

# A Post-Auction Rainbow

While TV broadcasters' spectrum auction results were underwhelming, new market conditions may provide favorable opportunities. **BY JOHN S. SANDERS**

**N**ow that the Federal Communications Commission's (FCC's) broadcast incentive auction has concluded, TV station owners face circumstances that could be quite conducive to new transactions for three related reasons.

First, there's a pent-up demand for deals, instigated by the "quiet period" that restricted broadcasters from sharing information and the FCC's related moratorium on approving broadcast station transfers.

Additionally, station owners will receive significant proceeds from the auction and have an opportunity to defer capital gains taxes as long as they reinvest the proceeds in a properly structured like-kind exchange (LKE).

Third, a recent Internal Revenue Service private letter ruling (PLR 201702034) raised the possibility of further tax relief.

## LIKE-KIND DEALS

The Internal Revenue code that governs LKEs (Sec. 1031) was developed in the early 1920s to encourage reinvestment and to avoid penalizing companies and individuals who reinvest profits. The same holds true today.

The government had agricultural entities in mind at that time, and a ranch provides a simple example. If a rancher sold a steer for \$100 and made a \$50 profit, he would be able to defer the capital gains tax on the \$50 as long as he reinvested the proceeds in livestock (i.e. "like-kind" property) within a certain period.

Conversely, in a "reverse like-kind exchange," the participant first arranges to purchase the steer, and then must arrange to divest one, hopefully of similar value.

The same arrangement can apply to an FCC broadcast license. For example, a company that totally relinquished an FCC license for \$25 million and enjoyed a \$15

million gain could defer tax on the \$15 million as long as the proceeds are reinvested in a similar license.

To comply with the strict requirements of Sec. 1031, an entity called a qualified intermediary (QI) is often used so that the seller never actually holds cash. It can be an attorney, a CPA or another party as long as the person is independent from the properties being exchanged.

Like most financial transactions (and the spectrum auction itself), LKEs can get complicated very quickly, and there are numerous valuation and legal pitfalls that should be considered.

Different asset categories must be properly matched in the exchanges. For example, real estate is not like-kind with broadcast equipment, and an FCC license is not like-kind

with an entire television station, only with its license. Goodwill is never a like-kind asset.

In past instances, only a small portion of some large transactions qualified for tax deferral because valuation categories matched poorly. For example, a suboptimal exchange results if a station with substantial real estate is exchanged for one with none.

Timing is also key. When a property is sold (and the proceeds received by the QI), the seller has 45 days to identify the reinvestment property and 180 days to acquire it.

## PRIVATE-LETTER PROSPECTS

Further tax relief may come from a recent IRS private-letter ruling (PLR). The taxpayer argued that a relinquishment of spectrum in the auction could, in some cases, be defined as "a sale under threat of involuntary conversion." While PLRs do not serve as precedent, the taxpayer's logic may open a more favorable tax opportunity for some broadcasters. The letter involves a taxpayer that fully relinquished its license and successfully argued that it had been left with a stark choice:

either participate in the incentive auction or accept the very real possibility that mandatory repacking would damage its coverage and economic viability.

The broadcaster explained that in the post-auction spectrum repacking process stations will be forcibly relocated to different and possibly inferior channel positions. In other words, although the auction was

described as "voluntary," it was not really all that voluntary for some broadcasters, including those, for example, with channel positions that were likely to be repacked.

As such, this type of transaction qualifies for Sec. 1033 treatment, rather than the Sec. 1031 like-kind provisions. Sec. 1033 was intended to soften the blow when a taxpayer involuntarily relinquishes property due to eminent domain,

condemnation or other cases when the owner is essentially forced to relinquish property rights.

Under Sec. 1033, the taxpayer has two years, rather than 180 days, to reinvest. No QI is required, so the proceeds are available immediately.

Additionally, in contrast to the Byzantine LKE categories, the taxpayer can reinvest in "similar or related" property, which is a more flexible definition. Any determination in this regard will depend upon specific facts and circumstances.

In short, while some broadcasters felt compelled to relinquish their licenses, the more liberal Sec. 1033 rules may open up opportunities for reinvestment.



John Sanders is a principal with Bond & Pecaro, Inc., an economic and financial consulting firm in Washington, DC. He can be reached at (202) 775-8870 or [johnsanders@bondpecaro.com](mailto:johnsanders@bondpecaro.com).

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