multiple ownership rules.[3]

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1. *See infra* part IV.
2. *See* 47 C.F.R. § 73.3555 (1989).
3. I.R.C. § 1071(a) (1990) provides, in pertinent part:

If the sale or exchange of property (including stock in a corporation) is certified by the Federal Communications Commission to be necessary or appropriate to effectuate a change in policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033. For purposes of such section . . . , stock of a corporation operating a radio broadcasting station, whether or not representing control of such a corporation, shall be treated as property similar or related in service or use to the property so converted. The part of the gain, if any, on such sale or exchange to which section 1033 is not applied shall nevertheless not be recognized, if the taxpayer so elects, to the extent that it is applied to reduce the basis for determining gain or loss on the sale or exchange of property, of a character subject to the allowance for depreciation . . . , remaining in the hands of the taxpayer immediately after the sale or exchange or acquired in the same taxable year.

In the late 1970s, the FCC sought to create new opportunities for minority ownership in broadcasting. Several organizations, including the National Association of Broadcasters (NAB), the National Telecommunications and Information Administration of the U.S. Department of Commerce, the National Black Media Coalition, and the Congressional Black Caucus, met in 1977 under the auspices of the FCC to address the underrepresentation of minorities in broadcasting. That year, the NAB filed a Petition for Rulemaking urging the FCC to extend its tax certificate policy to promote minority ownership.[4] Since the adoption of the policy in 1978,[5] the FCC has issued over 265 minority tax certificates.[6]

Minority tax certificates can provide benefits to taxpayers in two transactional settings: (1) when an owner of a broadcast or cable property desires to sell to a minority purchaser, and (2) when an investor that contributed "start-up capital" to a minority-controlled entity operating broadcast or cable property sells an interest in that company. A tax certificate enables the seller in either of the above cases to defer the payment of federal income tax otherwise due if (a) the proceeds are reinvested in appropriate "qualified replacement property" and/or (b) to the extent of any gain attributable to the ownership interest sold, the seller elects to reduce the tax basis of appropriate depreciable property (whether or not used in connection with a broadcasting or cable business) owned immediately after the sale or acquired within the same taxable year of the sale. These provisions allow sellers to defer the payment of taxes to encourage the sale or investment in minority controlled companies operating broadcast or cable property. The seller's anticipated tax savings enable the minority company to negotiate for a reduction in the purchase price.

Section 1071 of the Internal Revenue Code (Code) confers broad powers upon the FCC. The FCC's grant of a tax certificate is based on the agency's determination that the proposed sale or exchange of property "is necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations . . . ."[7] Section

4. *See Statement of Policy on Minority Ownership of Broadcasting Facilities,* 68 F.C.C.2d 979, 983 (1978).

5. *Id.*

6. FCC, CONSUMER ASSISTANCE AND SMALL BUSINESS DIVISION, OFFICE OF PUBLIC AFFAIRS, MINORITY OWNERSHIP LISTS (Sept. 3, 1991) (periodically updated listing of the number of broadcast stations and cable systems acquired through the FCC's minority ownership policies).

7. I.R.C. § 1071(a) (1990).

1071 is a unique provision because its implementation involves both the FCC and the Internal Revenue Service (IRS).[8]

The FCC first issues the tax certificate, but its use involves application of the IRS's rules on involuntary conversions and depreciable property basis reductions. The FCC does not concern itself with how the taxpayer will use the tax certificate; the IRS does not second-guess the FCC's determination that the sale or exchange is necessary or appropriate to promote its policies and thus qualifies for tax certificate treatment.

A. The Economic Value of Tax Certificates

Tax certificates allow taxpayers to sell broadcast and cable property and to defer the taxes on gain from the sale that otherwise would be due to the IRS. These certificates also permit taxpayers to diversify a portfolio of assets on a tax-free basis. A simple illustration demonstrates the value of a tax certificate to an individual who sells a broadcast station. Assume that the seller of a broadcast station has a tax basis[9] in the station of $1 million and sells the station for $2 million. By selling the station to a minority company, the seller can defer all taxes otherwise due on the gain from the sale, provided that the seller reinvests the proceeds in appropriate replacement property or applies the gain to reduce the basis of certain depreciable property.[10] On the other hand, if the sale does not qualify for tax certificate treatment, the IRS would assess taxes of at least $280,000.[11]

Sales Price	$2,000,000
Basis for Gain or Loss	$1,000,000
Gain	$1,000,000
Cash from Sale	$2,000,000
Tax Due (With Tax Certificate)	$ 0[12]
Tax Due (Without Tax Certificate)	$ 280,000

Although this example, for the sake of simplicity, assumes that the individual holds the operating assets directly, in fact, these properties are held by a wide variety of entities, including corporations, partnerships,

8. *See* Blake & McKinney, *Section 1071: Deferral of Tax on FCC Sanctioned Dispositions of Communication Properties*, 36 TAX L. REV. 101 (1980).

9. For the sake of simplicity, we have considered the station to be one asset rather than considering separately all the component assets that comprise the station. We are assuming an adjusted tax basis for these assets that reflects the cost of the assets as increased for various capital expenditures and decreased to reflect the various downward adjustments as required by the Internal Revenue Code. I.R.C. §§ 1011, 1012, 1016 (1990).

10. For the sake of simplicity, this example assumes that there is no recapture income generated upon the disposition of the broadcast or cable assets.

11. The numbers used in this example are approximations.

12. All tax is deferred, provided that the seller reinvests in "qualified replacement property" or elects to reduce the basis of depreciable property remaining in the seller's hands after the sale by the amount of the gain.

partnerships with corporate general partners, and other entities. There are many complex issues raised by reason of the various forms of ownership, the discussion of which is beyond the scope of this article.

The 1986 purchase of WTVT(TV), a Columbia Broadcasting System (CBS) affiliate in Tampa, Florida, provides a dramatic example of the tax deferral benefits derived from the use of a tax certificate. George N. Gillett, a nonminority who, through various companies, controls multiple broadcast stations, and Clarence V. McKee, a black lawyer, jointly purchased the station for $365 million. Mr. McKee provided little equity capital, but obtained 51.53% of the voting control and 20.1% of the equity.[13] The Commission issued a tax certificate on this basis, and the seller deferred almost $100 million in capital gains tax.[14]

B. Eligibility Requirements for Minority Companies

For the purposes of the tax certificate policy, the term "minority" includes blacks, hispanics, American Indians, Alaskan natives, Asians, and Pacific Islanders.[15] The term "hispanic" includes a "person of Mexican, Puerto Rican, Cuban, Central or South American or other Spanish culture or origin, regardless of race" and regardless of whether the individual has a hispanic surname.[16] The term "Asian or Pacific Islander" includes a person having origins in any of the original peoples of the Far East, Southeast Asia, the Indian Subcontinent, or the Pacific Islands. This area includes, for example, China, Japan, Korea, the Philippine Islands, and Samoa. The Commission has issued tax certificates for sales to companies controlled by natives of India who have become natural-

13. Mr. McKee owns 100% of the Class A common stock (210 shares) of WTVT Holdings, Inc., the licensee; each share is entitled to four votes. GNC-3, Inc., which is 100% owned by Gillett Group, Inc., owns 100% (790 shares) of the Class B common stock of WTVT Holdings, Inc. Each share of Class B common stock is entitled to one vote. Thus, Mr. McKee votes 51.53% of WTVT Holdings' 1000 shares of common stock. *See* Application for Assignment of the License of WTVT(TV) in File No. BALCT-870309KK (Mar. 9, 1987).

14. The transaction generated controversy because Mr. Gillett retained an option to buy out Mr. McKee for $1 million. *See, e.g., How the Rich Get Richer,* FORBES, May 15, 1989, at 38. Mr. McKee, who became general manager of the station, had no previous broadcast experience and paid only approximately $25,000 for his equity interest. Gillett Holdings reportedly plans to purchase 49% of the Class A common stock held by Mr. McKee. *Buyout,* BROADCASTING, Feb. 18, 1991, at 6.

15. *In re* Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, *Policy Statement and Notice of Proposed Rule Making,* 92 F.C.C.2d 849, 849 n. 1, 52 Rad. Reg. 2d (P & F) 1301 (1982) [hereinafter 1982 Policy Statement].

16. In re Storer Brdcst. Co., *Memorandum Opinion and Order,* 87 F.C.C.2d 190, para. 8 (1981). In *Storer,* the Commission issued a tax certificate for the sale of a broadcast station controlled by Adolfo Liberman and his family. Mr. Liberman was born in Poland, the descendent of Spanish Jews. He demonstrated that his family spent many years in Mexico and Central America, that the family's native language is Spanish, and that the family is regarded as Hispanic in the community. *See Id.* at para. 3.

ized U.S. citizens.[17] An American Indian or Alaskan native includes any person having origins in the original peoples of North America and who maintains cultural identification through tribal affiliation or community recognition.

To qualify under the policy, the minority company must demonstrate that it is minority-controlled. Traditionally, the test with respect to corporate applicants has been whether more than 50% of the voting stock is owned by minorities.[18] In 1982, the Commission expanded the eligibility requirements to permit limited partnerships with minority general partners to qualify, provided that the minority general partner owns at least 20% of the partnership's total equity.[19] The Commission has held that a limited partnership with a corporate general partner qualifies under the policy. For example, in one instance minorities owned 51% of the voting stock of the corporate general partner. This corporate general partner owned 21% of the limited partnership's total equity.[20] Thus, the traditional test is not definitive on the issue of actual control.

The Commission looks, therefore, beyond mere percentages of voting stock and partnership equity. It evaluates tax certificate requests on a case-by-case basis. Applicants must be prepared to demonstrate that, based on the totality of the circumstances, minorities are in control of the entity. The Commission does not require that minority owners work day-to-day in the management of the broadcast station or the cable system, but minorities must control the overall decision-making of the enterprise. The Commission believes that minority ownership will promote program diversity, which is the overriding goal of the Commission's minority ownership policies.[21]

17. *See Sharad Tak*, REGARDIES, Sept. 1989, at 86.

18. *Statement of Policy on Minority Ownership of Broadcasting Facilities*, 68 F.C.C.2d 979, 979 n.20 (1978). The Policy Statement also contemplates the issuance of tax certificates for the sale of a broadcast station or cable system to a corporation with less than 50% minority ownership upon a demonstration that working control resides in the minority shareholders. *Id.* at 982. *See also* Letter from Donna R. Searcy, Secretary, FCC to Martin J. Gaynes, Esq., 5 FCC Rcd. 6781 (1990). *But cf.* Issuance of Tax Certificate to Long-Pride Broadcasting Co. For KEYN(AM/FM), 48 Rad. Reg. 2d (P & F) 1243 (1980).

19. 1982 Policy Statement, *supra*, note 15, at 855-59, 52 Rad. Reg. 2d at 1305-07.

20. *See* Issuance of Tax Certificate for the Sale of KIXI(AM) in File No. BTC-851011FK (May 6, 1986); Issuance of Tax Certificate for the Sale of KIXI(FM) in File No. BTCH-851011FL (May 6, 1986) (contact the FCC Duplicating Contractor for a copy of the certificates (202) 632-7000).

21. *See generally* Metro Brdcst., Inc. v. FCC, 110 S. Ct. 2997 (1990). Whether the seller is a minority company is irrelevant to the Commission's determination. It routinely issues tax certificates for sales of broadcast and cable properties from one minority company to another. Telephone interview with Alan Glasser, Staff Attorney, FCC, MM, Video Services Division (Sept. 11, 1991).

C. The One-Year Holding Rule

A minority company that obtains a broadcast station through the benefit of a tax certificate must retain the station for at least one year. The Commission has determined that "the rapid resale of such a station to a nonminority at a profit would subvert our goal of increasing minority ownership of broadcast stations."[22] This rule does not apply, however, if the minority company proposes to sell the station to another minority company within the one-year period.[23] To date, the FCC has not adopted a similar rule with respect to cable television systems.

D. Applying for the Tax Certificate

A tax certificate may be obtained by filing a request with the FCC which describes the transaction and explains the qualifications for tax certificate treatment. Typically, the request is filed by the seller. The request should be filed well in advance of the closing, preferably simultaneously with the filing of an application for the FCC's consent to transfer the authorizations involved in the transaction.

Sellers often demand assurances from the buyer that the FCC will grant the tax certificate prior to entering into a binding contract to sell the property. In the past, the Commission has issued advance rulings that a proposed transaction will qualify for a tax certificate,[24] but has conditioned the certificate upon consummation of the transaction.[25] However, awaiting written assurances from the Commission may introduce delay that either party may find unacceptable. As an alternative, the buyer and seller typically present the proposed transaction to the Commission staff and receive informal assurances that the transaction will qualify for a tax certificate. A cautious seller will generally seek a warranty from the buyer that the transaction will qualify for a tax certificate and may require the buyer to agree not to take any action that might render the buyer ineligible for the issuance of the tax certificate. In some cases, sellers require the buyer to indemnify the seller against a change in

22. *In re* Amendment of Section 73.3597 of the Commission's Rules, *Memorandum Opinion and Order*, 99 F.C.C.2d 971, 974, 57 Rad. Reg. 2d (P & F) 1149, 1152 (1985).

23. *Id.*

24. Letter from Vincent J. Mullins, Secretary, FCC to William S. Green, 59 F.C.C.2d 78 (1976); Letter from MM, FCC to Spacecoast Cablevision, Inc., CSR-3140 (Nov. 22, 1988) (contact the Mass Media Bureau of the FCC for a copy of this letter (202) 632-7000).

25. *In re* Request for Issuance of Tax Certificate for Anticipated Sale of Viacam Incorporated, Inc. Common Stock Pursuant to Sections 73.501(a)(1) of the Commission's Rules by J.A.W. Iglehart, *Memorandum Opinion and Order*, 38 F.C.C.2d 541 (1972). Currently, the Mass Media Bureau has adopted a policy of issuing tax certificates when processing the assignment or transfer application. Telephone interview, *supra* note 21.

Commission policy or a restructuring of the buyer's company that might jeopardize issuance of a tax certificate.

II
Negotiating the Tax Certificate Transaction

A. Educating the Seller

Minority companies seeking to take full advantage of a tax certificate must educate sellers about the benefits of the tax certificate early in the negotiation. Sellers are often unaware of the full benefits of tax certificates or have the misconception that qualifying for a tax certificate involves an expensive, uncertain, and time-consuming regulatory process which will delay the sale.

For the buyer, outlining the procedures involved in applying for a tax certificate is far easier than placing a dollar value on the tax certificate for the seller. Unless the buyer knows the seller's estimated adjusted basis in the property—information that sellers do not readily disclose early in the negotiation process—it is not possible to place an exact dollar value on the tax certificate. Obtaining the purchase price from the Commission's public records may be useful in establishing a ballpark estimate, particularly if the seller recently purchased the property. Brokers and investment bankers are often very effective in explaining the value of the tax certificate to sellers. Additionally, the buyer can communicate information about tax certificates to the seller's accountant and suggest that the accountant estimate the value of the tax certificate for the seller.

If a minority buyer is bidding for a property against nonminority buyers, it is essential that the buyer make sure the seller understands how the tax certificate policy works and the value of the tax deferral benefits that it offers. In some instances, however, a tax certificate may not be attractive to a seller. The most common such instance is when the seller will not realize significant gain from the sale of the property. In other cases, the seller may have neither the desire to reinvest the proceeds of the sale in qualified replacement property, nor sufficient depreciable property to elect the basis reduction.[26]

B. Educating Potential Investors

Since 1982, the FCC has issued tax certificates to investors who provide "start-up capital" to minority companies formed to acquire broad-

26. According to Tom Billingslea, president of Acquisition Advising & Capital Corp., an investment banking firm, the "rule of thumb" is that "the tax certificate can shave between 11 percent and 17 percent off the purchase price." *Minority Tax Break Gains Converts*, CABLE WORLD, Mar. 19, 1990, at 44.

cast or cable properties.[27] To qualify for such a tax certificate, the investment must meet the following criteria:

(1) The investor must have provided "start-up capital" to the minority enterprise, defined as funds provided within one year of the company's acquisition of a broadcast or cable property;
(2) The investor must sell the interest in the company to which this "start-up capital" has been provided; and
(3) The company must qualify as a minority company under the tax certificate policy both *before* the investor purchases the interest and *after* the investor sells the interest in the company.[28] (The FCC has issued tax certificates to investors in situations where the sale of the investor's interest and the liquidation of the corporation occur simultaneously.)

The Commission designed the policy to enable minority companies to attract equity investors by offering them the prospect of a tax certificate upon the eventual sale of their interests in the company. The Commission provided the following example of how the policy works:

> [A]ssume shareholder A, a Black person, owns 70 percent of Corporation X, while shareholders B and C each own 15 percent. If B and C purchase their shares before or within one year after acquisition of a license, they can later sell their interest and be eligible to receive a tax certificate. Whether B and C and/or the subsequent buyers are racial or ethnic minorities would be inconsequential—what is relevant is that B and C provided necessary financing enabling a minority-owned or controlled entity to acquire and start a broadcasting station, thereby increasing minority ownership in the market. So long as the entity is minority controlled, it is immaterial whether minority members own 51% or 91%.[29]

Under this aspect of the tax certificate policy, the Commission has issued tax certificates to individuals who purchased stock subscription warrants in a minority start-up company.[30]

A minority company can thus offer a tax certificate to the seller of the broadcast or cable property *and* to investors who will realize tax deferral benefits upon the eventual sale of their interests in the company. Minority entrepreneurs often overlook this feature of the tax certificate policy, yet it is a quite significant means of enhancing the value of an investment in a minority-controlled enterprise.

27. *See* 1982 Policy Statement, *supra* note 15, at 855-59, 52 Rad. Reg. 2d at 1307-09.

28. *See* 1982 Policy Statement, *supra* note 15, at 857-58, 52 Rad. Reg. 2d 1307-08.

29. 1982 Policy Statement, *supra* note 15, at 857, n. 40, 52 Rad. Reg. 2d. at 1309.

30. Letter From Ed Jorgensen, Assistant Chief for Law, FCC, MM, Audio Services Division to Edward Hayes, Esq. (Jan. 19, 1990) (FCC Ref. No. 82920-RMK).

III
Tax Options for the Holder of a Tax Certificate

No discussion of the tax certificate would be complete without addressing the tax benefits that accrue to the holder. Herein lies the intrinsic value of the tax certificate. The availability of the benefits, however, demands some attention to the options that are offered as well as the time constraints within which the choices must be made.

A. The Section 1071 Election: Importance of Planning and Timing

To defer tax that would otherwise be due on the gain resulting from the sale of property certified by the FCC, the seller must make an affirmative election under section 1071. The seller files a written statement with the seller's federal income tax return for the year in which the sale takes place.

The seller must decide which of the following three options will provide the seller with the maximum tax deferral benefits. First, the seller may reduce the basis of depreciable property that the seller retains after the sale or acquires in the same tax year using all or part of the gain.[31] Second, the seller may reinvest the proceeds in qualifying replacement property (*i.e.*, broadcast or cable property).[32] Third, the seller may elect a combination of the preceding two options. A word of caution is in order, however, as the choice to apply all or part of the gain to reduce the basis of remaining property must be indicated on the tax return for the year of the sale. On that return, the seller must specify the amount of the gain that will be applied to reduce the basis of depreciable property. The seller may not file an amended return to retroactively reduce the basis of depreciable property in order to consume gain in excess of the amount the seller was able to defer by investing in replacement property.[33]

B. Reinvestment in Qualified Replacement Property

Generally, a seller has two years following the year of sale to purchase qualifying replacement property.[34] The cost basis of the quali-

31. Generally, all depreciable property, whether or not used in connection with a broadcasting or cable business, is eligible for basis reduction. 26 C.F.R. § 1.1071-3(a)(1) (1990). The reduction is applied to all such property that the taxpayer holds immediately after the sale of the broadcast or cable property or acquired in the same taxable year. *Id.*

32. The transaction is then treated as an involuntary conversion under section 1033 of the Internal Revenue Code, which is ordinarily reserved for property that has been stolen, condemned, or destroyed.

33. Rev. Rul. 79-277, 1979-2 C.B. 300; *see also* Cloutier v. United States, 709 F.2d 480, 485 (7th Cir. 1983).

34. The replacement period ends two years after the close of the first taxable year in which any part of the gain is realized. I.R.C. § 1033(a)(2)(B) (1990). Thus, for example, the sale of a

fied replacement property acquired with the proceeds of the FCC certified sale will be reduced by the amount of gain not recognized under section 1033(b) of the Code. This basis adjustment mechanism effectively reduces the adjusted basis of the newly acquired property by the amount of the gain that was generated but deferred with respect to the old property insuring that the deferred gain will ultimately be recognized and taxed when the replacement property is sold.

The replacement property must be "similar or related in service or use" to the converted property.[35] In applying this standard under section 1071, the IRS permits the taxpayer to change significantly the nature of the investment. Generally, it allows the seller to reinvest in different types of *electronic* media of *mass* communication and the investment may be in the form of assets or stock.[36] Thus, qualifying replacement property under section 1071 may consist of hard assets (*i.e.*, broadcast or cable assets) or stock in a corporation whose income is *directly* and *primarily* derived from broadcasting or cable operations.[37]

Reinvesting the proceeds from the sale of a television station in radio station assets qualifies under the policy. Similarly, reinvesting the proceeds of a radio or television sale in a cable television system would qualify because cable television and radio and television broadcasting are all electronic media of mass communication. By contrast, an investment in a closed circuit hotel television system or a wireline telephone company would not qualify. The IRS would likely accept reinvestment of the proceeds of the sale of a broadcast or cable property in one of the newer mass media services, such as multipoint distribution systems or direct broadcast satellites, provided that they are not offered on a common carrier basis.

C. Calculating the Effect of Recapture

Although sections 1071 and 1033 of the Code generally provide for the deferral of income taxes when the rules above are followed, various tax provisions can come into play which require a portion of the income

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television station in June, 1990, would require the seller to reinvest in replacement property by December 31, 1993. The IRS district director may extend the deadline only upon the taxpayer's showing of "reasonable cause" for the inability to reinvest in replacement property within the statutory period. 26 C.F.R. § 1.1033(a)-2(c)(3) (1990).

35. By contrast, under section 1033, the IRS has traditionally sought to prevent a taxpayer from reinvesting in property of a different nature or function. *See, e.g.*, Filipini v. United States, 318 F.2d 841, 845 (9th Cir.), *cert. denied*, 375 U.S. 922 (1963).

36. I.R.C. § 1033(b) (1990).

37. The taxpayer must invest in a corporation that *directly* operates a communications business. The IRS has ruled out reinvestment in a holding company wherein the broadcast licenses or cable television franchises are held by subsidiaries. Rev. Rul. 66-33, 1966-1 C.B. 183.

to be recognized rather than deferred. The term "recapture" refers to a situation in which a seller that disposes of property must restore to income an amount equal to depreciation deductions previously claimed with respect to the property.[38] It is therefore important that the seller be aware of the potential recapture consequences of an FCC-certified sale, which may affect the economics of the transaction. These recapture provisions may also affect the the selection of the reinvestment property or the structure of the sale.[39]

With respect to dispositions of depreciable personal property under section 1071 of the Code, recapture income will be reportable by the taxpayer to the extent that gain is recognized on the disposition, plus the fair market value of the property acquired that replaces depreciable personal property, but which is not itself depreciable personal property. Similar rules apply in the case of dispositions of depreciable realty. Very complex rules apply to the calculation of depreciation recapture in the case of involuntary conversions under section 1033 of the Code. For example, if depreciable operating assets are sold and replaced with the stock of a corporation holding qualified replacement assets, the recapture income may be significant despite the fact that the provisions of section 1071 of the Code apply because depreciable assets have been replaced with stock, an asset not subject to depreciation.

If a seller chooses to take advantage of the basis reduction rules either alone or in addition to the election to treat the sale as an involuntary conversion, the basis reduction rules may also impact the amount of the recapture income that may be generated by the sale. Although a complete description of the recapture rules and basis reduction rules is beyond the scope of this Article, they are important factors that must be considered when a seller is assessing the benefits of the tax certificate.

Sellers should consult competent tax counsel before making a section 1071 election to maximize the benefits that may be derived from the tax certificate. The IRS also provides guidance to taxpayers through the private letter rulings programs outlined in Revenue Procedure 91-1.[40]

38. In general, a sale of assets pursuant to section 1071 of the Code; which is treated as an involuntary conversion under section 1033, is also considered a disposition event requiring the restoration into income of an amount of the investment credit previously taken with respect to the disposed property.

39. Provisions governing investment credit recapture property require varying amounts of the investment credit previously claimed to be recaptured. Amounts depend on the number of years the property was in service prior to its disposition. The impact of the investment credit recapture provisions will decline in significance due to the repeal of the regular investment tax credit by the Tax Reform Act of 1986, as amended.

40. 1991-1 I.R.B. 9.

This document and Publication 1375 are available from the IRS and can be obtained at any local IRS office.

IV
Maximizing Economic Value: Case Studies

The tax certificate policy has proven to be an effective means of increasing minority ownership in broadcasting and cable. Since the adoption of the tax certificate policy in 1978, the number of stations owned by minorities has increased from 0.5% of television and radio stations to approximately 3.5%. Over 200 stations have been acquired through the benefit of tax certificates.[41] Since the adoption of the policy, two minority companies have emerged as major radio group owners. Companies controlled by Ragan A. Henry, a black businessman, now own 11 AM and 15 FM radio stations. Willis Broadcasting Corporation, another black-owned company, owns 15 AM and 15 FM broadcast stations.[42]

In recent years, several significant broadcast and cable transactions have involved tax certificates:

In 1989, New York Times Cable sold its 166,000-subscriber cable television system serving New York and New Jersey to a consortium led by J. Bruce Llewellyn for $422 million. The tax certificate received by New York Cable had a minimum value of $55 million. In an earlier deal, Mr. Llewellyn purchased WKBW-TV from Capital Cities for $65 million. Capital Cities accepted the offer after rejecting a $91 million bid from a nonminority company.[43]

Last year, Frank Washington, a black businessman, and InterMedia announced their purchase of a 160,000-subscriber cable television system from Cooke Media Group, Inc. for an estimated $400 million.[44]

Cook Inlet Communications, Inc. has also successfully employed the tax certificate policy. Cook Inlet Communications is the wholly-owned subsidiary of Cook Inlet Region, Inc., one of 13 Alaskan regional corporations established by Congress in 1971 which are controlled by Alaskan natives. In 1985, Cook Inlet purchased ABC-affiliate WTNH(TV), New Haven, Connecticut from Capital Cities for $170 million. The company purchased First Media's 11-station group in 1987 for

41. *Minority Tax Break Gains Converts, supra* note 26, at 48.

42. *See* BROADCAST PUBLICATIONS INC., 1991 BROADCASTING/CABLECASTING YEARBOOK.

43. *How the Rich Get Richer, supra* note 26, at 38-39; *Minority Partners,* CHANNELS, May, 1989 at 51.

44. *Minority Tax Break Gains Converts, supra* note 26, at 44.

over $170 million, and NBC-affiliate WSMV(TV) in Nashville, Tennessee, in 1989 for over $30 million.[45]

Last year, Hernandez Communications, Inc. purchased a 60,000 subscriber system near San Jose, California, from Hearst Corporation for an estimated $170 million.[46]

Two years ago, W. Don Cornwell, formerly an investment banker with Goldman, Sachs, formed Granite Broadcasting Corporation, which now owns two ABC and two NBC television station affiliates. Mr. Cornwell, who is black, is the majority voting shareholder in Granite Broadcasting Corporation and took advantage of the tax certificate policy in acquiring the four stations.[47]

V
Conclusion

By all indications, tax certificates will be used increasingly in the sale of broadcast and cable television properties. In the current climate of reduced cash flow multiples, sellers are more likely to sell at a reduced price if gain from the sale can be sheltered. In June, 1990, the United States Supreme Court affirmed the constitutionality of the Commission's minority ownership policies, which paves the way for increasing use of tax certificates.[48] Buyers, sellers and investors should be alert to the significant opportunities afforded by the tax certificate policy.

45. *Minority Partners, supra* note 44, at 51.
46. *Minority Tax Break Gains Converts, supra* note 26, at 44.
47. *Granite Brdcst. Emerges,* TELEVISION/RADIO AGE, Nov. 27, 1989, at 35.
48. Metro Brdcst., Inc. v. FCC, 110 S. Ct. 2997 (1990).