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Person To Contact:
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Telephone Number:

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Date:
July 23, 2020

TY:

Legend

Taxpayer =
Subsidiary 1 =
Subsidiary 2 =
Licensee 1 =
Licensee 2 =
X =
Y =
Date A =
Date B =
Date C =
Date D =
Year 1 =
Year 2 =
Order 1 =

Order 2 =

Order 3 =

Dear :

This responds to your request for a private letter ruling, dated Date A, Year 2, regarding the application of § 1033 of the Internal Revenue Code (Code) to your transactions. You have requested a ruling that the decision by wholly owned direct and indirect subsidiaries of Taxpayer to relinquish radio broadcast licenses in exchange for a payment and the ability to bid for new licenses in an auction pursuant to an order of the Federal Communications Commission (FCC) was made under threat or imminence of condemnation within the meaning of § 1033(a).

FACTS

Taxpayer is the parent of an affiliated group of corporations that file a consolidated federal income tax return. Taxpayer, through its corporate and other subsidiaries, provides wireline and wireless communications services to consumers. On Date B, Year 1, Taxpayer acquired all of the stock of Subsidiary 1, resulting in: (i) Subsidiary 1 becoming a wholly owned direct subsidiary of Taxpayer and a member of the affiliated group; (ii) Subsidiary 2, a wholly owned subsidiary of Subsidiary 1, becoming a wholly owned indirect corporate subsidiary of Taxpayer and member of the affiliated group; and (iii) the assets of Licensee 1, a single-member limited liability company wholly owned by Subsidiary 2 and disregarded for federal tax purposes, continuing to be treated as the assets of Subsidiary 2.

Licensee 2 is a general partnership of which X% of the general partnership interests are owned by Taxpayer through wholly owned direct and indirect subsidiaries that are disregarded for federal tax purposes, and of which the remaining Y% general partnership interests are owned by wholly owned indirect corporate subsidiaries of Taxpayer that are members of the affiliated group. Licensee 1 and Licensee 2 own radio broadcast licenses which are the subject of your request. Taxpayer, Subsidiary 1, Subsidiary 2 and Licensee 2 each has the calendar year as its annual accounting period and each is on the accrual method of accounting for financial accounting and federal income tax purposes.¹

Taxpayer's United States businesses operate under authority of radio broadcast licenses issued by the FCC, which authorize the holders to broadcast and receive radio waves within a specified range of frequencies on the electromagnetic spectrum and within a defined geographic area. The radio broadcast licenses held by Licensee 1 and Licensee 2 authorize them to operate in the 39 GHz band. Licensee 1 holds a greater portion of the total aggregate value of the 39 GHz licenses owned by both Licensee 1 and Licensee 2. The value of each 39 GHz license exceeds its adjusted tax basis.

¹ For purposes of convenience, "Taxpayers" refers to the collective group of the Taxpayer and the affiliated business entities, Subsidiary 1, Subsidiary 2, Licensee 1, and Licensee 2, making this ruling request.

Pursuant to the Middle-Class Tax Relief and Job Creation Act of 2012 (Spectrum Act),² on Date D, Year 1 the FCC began reorganizing and reconfiguring the 39 GHz band for the deployment of broadband services, including 5G services.³ The FCC intended to facilitate the reconfiguration of existing 39 GHz spectrum holdings into contiguous swathes of spectrum that would be conducive to wireless broadband deployment, including 5G services. To that end, the FCC initiated an incentive auction, "Auction 103," because a number of existing 39 GHz licenses did not conform to the FCC's plan to organize the 39 GHz band into licenses that each cover 100 megahertz (MHz) of spectrum in defined geographic areas, known as partial economic areas (PEA).

The FCC took the following steps: (i) the 39 GHz band plan was modified to 14 channels of 100 MHz each; (ii) holders of 39 GHz licenses were offered a reconfiguration of existing spectrum usage rights that conformed closely to the new band plan and service areas; (iii) license holders were afforded the option to select an alternative reconfiguration that was intended to better align the reconfiguration with license holders' operations; and (iv) license holders were informed they would be given the choice to accept modifications to their licenses, as proposed by the FCC or an acceptable alternative, or to participate in an auction to relinquish their existing spectrum usage rights in exchange for a share of auction proceeds.

Auction 103 includes a reverse auction component that allows spectrum usage license holders to relinquish their existing 39 GHz band licenses and a forward auction in which participating incumbent licensees and new applicants bid on licenses for all 39 GHz band spectrum, except for licenses for any spectrum retained to provide modified licenses to non-participating licensees. A licensee is required to relinquish all of its existing licenses as a prerequisite to participating in the incentive auction.

The FCC clarified that all existing licenses are subject to modification irrespective of whether an incumbent licensee participates in the incentive auction.⁴ Under the FCC's procedures, a 39 GHz licensee, or group of licensees if they are affiliated, must designate an Initial Commitment Representative to select among one of the following initial commitments:

Option 1: Accept modified licenses based on the Commission's proposed reconfiguration of the 39 GHz licenses;

Option 2: Accept modified licenses based on an acceptable alternative reconfiguration; or

² Pub. L. No. 112-96, §§ 6402-03, 126 Stat. 224 (2012).

³ Order 1.

⁴ Order 2, Order 3.

Option 3: Relinquish all spectrum usage rights pursuant to 39 GHz licenses in exchange for an incentive payment by having the licenses cancelled, thereby being eligible to bid for new licenses in the auction.

Further, any licensee that fails to make a selection by the established deadline will be deemed to have selected Option 1. Under the FCC's established procedures, an "Initial Commitment Representative" is one of three individuals named by an incumbent licensee or, in the case of a commonly controlled group that includes more than one incumbent licensee, a person named on behalf of the group to act on the group's behalf regarding auction matters. For purposes of designating an Initial Commitment Representative and participation in the auction, all commonly controlled entities are treated as a single entity by the FCC. Licensee 1 and Licensee 2 are commonly controlled under the FCC's standards and the procedures governing Auction 103. As a result, they are treated as a single entity respecting their decision about whether to participate in the auction of 39 GHz licenses.

The FCC reported that all incumbent license holders of 39 GHz licenses, including Licensee 1 and Licensee 2, elected Option 3, deciding to have their licenses cancelled in exchange for an incentive payment and thereby becoming eligible to bid for new licenses in Auction 103.

REQUESTED RULING

You have requested a ruling that Taxpayers elected Option 3 under threat or imminence of condemnation of the 39 GHz licenses within the meaning of § 1033(a) of the Code.

LAW AND ANALYSIS

Section 1033(a)(2)(A) of the Code provides that if the 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 specified 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 converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain must be recognized to the extent that the amount realized on the 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 when a taxpayer's property is subjected to a compensable government 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. 69-654, 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 motorboats 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 reorganizing and reconfiguring process is functionally equivalent to a direct physical taking of private property for public use without the consent of the property owner because it effectively deprives Taxpayers of their assets. Taxpayers’ choice to elect Option 3 and relinquish the radio broadcast licenses in exchange for an incentive payment and participation in Auction 103 was not a meaningful choice. Choosing to forego participation in Auction 103 would have subjected the Taxpayers to the reorganizing process and forced them to accept modified licenses.

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 has provided Taxpayers with notice, through the Spectrum Act and its published reports and orders, of its intent to acquire the radio broadcast licenses that Taxpayers possessed. Under these unique circumstances, it is reasonable for Taxpayers to believe that if they did not relinquish their radio broadcast licenses for an incentive payment and participate in Auction 103, then the FCC would take Taxpayers' radio broadcast licenses and force Taxpayers to accept modified radio broadcast licenses.

Accordingly, Taxpayers' election of Option 3 to exchange their radio broadcast licenses for an incentive payment and participation in Auction 103 constitutes a disposition under the threat or imminence of condemnation for purposes of § 1033 of the Code.

CONCLUSION

We therefore conclude that Taxpayers elected Option 3 under the threat or imminence of condemnation within the meaning of § 1033.

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. In particular, no opinion is expressed or implied concerning whether any particular property acquired by Taxpayers, or any party related to Taxpayers, constitutes property that is similar or related in service or use within the meaning of § 1033(a)(2) to the Spectrum Rights relinquished, which are discussed in this private letter ruling.

This ruling is directed only to the Taxpayers 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.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers 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,

Christina M. Glendening
Senior Counsel
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: