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FCC Affirmative Action [5]

104TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
104–92

SELF-EMPLOYED HEALTH INSURANCE ACT

MARCH 29, 1995.—Ordered to be printed

Mr. ARCHER, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 831]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 831), to amend the Internal Revenue Code of 1986 to permanently extend the deduction for the health insurance costs of self-employed individuals, to repeal the provision permitting nonrecognition of gain on sales and exchanges effectuating policies of the Federal Communications Commission, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

SECTION 1. PERMANENT EXTENSION AND INCREASE OF DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) PERMANENT EXTENSION.—Subsection (l) of section 162 of the Internal Revenue Code of 1986 (relating to special rules for health insurance costs of self-employed individuals) is amended by striking paragraph (6).

(b) INCREASE IN DEDUCTION.—Paragraph (1) of section 162(l) of the Internal Revenue Code of 1986 is amended by striking "25 percent" and inserting "30 percent".

(c) EFFECTIVE DATES.—

(1) EXTENSION.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1993.

(2) INCREASE.—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1994.

99–006

SEC. 2. REPEAL OF NONRECOGNITION ON FCC CERTIFIED SALES AND EXCHANGES.

(a) IN GENERAL.—Subchapter O of chapter 1 of the Internal Revenue Code of 1986 is amended by striking part V (relating to changes to effectuate FCC policy).

(b) CONFORMING AMENDMENTS.—Sections 1245(b)(5) and 1250(d)(5) of the Internal Revenue Code of 1986 are each amended—

(1) by striking "section 1071 (relating to gain from sale or exchange to effectuate polices of FCC) or", and

(2) by striking "1071 AND" in the heading thereof.

(c) CLERICAL AMENDMENT.—The table of parts for such subchapter O is amended by striking the item relating to part V.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to—

(A) sales and exchanges on or after January 17, 1995, and

(B) sales and exchanges before such date if the FCC tax certificate with respect to such sale or exchange is issued on or after such date.

(2) BINDING CONTRACTS.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written contract which was binding on January 16, 1995, and at all times thereafter before the sale or exchange, if the FCC tax certificate with respect to such sale or exchange was applied for, or issued, on or before such date.

(B) SALES CONTINGENT ON ISSUANCE OF CERTIFICATE.—

(i) IN GENERAL.—A contract shall be treated as not binding for purposes of subparagraph (A) if the sale or exchange pursuant to such contract, or the material terms of such contract, were contingent, at any time on January 16, 1995, on the issuance of an FCC tax certificate. The preceding sentence shall not apply if the FCC tax certificate for such sale or exchange is issued on or before January 16, 1995.

(ii) MATERIAL TERMS.—For purposes of clause (i), the material terms of a contract shall not be treated as contingent on the issuance of an FCC tax certificate solely because such terms provide that the sales price would, if such certificate were not issued, be increased by an amount not greater than 10 percent of the sales price otherwise provided in the contract.

(3) FCC TAX CERTIFICATE.—For purposes of this subsection, the term "FCC tax certificate" means any certificate of the Federal Communications Commission for the effectuation of section 1071 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act).

SEC. 3. SPECIAL RULES RELATING TO INVOLUNTARY CONVERSIONS.

(a) REPLACEMENT PROPERTY ACQUIRED BY CORPORATIONS FROM RELATED PERSONS.—

(1) IN GENERAL.—Section 1033 of the Internal Revenue Code of 1986 (relating to involuntary conversions) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) NONRECOGNITION NOT TO APPLY IF CORPORATION ACQUIRES REPLACEMENT PROPERTY FROM RELATED PERSON.—

"(1) IN GENERAL.—In the case of—

"(A) a C corporation, or

"(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3)), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion,

subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period described in subsection (a)(2)(B).

"(2) RELATED PERSON.—For purposes of this subsection, a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1)."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to involuntary conversions occurring on or after February 6, 1995.

(b) APPLICATION OF SECTION 1033 TO CERTAIN SALES REQUIRED FOR MICROWAVE RELOCATION.—

(1) IN GENERAL.—Section 1033 of the Internal Revenue Code of 1986 (relating to involuntary conversions), as amended by subsection (a), is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) SALES OR EXCHANGES TO IMPLEMENT MICROWAVE RELOCATION POLICY.—

"(1) IN GENERAL.—For purposes of this subtitle, if a taxpayer elects the application of this subsection to a qualified sale or exchange, such sale or exchange shall be treated as an involuntary conversion to which this section applies.

"(2) QUALIFIED SALE OR EXCHANGE.—For purposes of paragraph (1), the term 'qualified sale or exchange' means a sale or exchange before January 1, 2000, which is certified by the Federal Communications Commission as having been made by a taxpayer in connection with the relocation of the taxpayer from the 1850–1990MHz spectrum by reason of the Federal Communications Commission's reallocation of that spectrum for use for personal communications services. The Commission shall transmit copies of certifications under this paragraph to the Secretary."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to sales or exchanges after March 14, 1995.

SEC. 4. DENIAL OF EARNED INCOME CREDIT FOR INDIVIDUALS HAVING EXCESSIVE INVESTMENT INCOME.

(a) IN GENERAL.—Section 32 of the Internal Revenue Code of 1986 is amended by redesignating subsections (i) and (j) as sub-

sections (j) and (k), respectively, and by inserting after subsection (h) the following new subsection:

"(i) DENIAL OF CREDIT FOR INDIVIDUALS HAVING EXCESSIVE INVESTMENT INCOME.—

"(1) IN GENERAL.—No credit shall be allowed under subsection (a) for the taxable year if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $2,350.

"(2) DISQUALIFIED INCOME.—For purposes of paragraph (1), the term 'disqualified income' means—

"(A) interest or dividends to the extent includible in gross income for the taxable year,

"(B) interest received or accrued during the taxable year which is exempt from tax imposed by this chapter, and

"(C) the excess (if any) of—

"(i) gross income from rents or royalties not derived in the ordinary course of a trade or business, over

"(ii) the sum of—

"(I) the deductions (other than interest) which are clearly and directly allocable to such gross income, plus

"(II) interest deductions properly allocable to such gross income."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

SEC. 5. EXTENSION OF SPECIAL RULE FOR CERTAIN GROUP HEALTH PLANS.

Section 13442(b) of the Omnibus Budget Reconciliation Act of 1993 (Public Law 103–66) is amended by striking "May 12, 1995" and inserting "December 31, 1995".

SEC. 6. STUDY OF EXPATRIATION TAX.

(a) IN GENERAL.—The staff of the Joint Committee on Taxation shall conduct a study of the issues presented by any proposals to affect the taxation of expatriation, including an evaluation of—

(1) the effectiveness and enforceability of current law with respect to the tax treatment of expatriation,

(2) the current level of expatriation for tax avoidance purposes,

(3) any restrictions imposed by any constitutional requirement that the Federal income tax apply only to realized gains,

(4) the application of international human rights principles to taxation of expatriation,

(5) the possible effects of any such proposals on the free flow of capital into the United States,

(6) the impact of any such proposals on existing tax treaties and future treaty negotiations,

(7) the operation of any such proposals in the case of interests in trusts,

(8) the problems of potential double taxation in any such proposals,

(9) the impact of any such proposals on the trade policy objectives of the United States,

(10) the administrability of such proposals, and

(11) possible problems associated with existing law, including estate and gift tax provisions.

(b) REPORT.—The Chief of Staff of the Joint Committee on Taxation shall, not later than June 1, 1995, report the results of the study conducted under subsection (a) to the Chairmen of the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

And the Senate agree to the same.

BILL ARCHER,
PHILIP CRANE,
WM. THOMAS,
CHARLES B. RANGEL,
Managers on the Part of the House.

BOB PACKWOOD,
BOB DOLE,
BILL ROTH,
JOHN H. CHAFEE,
CHUCK GRASSLEY,
DANIEL PATRICK MOYNIHAN,
MAX BAUCUS,
CAROL MOSELEY-BRAUN,
Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 831) to amend the Internal Revenue Code of 1986 to permanently extend the deduction for the health insurance costs of self-employed individuals, to repeal the provision permitting nonrecognition of gain on sales and exchanges effectuating policies of the Federal Communications Commission, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clerical changes.

A. Permanently Extend Deduction for Health Insurance Costs of Self-Employed Individuals

(Sec. 1 of the House bill, sec. 1 of the Senate amendment, sec. 1 of the conference agreement and sec. 162(l) of the Code)

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether the taxpayer is an employee and whether the taxpayer is covered under a health plan paid for by the employee's employer. An employer's contribution to a plan providing accident or health coverage for the employee and the employee's spouse and dependents is excludable from an employee's income. The exclusion is generally available in the case of owners of a business who are also employees.

In the case of self-employed individuals (i.e., sole proprietors or partners in a partnership), no equivalent exclusion applies. However, prior law provided a deduction for 25 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 25-percent deduction was available with respect to the cost of self-insurance as well as commercial insurance. In the case of self insurance, the deduction was not available unless the self-insured plan was in fact insurance (e.g., there was appropriate risk shifting) and not merely a reimbursement arrangement. The 25-percent deduction was not available for any month if the taxpayer was eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. In addition, no deduction was available to the extent that the deduction exceeded the taxpayer's earned income. The amount of expenses paid for health insurance in excess of the deductible amount could be taken into account in determining whether the individual was entitled to an itemized deduction for medical expenses. The 25-percent deduction expired for taxable years beginning after December 31, 1993.

For purposes of these rules, more than 2-percent shareholders of S corporations are treated the same as self-employed individuals. Thus, they were entitled to the 25-percent deduction.

Other individuals who purchase their own health insurance (e.g., someone whose employer does not provide health insurance) can deduct their insurance premiums only to the extent that the premiums, when combined with other unreimbursed medical expenses, exceed 7.5 percent of adjusted gross income.

House Bill

The House bill would retroactively reinstate the deduction for 25 percent of health insurance costs of self-employed individuals for 1994 and would extend the deduction permanently.

Effective date.—The provision would be effective for taxable years beginning after December 31, 1993.

Senate Amendment

The Senate amendment is the same as the House bill, except that the deduction would be increased to 30 percent for years beginning after December 31, 1994.

Effective date.—The provision generally would be effective for taxable years beginning after December 31, 1993. The increase in the deduction to 30 percent of health insurance costs would be effective for taxable years beginning after December 31, 1994.

Conference Agreement

The conference agreement follows the Senate amendment.

B. REPEAL OF SPECIAL RULES APPLICABLE TO FCC-CERTIFIED SALES OF BROADCAST PROPERTY

(Sec. 2 of the House bill, sec. 2 of the Senate amendment, sec. 2 of the conference agreement, and sec. 1071 of the Code)

Present Law and Background

Tax treatment of a seller of broadcast property

General tax rules

Under generally applicable Code provisions, the seller of a business, including a broadcast business, recognizes gain to the extent the sale price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is then subject to the current income tax unless the gain is deferred or not recognized under a special tax provision.

Special rules under Code section 1033

Under Code section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property. The replacement property may be acquired directly or by acquiring control of a corporation (generally, 80 percent of the stock of the corporation) that owns replacement property. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property, decreased by the amount of any money or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion.

Only involuntary conversions that result from destruction, theft, seizure, or condemnation (or threat or imminence thereof) are eligible for deferral under Code section 1033. In addition, the term "condemnation" refers to the process by which private property is taken from public use without the consent of the property owner but upon the award and payment of just compensation, according to a ruling by the Internal Revenue Service (IRS).[1] Thus, for example, an order by a Federal court to a corporation to divest itself of ownership of certain stock because of anti-trust rules is not a condemnation (or a threat or imminence thereof), and the divestiture is not eligible for deferral under this provision.[2] Under another IRS ruling, the "threat or imminence of condemnation" test is satisfied if, prior to the execution of a binding contract to sell the property, "the property owner is informed, either orally or in writing by a representative of a governmental body or public official authorized to acquire property for public use, that such body or official has decided to acquire his property, and from the information conveyed to him has reasonable grounds to believe that his property will be condemned if a voluntary sale is not arranged."[3] However, under

[1] Rev. Rul. 58-11, 1958-1 C.B. 273.
[2] Id.
[3] Rev. Rul. 74-8, 1974-1 C.B. 200.

this ruling, the threatened taking also must constitute a condemnation, as defined above.

Special rules under Code section 1071

Under Code section 1071, if the FCC certifies that a 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 FCC with respect to the ownership and control of "radio broadcasting stations," a taxpayer may elect to treat the sale or exchange as an involuntary conversion. The FCC is not required to determine the tax consequences of certifying a sale or to consult with the IRS about the certification process.

Under Code section 1071, the replacement requirement in the case of FCC-certified sales may be satisfied by purchasing stock of a corporation that owns broadcasting property, whether or not the stock represents control of the corporation. In addition, even if the taxpayer does not reinvest all the sales proceeds in similar or related replacement property, the taxpayer nonetheless may elect to defer recognition of gain if the basis of depreciable property that is owned by the taxpayer immediately after the sale or that is acquired during the same taxable year is reduced by the amount of deferred gain.

Tax treatment of a buyer of broadcast property

Under generally applicable Code provisions, the purchaser of a broadcast business, or any other business, acquires a basis equal to the purchase price paid. In an asset acquisition, a buyer must allocate the purchase price among the purchased assets to determine the buyer's basis in these assets. In a stock acquisition, the buyer generally takes a basis in the stock equal to the purchase price paid, and the business retains its basis in the assets. This treatment applies whether or not the seller of the broadcast property has received an FCC certificate exempting the sale transaction from the normal tax treatment.

FCC tax certificate program

Multiple ownership policy

The FCC originally adopted multiple ownership rules in the early 1940s.[4] These rules prohibited broadcast station owners from owning more than one station in the same service area, and, generally, more than six high frequency (radio) or three television stations. Owners wishing to acquire additional stations had to divest themselves of stations they already owned in order to remain in compliance with the FCC's rules.

In November 1943, the FCC adopted a rule that prohibited duopolies (ownership of more than one station in the same city).[5] After these rules were adopted, owners wishing to acquire additional stations in excess of the national ownership limit had to divest themselves of stations they already owned in order to remain in compliance with the FCC's rules. After Code section 1071 was

[4] Fed. Reg. 2382 (June 26, 1940) (multiple ownership rules for high frequency broadcast stations); 5 Fed. Reg. 2284 (May 6, 1941) (multiple ownership rules for television stations).

[5] 8 Fed. Reg. 16065 (Nov. 23, 1943).

adopted in 1943, in some cases, parties petitioned the FCC for tax certificates pursuant to Code section 1071 when divesting themselves of stations. These divestitures were labeled "voluntary divestitures" by the FCC. When the duopoly rule was adopted, 35 licensees that held more than one license in a particular city were required by the rule "involuntarily" to divest themselves of one of the licenses.[6]

Minority ownership policy

In 1978, the FCC announced a policy of promoting minority ownership of broadcast facilities by offering an FCC tax certificate to those who voluntarily sell such facilities (either in the form of assets or stock) to minority individuals or minority-controlled entities.[7] The FCC's policy was based on the view that minority ownership of broadcast stations would provide a significant means of fostering the inclusion of minority views in programming, thereby serving the needs and interests of the minority community as well as enriching and educating the non-minority audience. The FCC subsequently expanded its policy to include the sale of cable television systems to minorities as well.[8]

"Minorities," within the meaning of the FCC's policy, include "Blacks, Hispanics, American Indians, Alaska Natives, Asians, and Pacific Islanders."[9] As a general rule, a minority-controlled corporation is one in which more than 50 percent of the voting stock is held by minorities. A minority-controlled limited partnership is one in which the general partner is a minority or minority-controlled, and minorities have at least a 20-percent interest in the partnership.[10] The FCC requires those who acquire broadcast properties with the help of the FCC tax certificate policy to hold those properties for at least one year.[11] An acquisition can qualify even if there is a pre-existing agreement (or option) to buy out the minority interests at the end of the one-year holding period, providing that the transaction is at arm's-length.

In 1982, the FCC further expanded its tax certificate policy for minority ownership. At that time, the FCC decided that, in addition to those who sell properties to minorities, investors who contribute to the stabilization of the capital base of a minority enterprise would be entitled to a tax certificate upon the subsequent sale of their interest in the minority entity.[12] To qualify for an FCC tax certificate in this circumstance, an investor must either (1) provide start-up financing that allows a minority to acquire either broadcast or cable properties, or (2) purchase shares in a minority-controlled entity within the first year after the license necessary to operate the property is issued to the minority. An investor can qualify

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[6] FCC Announces New Policy Relating to Issuance of Tax Certificates, 14 FCC2d 827 (1966).

[7] Minority Ownership of Broadcasting Facilities, 68 FCC2d 979 (1978).

[8] Minority Ownership of Cable Television Systems, 52 R.R.2d 1469 (1982).

[9] 52 R.R.2d at n. 1.

[10] Commission's Policy Regarding the Advancement of Minority Ownership in Broadcasting, Policy Statement, and Notice of Proposed Rulemaking, 92 FCC2d 853–855 (1982).

[11] See Amendment of Section 73.3597 of the Commission's Rules (Applications for Voluntary Assignments or Transfers of Control), 57 R.R.2d 1149 (1985). Anti-trafficking rules require cable properties to be held for at least three years (unless the property is sold pursuant to a tax certificate).

[12] Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC2d 849 (1982).

for a tax certificate even if the sale of the interest occurs after participation by a minority in the entity has ceased. In these situations, the status of the divesting investor and the purchaser of the divested interest is irrelevant, because the goal is to increase the financing opportunities available to minorities.

Personal communications services ownership policy

In 1993, Congress provided for the orderly transfer of frequencies, including frequencies that can be licensed pursuant to competitive bidding procedures.[13] The FCC has adopted rules to conduct auctions for the award of more than 2,000 licenses to provide personal communications services ("PCS"). PCS will be provided by means of a new generation of communication devices that will include small, lightweight, multi-function portable phones, portable facsimile and other imaging devices, new types of multichannel cordless phones, and advanced paging devices with two-way data capabilities. The PCS auctions (which began last year) will constitute the largest auction of public assets in American history and are expected to generate billions of dollars for the United States Treasury.[14]

The FCC has designed procedures to ensure that small businesses, rural telephone companies and businesses owned by women and minorities have "the opportunity to participate in the provision" of PCS, as Congress directed in 1993.[15] To help minorities and women participate in the auction of the PCS licenses, the FCC took several steps including up to a 25-percent bidding credit, a reduced upfront payment requirement, a flexible installment payment schedule and an extension of the tax certificate program for businesses owned by minorities and women.[16]

The FCC will employ the tax certificate program in three ways: (1) initial investors (who provide "start-up" financing or purchase interests within the first year after license issuance) in minority and woman-owned PCS businesses will be eligible for FCC tax certificates upon the sale of their investments; (2) holders of PCS licenses will be able to obtain FCC tax certificates upon the sale of the business to a company controlled by minorities and women; and (3) a cellular operator that sells its interest in an overlapping cellular system to a minority or a woman-owned business to come into compliance with the FCC PCS/cellular cross-ownership rule will be eligible for a tax certificate. In addition, as discussed below, the FCC will issue tax certificates for PCS to encourage fixed microwave operators voluntarily to relocate to clear a portion of the spectrum for PCS technologies.

Microwave relocation policy

PCS can operate only on frequencies below 3GHz. However, because that frequency range is currently occupied by various private fixed microwave communications systems (such as railroads, oil pipelines, and electric utilities), there are no large blocks of unallocated spectrum available to PCS. To accommodate PCS, the

[13] Omnibus Budget Reconciliation Act of 1993, P.L. 103–66, Title VI.
[14] Fifth Report and Order, 9 FCC Rcd 5532 (1994).
[15] Omnibus Budget Reconciliation Act of 1993, P.L. 103–66, section 6002(a).
[16] Installment payments are available to small businesses and rural telephone companies.

FCC has reallocated the spectrum; the 1850–1990MHz spectrum will be used for PCS, and the microwave systems will be required to move to higher frequencies. Current occupants of the 1850–1990MHz spectrum allocated to PCS must relocate to higher frequencies not later than three years after the close of the bidding process.[17] In accordance with FCC rules, these current occupants have the right to be compensated for the cost of replacing their old equipment, which can operate only on the 1850–1990MHz spectrum, with equipment that will operate at the new, higher frequency. At a minimum, the winners of the new PCS licenses must pay for and install new facilities to enable the incumbent microwave operators to relocate. The amount of these payments and characteristics of the new equipment will be the subject of negotiation between the incumbent microwave operators and the PCS licensees; thus, the nature of the compensation (i.e., solely replacement equipment, or a combination of replacement equipment plus a cash payment) is unknown at present. If no agreement is reached within the 3-year voluntary negotiation period, the microwave operators will be required by the FCC to vacate the spectrum; however, the timing of such relocation is uncertain because the relocation would take place only after completion of a formal negotiation process in which the FCC would be a participant.

The FCC will employ the tax certificate program for PCS to encourage fixed microwave operators voluntarily to relocate from the 1850–1990 MHz band to clear the band for PCS technologies.[18] Tax certificates will be available to incumbent microwave operators that relocate voluntarily within three years following the close of the bidding process. Thus, the certificates are intended to encourage such occupants to relocate more quickly than they otherwise would and to clarify the tax treatment of such transactions.[19]

Congressional appropriations rider

Since fiscal year 1988, in appropriations legislation, the Congress has prohibited the FCC from using any of its appropriated funds to repeal, to retroactively apply changes in, or to continue a reexamination of its comparative licensing, distress sale and tax certificate policies.[20] This limitation has not prevented an expansion of the existing program.[21] The current rider will expire at the end of the 1995 fiscal year, September 30, 1995.

House Bill

The House bill would repeal Code section 1071. Thus, a sale or exchange of broadcast properties would be subject to the same

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[17] The PCS auctions for the 1850–1990MHz spectrum commenced in December, 1994.

[18] See, Third Report and Order and Memorandum Opinion and Order, 8 FCC Rcd 6589 (1993).

[19] The transaction between the PCS licensee and the incumbent microwave operator might qualify for tax-free treatment as a *like-kind exchange* under Code section 1031 or as an involuntary conversion under Code section 1033. However, the availability of deferral under these Code provisions may be uncertain in certain circumstances. For example, it may be unclear whether the transaction would qualify as an involuntary conversion under currently applicable IRS standards.

[20] Pub. L. No. 100–202 (1987).

[21] The appropriations restriction "does not prohibit the agency from taking steps to create greater opportunity for minority ownership." H. Rept. No. 103–708 (Conf. Rept.), 103d Cong. 2d Sess. 40 (1994).

tax rules applicable to all other taxpayers engaged in the sale or exchange of a business.

Effective date.—The repeal of section 1071 would be effective for (1) sales or exchanges on or after January 17, 1995, and (2) sale or exchanges before that date if the FCC tax certificate with respect to the sale or exchange is issued on or after that date. The provision would not apply to taxpayers who have entered into a binding written contract (or have completed a sale or exchange pursuant to a binding written contract) before January 17, 1995, and who have applied for an FCC tax certificate by that date. A contract would be treated as not binding for this purpose if the sale or exchange pursuant to the contract (or the material terms of the contract) were contingent on January 16, 1995, on issuance of an FCC tax certificate. A sale or exchange would not be contingent on January 16, 1995, on issuance of an FCC tax certificate if the tax certificate had been issued by the FCC by that date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with a clarification that the material terms of an otherwise binding contract in effect on January 16, 1995, would not be treated as contingent on the issuance of an FCC tax certificate solely because the contract provides that the sales price is increased by an amount not greater than 10 percent of the sales price in the event an FCC tax certificate is not issued.

C. Modification of Code Section 1033

(Sec. 3 of the House bill, sec. 3 of the Senate amendment, sec. 3 of the conference agreement, and sec. 1033 of the Code)

Present Law

As described above (item B), under Code section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period.

Under rulings issued by the IRS to taxpayers, property (stock or assets) purchased from a related person may, in some cases, qualify as property similar or related in service or use to the converted property.[22] Thus, in certain circumstances, related taxpayers may obtain significant (and possible indefinite or permanent) tax deferral without any additional cash outlay to acquire new properties. In cases in which a taxpayer purchases stock as re-

[22] See, e.g., PLR 8132072, PLR 8020069. Private letter rulings do not have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

placement property, section 1033 permits the taxpayer to reduce basis of stock, but does not require any reduction in the basis of the underlying assets. Thus, the reduction in basis of stock does not result in reduced depreciation deductions.

House Bill

Under the House bill, a taxpayer would not be entitled to defer gain under Code section 1033 when the replacement property or stock is purchased from a related person. For purposes of the bill, a person would be treated as related to another person if the relationship between the persons would result in a disallowance of losses under the rules of Code section 267 or 707(b). The provision would be intended to apply to all cases involving relationships to the taxpayer described in Code section 267(b) or 707(b)(1), including members of controlled groups under Code section 267(f).

Effective date.—The provision would apply to replacement property or stock acquired on or after February 6, 1995.

Senate Amendment

Related-party transactions

Under the Senate amendment, subchapter C corporations would not be entitled to defer gain under Code section 1033 if the replacement property or stock is purchased from a related person. A person would be treated as related to another person if the person bears a relationship to the other person described in Code section 267(b) or 707(b)(1). An exception to the general rule would provide that a taxpayer could purchase replacement property or stock from a related person and defer gain under Code section 1033 to the extent the related person acquired the replacement property or stock from an unrelated person within the period prescribed under Code section 1033. Thus, property acquired from outside the group within the period prescribed by section 1033 and retransferred to the taxpayer member of the group within the prescribed time period, would qualify in the hands of the taxpayer to the extent that the property's basis or other net tax consequences to the group do not change as a result of the transfer.

Microwave relocation transactions

The Senate amendment would provide that sales or exchanges that are certified by the FCC as having been made by a taxpayer in connection with the relocation of the taxpayer from the 1850–1990MHz spectrum by reason of the FCC's reallocation of that spectrum for use for PCS would be treated as involuntary conversions to which Code section 1033 applies.

Effective date

The provision prohibiting the purchase of qualified replacement property from a related party would apply to involuntary conversions occurring on or after February 6, 1995.

The provision treating certain microwave relocation transactions as involuntary conversions would apply to sales or exchanges occurring before January 1, 2000.

Conference Agreement

The conference agreement follows the Senate amendment with a modification to provide that the amendments made to section 1033 will apply not only to C corporations, but also to certain partnerships. Specifically, the provision will apply to a partnership if more than 50 percent of the capital interest, or profits interest, of the partnership are owned, directly or indirectly (as determined under section 707(b)(3)), by C corporations at the time of the involuntary conversion. If the provision applies to a partnership under the above rule, the provision would apply to all partners of the partnership, including partners that are not C corporations. If a partnership is not described by the above rule, none of the partners of the partnership will be subject to the provision by reason of their interest in the partnership.

In addition, the conference agreement clarifies that the determination of whether or not a partnership is related to another party will be made at the partnership level.

D. Unearned Income Test for Earned Income Tax Credit

(Sec. 4 of the House bill, sec. 4 of the Senate amendment, sec. 4 of the conference agreement, and sec. 32 of the Code)

Present Law

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. For taxpayers with earned income (or adjusted gross income, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or adjusted gross income, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or adjusted gross income, if greater) exceeds the phaseout limit. There is no additional limitation on the amount of unearned income that the taxpayer may receive.

The parameters for the EITC depend upon the number of qualifying children the taxpayer claims. For 1995, the parameters are as follows:

	Two or more qualifying children—	One qualifying child—	No qualifying children—
Credit rate	36.00%	34.00%	7.65%
Phaseout rate	20.22%	15.98%	7.65%
Earned income threshold	$8,640	$6,160	$4,100

	Two or more qualifying children—	One qualifying child—	No qualifying children—
Maximum credit	$3,110	$2,094	$314
Phaseout threshold	$11,290	$11,290	$5,130
Phaseout limit	$26,673	$24,396	$9,230

The earned income threshold and the phaseout threshold are indexed for inflation; because the phaseout limit depends on those amounts, the phaseout rate, and the credit rate, the phaseout limit will also increase if there is inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates and phaseout rates for the EITC change over time under present law. For 1996 and after, the credit rate will be 40 percent and the phaseout rate will be 21.06 percent for taxpayers with two or more qualifying children. The credit rate and the phaseout rate for taxpayers with one qualifying child or no qualifying children will be the same as those listed in the table above.

In order to claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, and a residence test. In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 24 and under age 65.

House Bill

Under the House bill, a taxpayer would not be eligible for the EITC if the aggregate amount of interest and dividends includible in the taxpayer's income for the taxable year exceeds $3,150. The otherwise allowable EITC amount would be phased out ratably for taxpayers with aggregate taxable interest and dividend income between $2,500 and $3,150. For taxable years beginning after 1996, the $2,500 threshold and the $650 size of the phaseout would be indexed for inflation with rounding to the nearest multiple of $10.

Effective date.—The provision would be effective for taxable years beginning after December 31, 1995.

Senate Amendment

Under the Senate amendment, a taxpayer would not be eligible for the EITC if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds $2,450. Disqualified income would be the sum of:

(1) interest (whether or not subject to tax) received or accrued in the taxable year,

(2) dividends to the extent includible in gross income for the taxable year, and

(3) net income (if greater than zero) from rents and royalties not derived in the ordinary course of business.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement provides that a taxpayer is not eligible for the EITC if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds $2,350. Disqualified income is the sum of:

(1) interest and dividends includible in gross income for the taxable year,

(2) tax-exempt interest received or accrued in the taxable year, and

(3) net income (if greater than zero) from rents and royalties not derived in the ordinary course of business.

Tax-exempt interest is defined as amounts required to be reported on the taxpayer's return under Code section 6012(d).

Effective date.—The provision is effective for taxable years beginning after December 31, 1995.

E. Extension of Rule for Certain Group Health Plans

(Sec. 5 of the conference agreement and sec. 162(n) of the Code)

Present Law

In general, present law disallows employer deductions for any amounts paid or incurred in connection with a group health plan if the plan fails to reimburse hospitals for inpatient services provided in the State of New York at the same rate that licensed commercial insurers are required to reimburse hospitals for inpatient services of individuals not covered by a group health plan. This provision applies with respect to inpatient hospital services provided to participants after February 2, 1993, and on or before May 12, 1995.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement extends the present-law deduction disallowance for expenses in connection with certain group health plans through December 31, 1995.

Effective date.—The provision is effective on the date of enactment.

F. Imposition of Tax on U.S. Citizens Who Relinquish Citizenship

(Sec. 5 of the Senate amendment, sec. 6 of the conference agreement, proposed new sec. 877A, and secs. 877 and 7701 of the Code)

Present Law

U.S. citizens and residents generally are subject to U.S. income taxation on their worldwide income. The United States imposes tax on gains recognized by foreign persons that are attributable to dispositions of interests in U.S. real property. Distributions, including lump-sum distributions, that foreign persons receive from qualified U.S. retirement plans generally are subject to U.S. tax at a 30-percent rate.

A U.S. citizen who relinquishes U.S. citizenship with a principal purpose to avoid Federal tax may be subjected to an alternative taxing method for 10 years after expatriation (sec. 877). Under this alternative method, the expatriate generally is taxed on his U.S. source income (net of certain deductions), as well as on certain business profits, at rates applicable to U.S. citizens and residents.

The United States imposes its estate tax on the worldwide estates of persons who were citizens or domiciliaries of the United States at the time of death, and on certain property belonging to nondomiciliaries of the United States which is located in the United States at the time of their death. The U.S. gift tax is imposed on all gifts made by U.S. citizens and domiciliaries, and on gifts of property made by nondomiciliaries where the property is located in the United States at the time of the gift. Special rules apply to the estate and gift tax treatment of individuals who relinquished their U.S. citizenship within 10 years of death or gift, if the individual's loss of U.S. citizenship has as one of its principal purposes a tax avoidance motive.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, a U.S. citizen who relinquishes citizenship generally would be treated as having sold all of his property at fair market value immediately prior to the expatriation. Gain or loss from the deemed sale would be recognized at that time, generally without regard to other provisions of the Code. Net gain on the deemed sale would be recognized under the bill only to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom expatriate).

Property treated as sold by an expatriating citizen under the provision would include all items that would be included in the individual's gross estate under the Federal estate tax if such individual were to die on the day of the deemed sale, plus certain trust interests that are not otherwise includible in the gross estate and other interests that may be specified by the Treasury Department in order to carry out the purposes of the provision.

Certain types of property generally would not be taken into account for purposes of determining the expatriation tax: U.S. real property interests, interests in qualified retirement plans (other than interests attributable to excess contributions or contributions that violate any condition for tax-favored treatment), and, under regulations, interests in foreign pension plans and similar retirement plans or programs (up to a maximum amount of $500,000).

Under the amendment, an expatriate who is a beneficiary of a trust would be deemed to own a separate trust consisting of the assets allocable to his share of the trust, in accordance with his interest in the trust. The separate trust would be treated as selling its assets for fair market value immediately before the beneficiary relinquishes his citizenship, and distributing all resulting income and corpus to the beneficiary.

Under the amendment, a U.S. citizen who renounces his U.S. nationality before a diplomatic or consular officer of the United States would be treated as having relinquished his citizenship on that date, provided that the renunciation is later confirmed by the issuance of a certificate of loss of nationality ("CLN") by the U.S. Department of State. A U.S. citizen who furnishes to the Department of State a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act would be treated as having relinquished his citizenship on the date such statement is so furnished, provided that the voluntary relinquishment is later confirmed by the issuance of a CLN. Any other U.S. citizen to whom the Department of State issues a CLN would be treated as having relinquished his citizenship on the date the CLN is issued to the individual. A naturalized citizen is treated as having relinquished his citizenship on the date a court of the United States cancels his certificate of naturalization.

Under the amendment, an individual who is subject to the tax on expatriation would be required to pay a tentative tax equal to the amount of tax that would have been due based on a hypothetical short tax year that ended on the date the individual relinquished his citizenship. The tentative tax would be due on the 90th day after the date of relinquishment.

The amendment would provide that the time for the payment of the tax on expatriation may be extended for a period not to exceed 10 years at the request of the taxpayer, as provided by section 6161.

The amendment would authorize the Treasury Department to issue regulations to permit a taxpayer to allocate the taxable gain (net of any applicable exclusion) to the basis of assets taxed under this provision, thereby preventing double taxation if the assets remain subject to U.S. tax jurisdiction.

Effective date.—The amendment would be effective for U.S. citizens who relinquish their U.S. citizenship (as determined under the provision) on or after February 6, 1995. The tentative tax would not be required to be paid until 90 days after the date of enactment.

Present law would continue to apply to U.S. citizens who relinquished their citizenship prior to February 6, 1995.

Conference Agreement

The conference agreement does not include the Senate amendment.

The conference agreement, however, directs that the staff of the Joint Committee on Taxation undertake a study of the issues presented by any proposals to affect the tax treatment of expatriation, including an evaluation of (1) the effectiveness and enforceability of current law with respect to the tax treatment of expatriation, (2) the current level of expatriation for tax avoidance purposes, (3) any restrictions imposed by any constitutional requirement that Federal income tax apply only to realized gains, (4) the application of international human rights principles to the taxation of expatriation, (5) the possible effects of any such proposals on the free flow of capital into the United States, (6) the impact of any such proposals on existing tax treaties and future treaty negotiations, (7) the operation of any such proposals in the case of interests in trusts, (8) the problems of potential double taxation in any such proposals, (9) the impact of any such proposals on the trade policy objectives of the United States, (10) the administrability of such proposals, and (11) possible problems associated with existing law, including estate and gift tax provisions. The results of such study are to be reported to the Chairman of the House Committee on Ways and Means and to the Chairman of the Senate Committee on Finance by June 1, 1995.

ESTIMATED REVENUE EFFECTS OF H.R. 831 AS AGREED TO BY HOUSE AND SENATE CONFEREES—FISCAL YEARS 1995-2005

[Millions of Dollars]

Provision	Effective	1995	1996	1997	1998	1999	2000	1995-00	2001-05	1995-05
1. Extend self-employed health deduction: 25% for 1994 and 30% thereafter.	tyba Dec. 31, 1993	−514	−482	−527	−587	−649	−708	−3,467	−4,520	−7,987
2. Repeal section 1071 (FCC tax certificate program with transition).	Jan. 17, 1995	303	379	135	135	170	201	1,323	1,465	2,786
3. Modify section 1033 for corporations with transition rule for microwave relocation previously entitled to section 1071 (nonrecognition of gain on involuntary conversions not to apply to acquisitions from related persons).	Feb. 6, 1995	5	9	23	33	47	67	184	505	689
4. Deny earned income tax credit to individuals with interest, dividends, tax-exempt interest income, and net rental and royalty income over $2,350 (the threshold is not indexed for inflation)[1].	Jan. 1, 1996		22	436	487	521	556	2,023	3,515	5,538
5. Extension of rule for certain group health plans.	DoE	−42	−11					−53		−53
Net totals		−248	−83	67	68	89	116	10	965	975

[1] Included in this estimate are decreases in EITC outlays of $18 million for FY 1996, $353 million for FY 1997, $397 million for FY 1998, $426 million for FY 1999, $449 million for FY 2000, $495 million for FY 2001, $529 million for FY 2002, $566 million for FY 2003, $605 million for FY 2004, and $647 million for FY 2005.

Note.—Details may not add to totals due to rounding. Legend for "Effective" column: tyba=taxable years beginning after. DoE=date of enactment.

Source: Joint Committee on Taxation.

BILL ARCHER,
PHILIP CRANE,
WM. THOMAS,
CHARLES B. RANGEL,
Managers on the Part of the House.
BOB PACKWOOD,
BOB DOLE,
BILL ROTH,
JOHN H. CHAFEE,
CHUCK GRASSLEY,
DANIEL PATRICK MOYNIHAN,
MAX BAUCUS,
CAROL MOSELEY-BRAUN,
Managers on the Part of the Senate.

I. The Federal Communications Commission

The FCC -- which is an independent regulatory agency -- has several programs through which it attempts to accomplish diversity in broadcast and related areas by providing assistance to women and minorities. (The agency has defined "minority" to include "those of Black, Hispanic Surnamed, American Eskimo, Aleut, American Indian and Asiatic American extraction.") Attached to this summary are a description, prepared by the FCC, of the various programs, and the recent testimony of the FCC General Counsel regarding one such program (concerning tax certificates). These programs have been highly controversial, and have been the subject of considerable judicial scrutiny.

A. Since 1934, the FCC has had exclusive statutory authority to grant licenses based on "public convenience, interest, or necessity" to persons wishing to construct and operate radio and television broadcast stations in the United States. In 1971, the FCC found that minorities owned only ten of the approximately 7,500 radio stations, and none of the more than 1,000 television stations. In 1978, minorities owned less than one percent of the nation's radio and television stations. In addition, many of the minority broadcasters served small and geographically limited audiences.

In 1978, after convening a conference on minority ownership policies, the agency announced that the views of minorities are inadequately represented in the broadcast media, and that adequate representation of minority viewpoints is necessary for both the minority and non-minority communities. The agency determined that minority ownership was needed to ensure representation of minority views on a broadcast station.

Accordingly, the FCC pledged to consider minority ownership as one of the factors it would take into account in granting new broadcast licenses when there are competing applications. Minority ownership would be considered a plus in a comparative hearing, to be weighed together with other relevant factors (diversification of control, owner participation in station activities, proposed service, past broadcast record, efficient use of frequency, and character of applicant). This new FCC policy was a reversal of the agency's prior determination that it was barred by statute from giving credit to applicants for being members of minority groups; that prior policy had been overturned by the D.C. Circuit, which ruled in 1975 that the underlying statute required the FCC to award credit for minority applicants.

In addition, at that time, the FCC outlined a plan to increase minority ownership through the transfer of existing licenses through the agency "distress sale" policy. Under that policy, a broadcaster whose license has been designated for a revocation hearing or whose renewal has been denied can assign the license to an FCC-approved minority enterprise, and thereby avoid the otherwise applicable transfer procedures. The purchase price by the minority entity must not exceed 75% of the fair market value. FCC staff informs us that this policy has been little used since its inception, and has not been used at all in the last five years because there are few stations that meet the policy criteria.

The FCC also in 1978 announced a tax certificate policy pursuant to the Internal Revenue Code. Under this policy, a seller of a radio or television station can sell to a minority-owned enterprise (the minority buyer must maintain both legal and actual control over business operations), and thereby defer capital gains and/or reduce the basis of certain depreciable property. This program often lowers the price of the station for a minority buyer, thus overcoming the general problem of lack of minority access to capital. This tax certificate program is the one most frequently used in transfer of licenses to minorities.

Further, the FCC's rules permit radio and television station owners to own more stations than would otherwise be allowed if the additional stations are controlled by minorities or small businesses.

The FCC subsequently, during the Reagan Administration, extended its broadcast tax certificate policy to cable television sales. (In the cable field, the 1992 Cable Act also permits a cable operator to set aside up to 1/3 of its leased access capacity for qualified minority programming sources. A qualified source is one that devotes substantially all of its programming to coverage of minority views or to programming directed at minorities, and is more than 50% minority-owned.)

B. The FCC has not extended all of these various preferences to women-owned businesses; only the policy that considers the status of the applicant as one factor in competing application cases has also covered women. In 1978, the FCC decided not to make the distress sale and tax certificate policies available to women-owned entities. A panel of the D.C. Circuit struck down the preference for women because the FCC did not have evidence of a link between women ownership and programs directed towards women (although the agency had found such a link for minorities). That ruling was vacated by the full D.C. Circuit, and the FCC asked for a remand in order to re-examine the entire issue of preferences in 1986.

C. Before the FCC reexamination process was completed, Congress enacted, and President Reagan signed, an appropriations provision for the FCC prohibiting the agency from spending its funds to weaken its minority and gender preference ownership policies. Congress reenacted this appropriations bar in each successive year, thereby keeping in place the FCC preference policies.

The FCC minority preference policies were then challenged, and were upheld by the Supreme Court in Metro Broadcasting, Inc. v. FCC, 497 U.S. 547 (1990). The Court based its decision in significant part on the congressional findings regarding the lack of minority ownership in this area, and the link between minority ownership and programming directed towards minorities.

Shortly thereafter, however, the D.C. Circuit -- in an opinion by then-Judge Thomas over a dissent by then-Judge Mikva -- struck down as unconstitutional the FCC preference favoring women applicants. In Lamprecht v. FCC, 958 F.2d 382 (D.C. Cir. 1992), the court found no correlation demonstrated by the FCC between women ownership and programming directed towards women. The FCC has not attempted to reinstate this gender-based preference. However, the agency currently has open for comment the question of whether it should give tax credit and ownership concentration benefits to women-owned entities.

D. Congress has itself provided for preferences in other areas. In 1982, it mandated a "significant preference" for minority applicants participating in lotteries for low power and TV translator stations. Under this provision, the FCC specially weights minority bids.

Most recently, in 1993, Congress gave the FCC authority to auction certain types of licenses for non-broadcast communications systems. The statute directs the FCC to prescribe regulations to "ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures."

The FCC divided the types of licenses to be auctioned into four groups, and held auctions for three of them in 1994. The FCC created bidding credits and tax certificates for women and minority-owned businesses in these auctions. In the fourth auction, which was to be held in mid-1995, the FCC created preferences for smaller entities, as well as women and minority-owned ones. However, that auction has recently been stayed by the D.C. Circuit, which is considering a constitutional challenge to the preferences provided by the statute and FCC implementing rules.

E. There is some evidence on how these various FCC policies have worked. As the attached FCC report shows, there has been a marked increase in the percentage of minority-owned broadcast licenses since 1978, going from .5 percent at that time to 2.9

percent by 1994. (The ownership figures are highest for AM radio stations, and lowest for FM radio stations.) The FCC believes that there is a high correlation between its tax certificate program and the sale of television and radio stations to minorities.

The vast majority of existing minority broadcast owners have utilized tax certificates at some point during the past 15 years either to attract initial investors, purchase a broadcast property, or sell a station to another minority entity. We note that in 42% of the instances in which tax certificates were issued, broadcast licenses were later transferred; the average length these licenses were held by minority-controlled entities is four years. (We do not currently have statistics showing how these figures compare with the practices of non-minority owners.) The data show that the great majority of tax certificates have been used to acquire relatively small radio and television stations.

In January 1995, the FCC General Counsel, William Kennard, told Congress that most sales to minorities occurring after 1978 would not have happened without the tax certificate policy. Kennard also stated that the program did not seem to suffer from rampant abuse through lack of true minority control or rapid flipping of licenses by new minority owners.

II. The Resolution Trust Corporation

By statute, Congress has provided various incentives, including preference points, on proposals and minority capital assistance programs, to preserve and expand bank ownership by minorities and women. The law authorizes the RTC to set guidelines to achieve parity in RTC contracts, and reasonable goals for subcontracting to minority and women-owned businesses. It also provides a minority preference in acquisition of institutions in predominantly minority neighborhoods. The RTC has implemented this statute through regulations providing certification of minority and women-owned businesses, incentives and bonus considerations for RTC prime contractors who commit to subcontract at least 25% of the work to such businesses, and awards directly to such businesses. A special outreach program is provided to promote participation by minority and women-owned law firms for RTC legal services.

Minority Programs Administered by the Federal Communications Commission

I. Preferences in Spectrum Auctions

In 1993 Congress gave the FCC authority to auction licenses for use of the electromagnetic spectrum for non-broadcast services. The statute requires the Commission to ensure that businesses owned by women and minorities (as well as small businesses and rural telephone companies) have the opportunity to provide spectrum-based services. Therefore, the FCC has adopted generic provisions for these companies that it can choose from on a service by service basis. Implementation of Section 309(j) of the Communications Act - Competitive Bidding, PP Docket No. 93-253, FCC 94-61, **Second Report and Order**, 9 FCC Rcd 2348 (1994); 59 Fed. Reg. 22,980 (May 4, 1994); **Second Memorandum Opinion and Order**, 9 FCC Rcd ____ (a: 08/12/94; r: 08/15/94); 59 Fed. Reg. 44,272 (Aug. 26, 1994). As detailed below, the Commission has already adopted specific rules for the auctions for licenses in several services.

A. Narrowband Personal Communications Service (PCS) (Nationwide). Third Report and Order, 9 FCC Rcd 2941 (1994).

We held the auction for these 10 licenses in July 1994. The rules provide that winning minority and women-owned companies on 3 of the licenses would be given a 25% bidding credit (or, in effect, a 25% discount off the bid price). We also adopted a tax certificate program whereby initial non-controlling investors in minority and women-owned applicants (for any of the licenses) would be able to defer capital gains taxes upon the sale of their interests. In addition, licensees who sell to minority and women-owned companies in post-auction sales will receive tax certificates. None of the licenses was won by businesses owned by minorities or women.

B. Interactive Video and Data Services. Fourth Report and Order, 9 FCC Rcd 2330 (1994); 59 Fed. Reg. 24,947 (May 13, 1994).

The auction for almost 600 of these licenses was also held in July 1994. We gave winning minority and women-owned companies on half of the licenses a 25% bidding credit. In addition, the same tax certificate program described above with regard to narrowband PCS was adopted. Many of the licenses were won by minorities and women.

C. Narrowband PCS (Regional). Third Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 9 FCC Rcd __

_ (a: 08/16/94; r: 08/17/94); Third MO&O, 59 Fed. Reg. 44,058 (Aug. 26, 1994); **Order on Reconsideration**, 9 FCC Rcd ___ (a + r: 09/22/94).

The auction for these 30 licenses was held in October 1994. Winning minority and women-owned companies on 10 of those licenses received a 40% bidding credit. In addition, businesses owned by women and minorities that won those 10 licenses are permitted to pay their winning bids in installments over the 10-year license term. Finally, the same tax certificate program described above was adopted.

D. Broadband PCS. Fifth Report and Order, 9 FCC Rcd ____ (a: 06/29/94; r: 07/15/94); 59 Fed. Reg. 37,566 (July 22, 1994); **Order on Reconsideration**, 9 FCC Rcd ____ (a + r: 08/15/94); 59 Fed. Reg. 43,062 (Aug. 22, 1994).

In this service we have reserved two frequency blocks for bidding only by companies with less than $125 million in gross revenues and $500 million in total assets. These financial caps are not race or gender-based. But, within these blocks we have adopted certain provisions for minority and women-owned companies. Specifically, we will give businesses owned by women and minorities a 15% bidding credit. Businesses that are both small (less than $40 million in gross revenues) and owned by women and minorities will receive a 25% bidding credit. Other small businesses will get a 10% bidding credit. Almost all winning bidders in these blocks will be permitted to pay the license price in installments and small businesses and businesses owned by women and minorities will have the installment payment plan "enhanced" (i.e., lower interest rates and longer moratorium on principal payments). We also have adopted a tax certificate program and have relaxed the attribution rules somewhat for minority and women-owned companies. These rules currently are subject to reconsideration and they may be adjusted somewhat before the auction, which probably will be held in the first or second quarter of 1995.

II. Broadcast Programs

Over the years the FCC has adopted various programs to enhance minority ownership of broadcast properties. These policies were upheld by the Supreme Court in Metro Broadcasting v. FCC, 497 U.S. 547, 564-65, on the ground that they were mandated by Congress and that they serve the important governmental interest of increasing diversity of programming.

A. Distress Sale Policy (1978 Policy Statement, 68 FCC 2d 979, 980 (1978))

This policy permits a broadcast licensee whose license has been designated for a revocation or renewal hearing to transfer the license to a qualified minority applicant at discounted or lower than fair market value.

B. Tax Certificates (1978 Policy Statement; 1982 Policy Statement, 52 RR 2d 1301 (1982))

Section 1071 of the Internal Revenue Code authorizes the Commission to issue tax certificates if the sale or exchange of broadcast properties is necessary to effectuate the adoption of a new policy. The Commission has held that tax certificates would promote its minority ownership policies and, therefore, it will issue tax certificates to licensees that sell to minority enterprises or to investors who provide start-up capital to minority companies formed to acquire broadcast or cable properties. The certificate enables the taxpayer to defer tax on the gain from the sale if the proceeds are reinvested in qualified replacement property. Or the taxpayer may elect to reduce the basis of depreciable property remaining in its hands.

C. Minority Preferences in Comparative Hearings (see Metro).

Pursuant to this policy, the Commission grants "qualitative enhancements" to minority-owned applicants competing against other applicants for an FCC license.

D. Multiple Ownership Rules Exceptions 47 C.F.R. § 73.3555(e)(1).

The Commission's Rules permit radio station owners to own 20 AM and 20 FM stations, and increase the cap to 23 AM and 23 FM stations if the additional three stations are controlled by minorities or small businesses. A television owner may own 12 stations, or 14 if 2 or more stations are minority-controlled.

III. Broadcast-Related Programs

The Commission has adopted various policies to promote minority ownership in broadcast-related areas, such as cable television.

A. Tax Certificates for Cable (Statement of Policy on Minority Ownership of CATV Systems, FCC 82-524 (Dec. 22, 1982)).

The Commission extended its broadcast tax certificate policy to cable television sales and exchanges.

B. Incentives for Cable Operators to Carry Minority-Controlled Programmers (1992 Cable Act, 47 U.S.C. § 612(i)(3)).

Section 612(i) of the Communications Act was added by the 1992 Cable Act. Section 612(i) permits a cable operator that is required to provide leased access to its channel capacity to set aside up to 33% of its leased access capacity for use by a qualified minority programming source, regardless of whether the minority source is affiliated with the cable operator. A qualified minority programming source is one that devotes substantially all of its programming to coverage of minority views or to programming directed at minorities, <u>and</u> is more than 50% minority-owned.

C. Preferences for Minority Applicants in Lotteries (47 U.S.C. § 309(i)(3)(A)).

In 1982 Congress mandated the grant of a "significant preference" to minority applicants participating in lotteries for low power television and TV translator stations. Under this policy, such applications are specially weighted.

Summary of Tax Certificate Data (as of 2/10/95)

Before 1978, minorities owned approximately one half of one percent (40) of the approximately 8,500 total broadcast licenses issued by the FCC. Today, a 1994 study performed by the National Telecommunication and Information Administration at the Department of Commerce, indicates that there are approximately 323 radio and television stations owned by minorities, 2.9% of the total 11,128 licenses held in 1994. This represents a 700% increase in the number of licenses issued to minorities since 1978, when section 1071 was applied to minority owned broadcast properties.

Industry Total	Black	Hispanic	Asian	Native American	Minority Totals
AM Stations 4,929	101 (2%)	76 (1.5%)	1 (0%)	2 (0%)	180 (3.7%)
FM Stations 5,044	71 (1.4%)	35 (.7%)	3 (.1%)	3 (.1%)	112 (2.2%)
TV Stations 1,155	21 (1.8%)	9 (.8%)	1 (.1%)	0 (0%)	31 (2.7%)
Cumulative Totals 11,128	**193 (1.7%)**	**120 (1.1%)**	**5 (0%)**	**5 (0%)**	**323 (2.9%)**

How Tax Certificates Work

To help achieve this growth in minority ownership, and thus promote diversity of viewpoints over the public airwaves, the Federal Communications Commission convened a conference on minority ownership of broadcast facilities in 1977. In 1978, the Commission's Minority Ownership Task Force released a report entitled Minority Ownership in Broadcasting, which documented findings from the 1977 conference and recommended several regulatory policy reforms. In 1978, the Commission adopted a policy statement on minority ownership of broadcast facilities and implemented policies on tax certificates. As a result, the Commission issued tax certificates under Section 1071 of the Internal Revenue Code to sellers of broadcast radio and television properties who sold their stations to minority buyers. In 1982 the availability of tax certificates was expanded to cable systems.

To qualify for a tax certificate, the minority buyer must have at least 50.1% of the voting control of the entity which is purchasing the station, and 20.1% of the equity of that purchaser. The minority buyer must maintain both legal, *de jure* control, as well as actual *de facto* control over the operations of the business. The Commission evaluates these criteria to determine whether a certificate is warranted. While the FCC has granted 356 tax certificates to promote minority broadcast and cable ownership, some requests for tax certificates have also been denied because the proposed transaction did not meet FCC standards.

If a certificate is granted, the seller is eligible to defer their tax payment on any capital gain (the amount of the sale over their basis in the property) or reduce the basis of certain depreciable property or both, if the seller reinvests in a qualifying replacement property within two years. In general, qualifying properties are other media properties or companies who hold FCC licenses. Upon the seller's sale of their interest in the qualifying replacement property, the tax on their gain becomes due.

Tax certificates create a market-based incentive for persons holding broadcast or cable properties to sell them to minorities. Because the seller can defer payment on the capital gain by selling to a qualified minority, it often lowers the price of the station for the minority buyer, thus helping minorities to overcome the barrier of lack of minority access to capital which both the FCC and Congress have identified as key issues preventing minority economic development.

Number of Tax Certificates Issued:

During the past 15 years, the issuance of minority tax certificates has resulted in the sale or transfer of over 287 radio licenses, 40 television licenses and 30 cable licenses, totalling approximately 356 tax certificates issued for minority deals. In contrast, approximately 117 non-minority tax certificates have been issued during the life of Section 1071 to, for example, encourage licensees to comply with the FCC's multiple ownership rules.

Type of License	Certificates Issued	of Total
Minority Radio	287	61%
Minority TV	39	8%
Minority Cable	30	6%
Non-minority	117	25%
Total	473	100%

In 1994, there was a total of 292 radio stations owned by minority broadcasters. When compared with the 287 tax certificates issued for minority radio stations there appears to be a high correlation between tax certificates issued and radio stations owned. In television, the correlation is more pronounced. In 1994, there was a total of 31 television stations owned by minorities compared with 39 tax certificates issued for minority owned television stations. Data is unavailable for cable. The National Association of Black Owned Broadcasters (NABOB) reports that the vast majority of existing minority broadcast owners have utilized tax certificates at some point during the past 15 years either: 1) as an incentive to attract initial investors; 2) to purchase a broadcast property; or 3) to sell a broadcast property to another minority.

The chart below shows that there was a significant increase in the number of minority tax certificates issued between the years 1987 and 1989. This increase corresponds with the robust trading experienced by the broadcast and cable industry during this period. The level of tax certificate activity also declined significantly in 1991 when federal restraints were placed on highly leveraged transactions and access to capital became a problem for the industry as a whole.

Year	Certificates Issued	of Total
N/A	34	10%
1978	1	0%
1979	7	2%
1980	7	2%
1981	7	2%
1982	7	2%
1983	2	1%
1984	12	3%
1985	19	5%
1986	19	5%
1987	30	8%
1988	45	13%
1989	37	10%
1990	55	16%
1991	24	7%
1992	9	3%
1993	19	5%
1994	19	5%
Total	353	100%

Diversity of Ownership:

Ownership data is available for approximately 57% (165) of the tax certificates issued in minority radio transactions. From this sample, there are approximately 82 separate owners (50%) of radio properties listed. Ownership data is available for approximately 98% (39) of the tax certificates in television transactions. From this sample there are approximately 21 (54%) separate owners listed. Ownership data is available for all 40 of the tax certificates issued in cable television transactions.

From this listing, there are 20 (66%) separate owners of cable properties. In sum, the data indicates that over half of the broadcast and cable properties receiving tax certificates are owned by different individuals or companies.

The racial allocation of the minority tax certificates are as follows:

African Americans	64%
Hispanics	23%
Native American	1%
Alaskan Native	4%
Asian	8%

Holding Period:

Although FCC regulations require the buyer of a property for which a tax certificate is issued to hold that station for one year, the overwhelming majority of minority buyers retain their licenses for much longer. Example, of the total certificates issued, minority buyers of radio and television properties have held their licenses for an average of 5 years. Cable is excluded from these figures because there is insufficient data available on the holding period. However, the Communication Act requires that all cable systems be held for a minimum of three years following either the acquisition or initial construction of such system. Holding period information is available for approximately 83% of the minority radio stations and all of the minority television stations.

The number of broadcast licenses transferred by a minority-controlled entity after a license was acquired in a tax certificate transaction is approximately 134 (42% of the total broadcast tax certificates issued). The average length of time these licenses were held by minority-controlled entities is 4 years.

Size of Transactions:

After reviewing a sample consisting of 72% of radio stations and 78% of television stations, the data indicates that the great majority of the sales transactions in which tax certificates are awarded are relatively small, averaging a sales price of $4 million for radio stations and $38 million for television stations. Data is not available for the 30 cable deals, although we know that cable deals tend to be larger transactions.

FCC has no data available on the amount of tax gains actually deferred.

Other Findings:

Although the tax certificate program is not the only FCC program designed to encourage transfer of licenses to minorities, it is the most frequently used program and is often used in concert with the other programs. In addition, various entrepreneurs and industry associations have submitted testimony which indicates that: "But for the tax certificate program the acquisition of existing broadcast and cable properties by minorities would be significantly more difficult to consummate."

STATEMENT OF

WILLIAM E. KENNARD
GENERAL COUNSEL
FEDERAL COMMUNICATIONS COMMISSION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT

ON

FCC ADMINISTRATION OF INTERNAL REVENUE CODE SECTION 1071

JANUARY 27, 1995

Chairwoman Johnson and Members of the Subcommittee:

Thank you for the opportunity to explain how the Federal Communications Commission has used Section 1071 of the Internal Revenue Code to further the FCC's and Congress' policies.

I. Introduction and Overview

Section 1071 of the Internal Revenue Code authorizes the FCC to permit sellers of broadcast properties to defer capital gains taxes on a sale or exchange if the sale or exchange is deemed by the agency to be "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." 26 U.S.C. § 1071.

Section 1071 was enacted in 1943 to alleviate the hardship of involuntary divestiture associated with the Commission's newly adopted multiple ownership rules. Those rules limited radio licensees to ownership of one outlet per market, and, as a result, approximately 35 licensees were required to sell overlapping stations. Later, tax certificates were used in voluntary transfers as an incentive to licensees to divest themselves of properties grandfathered under another provision of the multiple ownership rules which limited the number of stations a single entity could own nationwide.

Since that time, the FCC has used tax certificates in other contexts to further the goals of national communications policy. Today, the FCC issues tax certificates to encourage:

- licensees to come into compliance with the FCC's multiple ownership rules
- microwave licensees to relocate to other frequencies to facilitate licensing of personal communications services
- owners of AM radio to divest themselves of licenses in certain frequency bands to reduce interference
- minority ownership.

I understand that this Subcommittee is most interested in the FCC's use of tax certificates to promote minority ownership of broadcasting stations and cable television systems so I will focus on that area in my testimony today.

II. The FCC's Minority Tax Certificate Policy

A. Development of the Policy

Recognizing that the viewing and listening public suffers when minorities are underrepresented among owners of broadcast stations, the Commission began working to encourage minority participation in this industry in the late 1960s. Its first step was to formulate rules to prohibit discrimination in hiring and, several years later, in response to a court decision, it began to consider minority status in comparative licensing proceedings.

The FCC's minority ownership policies have been supported and expanded by Congress over the years. For example, in 1982, Congress added Section 309(i)(3)(A) to the

Communications Act, which directs the Commission to accord preferences to minority applicants participating in lotteries to award certain broadcast licenses.

The decision to grant tax certificates in sales involving minority buyers was prompted by requests from the broadcasting industry and others in the 1970s. In 1978, the Commission's Minority Ownership Task Force reported that although minorities constituted approximately 20 percent of the population, they controlled fewer than one percent of the 8500 commercial radio and television stations then operating in the United States. Thus, the National Association of Broadcasters (NAB) proposed that the FCC establish a minority tax certificate policy to provide incentives for established broadcasters to sell radio and television stations to minority entrepreneurs.

The Commission agreed with NAB that underrepresentation by minorities contributed to a dearth of representation of minority views over the public airwaves. The Commission determined that an increase in ownership by minorities would inevitably enhance the diversity of programming available to the American public. Therefore, in 1978, the Commission issued a policy statement in which it determined that it would grant tax certificates to licensees that assign or transfer control of their authorizations to minority-controlled entities. Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 FCC 2d 979 (1978).

In 1981, the Chairman of the FCC, Mark Fowler, began a review of the Commission's minority ownership policies with the goal of finding creative ways to advance minority ownership. To assist in this effort, he established the Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications. The Advisory Committee identified lack of access to capital as the largest obstacle to minority ownership and identified the tax certificate as a successful way to enable minorities to attract financing.

As a result, the Commission, by a unanimous vote, took a number of steps in 1982 to make the tax certificate policy more effective in providing meaningful opportunities for minorities to enter the communications business.

First, it extended the tax certificate policy to sales of cable television systems. The Commission determined that cable operators, like broadcasters, exercise discretion in determining which broadcast and non-broadcast signals they will carry and, thus, taking steps to increase minority ownership would help to ensure that the viewpoints of minorities are adequately represented in cable television system programming.

In expanding the tax certificate program to cable systems, Chairman Fowler emphasized in a separate statement endorsing the Commission's decision that such actions aim squarely at the problem of minority financing opportunities. Mr. Fowler noted: "As President Reagan has said, the best hope for a strong economic future rests with a healthy, growing private sector. And the private sector does best when all have opportunities to enter it." See Statement of Policy on Minority Ownership of CATV Systems, 52 R.R.2d 1459 (1982).

Second, the Commission modified the policy to allow issuance of tax certificates to investors in a minority-controlled broadcast or cable entity upon the sale of their interests, provided that the interests were acquired to assist in the financing of the acquisition of the facility. Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC 2d 849 (1982). The Commission found that by broadening the tax certificate policy in this manner "the pressing dilemma minority entrepreneurs face -- the lack of available financing to capitalize their telecommunications ventures -- is met and a creative tool of financing is created."

In 1990, the FCC's minority ownership programs were upheld as constitutional by the United States Supreme Court. The Court held that the Commission's policies designed to increase minority ownership were substantially related to the achievement of a legitimate government interest in broadcast diversity and that they did not impose an impermissible burden on nonminorities. Metro Broadcasting, Inc. v. FCC, 497 U.S. 547 (1990). Although the Court decision did not specifically involve tax certificates, the rationale for the decision clearly applies to this program.

B. Legislative Constraints on Changes to the Minority Tax Certificate Policy

Late in 1986, the Commission became concerned about the continuing validity of its minority ownership programs and commenced a proceeding aimed at determining whether these programs were appropriate as a matter of policy and constitutional law. It asked for public comment on a number of issues, including whether the Commission should continue to grant preferences to minorities and what social or other costs might result from the policies. Reexamination of the Commission's Comparative Licensing, Distress Sales and Tax Certificate Policies Premised on Racial, Ethnic or Gender Classifications, MM Docket No. 86-484, FCC 86-549, released December 30, 1986.

Congress reacted to the Commission's attempt to reevaluate its minority ownership policies by attaching a rider to the FCC's 1988 appropriations bill explicitly denying the Commission authority to spend any appropriated funds "to repeal, to retroactively apply changes in, or to continue a reexamination of, the policies of the Federal Communications Commission with respect to comparative licensing, distress sales and tax certificates granted under 26 U.S.C. 1071, to expand minority ownership of broadcasting licenses . . . ." Congress also ordered the Commission to terminate the proceeding reexamining its minority ownership programs and to reinstate the prior policy. Pub. L. No. 100-202, 101 Stat. 1329 (1987). This rider has been reenacted by Congress each year since 1988.

In the 1994 appropriations legislation, Congress clarified in the House Conference Report that the prohibition on reexamination is "intended to prevent the Commission from backtracking on its policies that provide incentives for minority participation in broadcasting" but that it "does not prohibit the agency from taking steps to create greater opportunities for minority ownership." H. Conf. Rep. No. 103-708, 103d Cong. 2d Sess. 40 (1994) (emphasis added). Therefore, the Commission has been greatly constrained in its ability to review the administration and effectiveness of the tax certificate program.

C. <u>Administration of the Tax Certificate Program</u>

Because the rider to the FCC's appropriations bill prevents the Commission from spending appropriated funds to impose limitations on the minority tax certificate program, the Commission must consider tax certificate requests in accordance with the policy as it was in effect in 1986, subject only to changes that would expand the policy.

A tax certificate allows a seller to defer capital gains taxes incurred in the sale of a communications property. Under Section 1071 of the Internal Revenue Code, this deferral can be accomplished by treating the sale as an involuntary conversion under 26 U.S.C. § 1033, with the recognition of gain postponed by the acquisition of qualified replacement property, or by electing to reduce the basis of certain depreciable property, or both.

Thus, the certificate provides incentives to licensees to sell to minority entrepreneurs, while at the same time enhancing the buyer's bargaining position. Section 1071 also encourages reinvestment in communications infrastrucure by requiring the seller to reinvest the gains from a tax certificate transaction in similar property.

A request for a tax certificate is submitted to the Commission in letter or petition form. In the broadcast context, the request is usually filed in conjunction with a sale and, thus, the parties also are required to submit applications for consent to assign or transfer control of the relevant license. Ownership information about both the seller and buyer is contained in these applications, and any interested party may oppose the grant of the tax certificate or of the sale.

To receive a minority tax certificate, the minority principals must demonstrate that they exercise both de facto and de jure control of the buyer. If the purchaser is a limited partnership, the minority general partner must own more than a 20 percent equity stake in the company. The minority status of individuals is determined by reference to the Office of Management and Budget's ethnic group or country of origin classifications.

The Commission reviews applications and tax certificate requests carefully and often asks the parties for additional information. The Commission has denied grant of tax certificates when the parties failed to demonstrate minority control or to satisfy other criteria.

If the Commission determines that grant of a tax certificate is warranted under its tax certificate policies and prior tax certificate decisions, it will issue the certificate to the seller, which in turn submits it to the Internal Revenue Service with its tax return.

D. Results of the Tax Certificate Policy

Before 1978, minorities owned approximately .05 percent (40) of the approximately

8,500 total broadcast licenses issued by the FCC. A 1994 study performed by the National Telecommunications and Information Administration of the Department of Commerce indicates that as of September 1994, there were approximately 323 commercial radio and television stations owned by minorities, 2.9 percent of the total 11,128 licenses.

Industry Total	Black	Hispanic	Asian	Native American	Minority Totals
AM Stations 4,929	101 (2%)	76 (1.5%)	1 (0%)	2 (0%)	180 (3.7%)
FM Stations 5,044	71 (1.4%)	35 (.7%)	3 (.1%)	3 (.1%)	112 (2.2%)
TV Stations 1,155	21 (1.8%)	9 (.8%)	1 (.1%)	0 (0%)	31 (2.7%)
Cumulative Totals 11,128	193(1.7%)	120(1.1%)	5(0%)	5(0%)	323 (2.9%)

Between 1943 and 1994, the Commission has granted approximately 507 tax certificates; 390 were granted between 1978 and 1994. Approximately 330 of the total involved sales to minority-owned entities; 260 for radio station sales, 40 for television and low power television sales, and 30 for cable television transactions.

Although FCC regulations require the buyer of a property for which a tax certificate is issued to hold that station for one year, the overwhelming majority of minority buyers retain their licenses for much longer. Of the 290 broadcast transactions in which tax certificates were granted between 1978 and 1993, the average holding period was approximately five years. We have not included 1994 tax certificate transactions in this figure because those licenses have been held for less than one year. In more than 100 cases in which minority tax certificates were granted, the station still is held by the original purchaser.

The great majority of the transactions in which tax certificates are awarded are relatively small, averaging a sale price of $3.5 million for radio. The 40 tax certificates we have granted for television station sales have a higher average sale price of $38 million. Data is not available for the 30 cable sales, although we know that cable transactions tend to be larger.

III. Conclusion

The minority tax certificate policy is the cornerstone of the Commission's policies to remedy the underrepresentation of minorities in the ownership of broadcast and cable facilities. Most of the broadcast and cable television sales to minorities that took place after 1978 would not have occurred without the existence of the tax certificate policy. And there has been a marked increase in minority ownership since 1978. Further, the program does not seem to have suffered from rampant abuse, such as a lack of real minority control of licenses or quick "flipping" of facilities.

At the same time, as we have stated, the Commission has been constrained in its ability to subject the program to a comprehensive reexamination. As with any program, this one could benefit from periodic review and improvement. If given the authority by Congress to undertake a reevaluation of the tax certificate policy, I am confident that the Commission could improve the administration and cost effectiveness of the minority tax certificate program.

This concludes my formal remarks. Once again, thank you for inviting the FCC to testify this morning. I would be happy to answer any of your questions.

Summary of FCC Tax Certificate Data (as of 2/28/95)

Before 1978, minorities owned approximately one half of one percent (40) of the approximately 8,500 total broadcast licenses issued by the FCC. Today, a 1994 study performed by the National Telecommunication and Information Administration at the Department of Commerce, indicates that there are approximately 323 radio and television stations owned by minorities, 2.9% of the total 11,128 licenses held in 1994. This represents a 700% increase in the number of licenses issued to minorities since 1978, when section 1071 was applied to minority owned broadcast properties.

Industry Total	Black	Hispanic	Asian	Native American	Minority Totals
AM Stations 4,929	101 (2%)	76 (1.5%)	1 (0%)	2 (0%)	180 (3.7%)
FM Stations 5,044	71 (1.4%)	35 (.7%)	3 (.1%)	3 (.1%)	112 (2.2%)
TV Stations 1,155	21 (1.8%)	9 (.8%)	1 (.1%)	0 (0%)	31 (2.7%)
Cumulative Totals 11,128	**193(1.7%)**	**120(1.1%)**	**5(0%)**	**5(0%)**	**323 (2.9%)**

How Tax Certificates Work

To help achieve this growth in minority ownership, and thus promote diversity of viewpoints over the public airwaves, the Federal Communications Commission convened a conference on minority ownership of broadcast facilities in 1977. In 1978, the Commission's Minority Ownership Task Force released a report entitled Minority Ownership in Broadcasting, which documented findings from the 1977 conference and recommended several regulatory policy reforms. In 1978, the Commission adopted a policy statement on minority ownership of broadcast facilities and implemented policies on tax certificates. As a result, the Commission issued tax certificates under Section 1071 of the Internal Revenue Code to sellers of broadcast radio and television properties who sold their stations to minority buyers. In 1982 the availability of tax certificates was expanded to cable systems.

To qualify for a tax certificate, the minority buyer must have more than 50 of the voting control of the entity which is purchasing the station, and 20.1% of the equity of that purchaser. The minority buyer must maintain both legal, de jure control, as well as actual de facto control over the operations of the business. The Commission evaluates these criteria to determine whether a certificate is warranted. While the FCC has granted 356 tax certificates to promote minority broadcast and cable ownership, many requests for tax certificates have also been denied because the proposed transaction did not meet FCC standards.

If a certificate is granted, the seller is eligible to defer their tax payment on any capital gain (the amount of the sale over their basis in the property)and/or reduce the basis of certain depreciable property, if the seller reinvests in a qualifying replacement property within two years. In general, qualifying properties are other media properties or companies who hold FCC licenses. Upon the seller's sale of their interest in the qualifying replacement property, the tax on their gain becomes due.

Tax certificates create a market-based incentive for persons holding broadcast or cable properties to sell them to minorities. Because the seller can defer payment on the capital gain by selling to a qualified minority, it often lowers the price of the station for the minority buyer, thus helping minorities to overcome the barrier of lack of minority access to capital which both the FCC and Congress have identified as key issues preventing minority economic development.

What The Data Shows:

During the past 15 years, the issuance of minority tax certificates has resulted in the sale or transfer of over 288 radio licenses, 43 television licenses and 31 cable licenses, totalling approximately 362 tax certificates issued for minority deals. In contrast, approximately 117 non-minority tax certificates have been issued during the life of Section 1071 to, for example, encourage licensees to comply with the FCC's multiple ownership rules.

Type of License	Certificates Issued	of Total
Minority Radio	288	61%
Minority TV	43	8%
Minority Cable	31	6%
Non-minority	117	25%
Total	479	100%

In 1994, there was a total of 292 radio stations owned by minority broadcasters. When compared with the 287 tax certificates issued for minority radio stations there appears to be a high correlation between tax certificates issued and radio stations owned. In television, the correlation is more pronounced. In 1994, there was a total of 31 television stations owned by minorities compared with 43 tax certificates issued for minority owned television stations. Data is unavailable for cable. The National Association of Black Owned Broadcasters (NABOB) reports that the vast majority of existing major market minority broadcast owners have utilized tax certificates at some point during the past 15 years either: 1) as an incentive to attract initial investors; 2) to purchase a broadcast property; or 3) to sell a broadcast property to another minority.

The chart below shows that there was a significant increase in the number of minority tax certificates issued between the years 1987 and 1989. This increase corresponds with the robust trading experienced by the broadcast and cable industry during this period. The level of tax certificate activity also declined significantly in 1991 when federal restraints were placed on highly leveraged transactions and access to capital became a problem for the industry as a whole.

Year	Certificates Issued	of Total
N/A	30	10%
1978	1	0%
1979	7	2%
1980	8	2%
1981	9	2%
1982	8	2%
1983	4	1%
1984	12	3%
1985	19	5%
1986	21	5%
1987	34	8%
1988	44	13%
1989	37	10%
1990	51	16%
1991	24	7%
1992	13	3%
1993	21	5%
1994	19	5%
Total	362	100%

Diversity of Ownership:

Ownership data is available for approximately 63% (180) of the tax certificates issued in minority radio transactions. From this sample, there are approximately 89 separate owners (50%) of radio properties listed. Ownership data is available for approximately 98% (39) of the tax certificates in television transactions. From this sample there are approximately 21 (54%) separate owners listed. Ownership data is available for all 31 of the tax certificates issued in cable television transactions. From this listing, there are 20 (66%) separate owners of cable properties. In sum, the data indicates that over half of the broadcast and cable properties receiving tax certificates are owned by different individuals or companies.

The racial allocation of the minority tax certificates are as follows:

African Americans	64%
Hispanics	23%
Native American	1%
Alaskan Native	4%
Asian	8%

Holding Period:

Although FCC regulations require the buyer of a property for which a tax certificate is issued to hold that station for one year, the overwhelming majority of minority buyers retain their licenses for much longer. Example, of the total certificates issued, minority buyers of radio and television properties have held their licenses for an average of 5 years. Cable is excluded from these figures because there is insufficient data available on the holding period. However, the Communication Act requires that all cable systems be held for a minimum of three years following either the acquisition or initial construction of such system. Holding period information is available for approximately 83% of the minority radio stations and all of the minority television stations.

The number of broadcast licenses transferred by a minority-controlled entity after a license was acquired in a tax certificate transaction is approximately 134 (42% of the total broadcast tax certificates issued). The average length of time these licenses were held by minority-controlled entities is 4 years.

Size of Transactions:

After reviewing a sample consisting of 72% of radio stations and 78% of television stations, the data indicates that the great majority of the sales transactions in which tax certificates are awarded are relatively small, averaging a sales price of $4 million for radio stations and $38 million for television stations. Data is not available for the 30 cable deals, although we know that cable deals tend to be larger transactions.

FCC has no data available on the amount of tax gains actually deferred.

Other Findings:

Although the tax certificate program is not the only FCC program designed to encourage transfer of licenses to minorities, it is the most frequently used program and is often used in concert with the other programs. In addition, various entrepreneurs and industry associations have submitted testimony which indicates that: "But for the tax certificate program the acquisition of existing broadcast and cable properties by minorities would be significantly more difficult to consummate."

STATEMENT OF

WILLIAM E. KENNARD
GENERAL COUNSEL
FEDERAL COMMUNICATIONS COMMISSION

BEFORE THE

UNITED STATES SENATE
COMMITTEE ON FINANCE

ON

FCC ADMINISTRATION OF INTERNAL REVENUE CODE SECTION 1071

MARCH 7, 1995

Chairman Packwood and Members of the Committee:

Thank you for the opportunity to explain how the Federal Communications Commission has used Section 1071 of the Internal Revenue Code to further the FCC's and Congress' policies.

I. Introduction and Overview

Section 1071 of the Internal Revenue Code authorizes the FCC to permit sellers of broadcast properties to defer capital gains taxes on a sale or exchange if the sale or exchange is deemed by the agency to be "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." 26 U.S.C. § 1071.

Section 1071 was enacted in 1943 to alleviate the hardship of involuntary divestiture associated with the Commission's newly adopted multiple ownership rules. Those rules limited radio licensees to ownership of one outlet per market, and, as a result, some broadcast licensees were required to sell overlapping stations. Later, tax certificates were used in voluntary transfers as an incentive to licensees to divest themselves of properties grandfathered under another provision of the multiple ownership rules which limited the number of stations a single entity could own nationwide.

Since that time, the FCC has used tax certificates in other contexts to further the goals of national communications policy. Today, the FCC issues tax certificates to encourage:

- licensees to come into compliance with the FCC's multiple ownership rules
- microwave licensees to relocate to other frequencies to facilitate licensing of personal communications services
- owners of AM radio to divest themselves of licenses in certain frequency bands to reduce interference
- minority ownership.

I understand that this Committee is most interested in the FCC's use of tax certificates to promote minority ownership of broadcasting stations and cable television systems so I will focus on that area in my testimony today.

II. The FCC's Minority Tax Certificate Policy

A. Development of the Policy

Recognizing that the viewing and listening public suffers when minorities are underrepresented among owners of broadcast stations, the Commission began working to encourage minority participation in broadcasting in the late 1960s. Its first step was to formulate rules to prohibit discrimination in hiring and, several years later, in response to a court decision, it began to consider minority status in comparative licensing proceedings.

The decision to grant tax certificates in sales involving minority buyers was prompted by requests from the broadcasting industry and others in the late 1970s. In 1978, the

Commission's Minority Ownership Task Force reported that although minorities constituted approximately 20 percent of the population, they controlled fewer than one percent of the 8500 commercial radio and television stations then operating in the United States. Thus, the National Association of Broadcasters (NAB) proposed that the FCC establish a minority tax certificate policy to provide incentives for established broadcasters to sell radio and television stations to minority entrepreneurs.

The Commission agreed with NAB that underrepresentation by minorities contributed to a dearth of representation of minority views over the public airwaves. The Commission determined that an increase in ownership by minorities would inevitably enhance the diversity of programming available to the American public. Therefore, in 1978, the Commission issued a policy statement in which it determined that it would grant tax certificates to licensees that assign or transfer control of their authorizations to minority-controlled entities. Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 FCC 2d 979 (1978).

In 1981, the Chairman of the FCC, Mark Fowler, began a review of the Commission's minority ownership policies with the goal of finding new ways to advance minority ownership. To assist in this effort, he established the Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications. The Advisory Committee identified lack of access to capital as the largest obstacle to minority ownership and identified the tax certificate as a successful way to enable minorities to attract financing.

As a result, the Commission, by a unanimous vote, took a number of steps in 1982 to make the tax certificate policy more effective in providing meaningful opportunities for minorities to enter the communications business.

First, it extended the tax certificate policy to sales of cable television systems. The Commission determined that cable operators, like broadcasters, exercise discretion in determining which broadcast and non-broadcast signals they will carry and, thus, taking steps to increase minority ownership would help to ensure that the viewpoints of minorities are adequately represented in cable television system programming.

In expanding the tax certificate program to cable systems, Chairman Fowler emphasized in a separate statement endorsing the Commission's decision that such actions aim squarely at the problem of minority financing opportunities. Mr. Fowler noted: "As President Reagan has said, the best hope for a strong economic future rests with a healthy, growing private sector. And the private sector does best when all have opportunities to enter it." See Statement of Policy on Minority Ownership of CATV Facilities, 52 R.R.2d 1469 (1982).

Second, the Commission modified the policy to allow issuance of tax certificates to investors in a minority-controlled broadcast or cable company upon the sale of their interests, provided that the interests were acquired to provide "start-up" capital to assist the company in acquiring its first broadcast or cable facilities. Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC 2d 849 (1982). The

Commission found that by broadening the tax certificate policy in this manner "the pressing dilemma minority entrepreneurs face -- the lack of available financing to capitalize their telecommunications ventures -- is met and a creative tool of financing is created."

In 1990, the FCC's minority ownership programs were upheld as constitutional by the United States Supreme Court. The Court held that the Commission's policies designed to increase minority ownership were substantially related to the achievement of a legitimate government interest in broadcast diversity and that they did not impose an impermissible burden on nonminorities. Metro Broadcasting, Inc. v. FCC, 497 U.S. 547 (1990). The Supreme Court cited numerous empirical studies demonstrating that there is a nexus between minority ownership and increased program diversity. Although the Court decision did not specifically involve tax certificates, the rationale for the decision clearly applies to this program.

B. Legislative Constraints on Changes to the Minority Tax Certificate Policy

Late in 1986, the Commission commenced a proceeding to determine whether its minority ownership programs were appropriate as a matter of policy and constitutional law. It asked for public comment on a number of issues, including whether the Commission should continue to grant preferences to minorities and what social or other costs might result from the policies. Reexamination of the Commission's Comparative Licensing, Distress Sales and

Tax Certificate Policies Premised on Racial, Ethnic or Gender Classifications, 1 FCC Rcd 1315 (1986).

Congress reacted to the Commission's attempt to reevaluate its minority ownership policies by attaching a rider to the FCC's 1988 appropriations bill explicitly denying the Commission authority to spend any appropriated funds "to repeal, to retroactively apply changes in, or to continue a reexamination of, the policies of the Federal Communications Commission with respect to comparative licensing, distress sales and tax certificates granted under 26 U.S.C. 1071, to expand minority ownership of broadcasting licenses . . . ." Congress also ordered the Commission to terminate the proceeding reexamining its minority ownership programs and to reinstate the prior policy. Pub. L. No. 100-202, 101 Stat. 1329 (1987). This rider has been reenacted by Congress each year since 1988.

In the 1994 appropriations legislation, Congress clarified in the House Conference Report that the prohibition on reexamination is "intended to prevent the Commission from backtracking on its policies that provide incentives for minority participation in broadcasting" but that it "does not prohibit the agency from taking steps to create greater opportunities for minority ownership." H. Conf. Rep. No. 103-708, 103d Cong. 2d Sess. 40 (1994) (emphasis added). Therefore, the Commission has been greatly constrained in its ability to review the administration and effectiveness of the tax certificate program.

C. Administration of the Tax Certificate Program

Because the rider to the FCC's appropriations bill prevents the Commission from spending appropriated funds to impose limitations on the minority tax certificate program, the Commission must consider tax certificate requests in accordance with the policy as it was in effect in 1986, subject only to changes that would expand the policy.

A tax certificate allows a seller to defer capital gains taxes incurred in the sale of a communications property. Under Section 1071 of the Internal Revenue Code, this deferral can be accomplished by treating the sale as an involuntary conversion under 26 U.S.C. § 1033, with the recognition of gain postponed by the acquisition of qualified replacement property, or by electing to reduce the basis of certain depreciable property, or both.

Thus, the certificate provides incentives to licensees to sell to minority entrepreneurs, while at the same time enhancing the buyer's bargaining position and ability to attract capital. Section 1071 also encourages reinvestment in communications infrastructure by requiring the seller to reinvest the gains from a tax certificate transaction in similar property.

A request for a tax certificate is submitted to the Commission in letter or petition form. The request is usually filed in conjunction with a sale and, thus, the parties also are required to submit applications for consent to assign or transfer control of the relevant licenses. Ownership information about both the seller and buyer is contained in these applications, and any interested party may oppose the grant of the tax certificate or of the sale.

To qualify for a tax certificate, the minority buyer must demonstrate that minorities have voting control of the company that is purchasing the broadcast station or cable system, and that they own more than 20% of the company's equity. Minorities must maintain both legal and actual control over the operation of the business. The Commission evaluates these criteria to determine whether issuance of a tax certificate is warranted. Many requests for tax certificates have been denied or withdrawn because the proposed transaction did not meet FCC standards.

The minority status of individuals is determined by reference to the Office of Management and Budget's ethnic group or country of origin classifications. Qualified minority groups include African Americans, Hispanics, American Indians, Alaska Natives, Asians and Pacific Islanders.

The Commission reviews applications and tax certificate requests carefully and often asks the parties for additional information. The Commission has denied grant of tax certificates when the parties failed to demonstrate minority control or to satisfy other criteria. If the Commission determines that grant of a tax certificate is warranted under its tax certificate policies and prior tax certificate decisions, it will issue the certificate to the seller, which in turn submits it to the Internal Revenue Service with its tax return.

D. Results of the Tax Certificate Policy

The Commission's tax certificate policy has been instrumental in substantially increasing the number of broadcast licenses owned by minorities. Before 1978, minorities owned approximately .05 percent (40) of the approximately 8,500 total broadcast licenses issued by the FCC. A 1994 study performed by the National Telecommunications and Information Administration of the Department of Commerce indicates that as of September 1994, there were approximately 323 commercial radio and television stations owned by minorities, 2.9 percent of the total 11,128 licenses. The more than eight-fold increase in the number of broadcast licenses owned by minorities in the seventeen-year history of the Commission's tax certificate program underscores its importance and effectiveness in helping minorities overcome what the Commission identified in 1981 as the biggest obstacle to ownership -- lack of access to capital . The following chart details current minority broadcast ownership levels by industry and by ethnicity.

Industry Total	**Black**	**Hispanic**	**Asian**	**Native American**	**Minority Totals**
AM Stations 4,929	101 (2%)	76 (1.5%)	1 (0%)	2 (0%)	180 (3.7%)
FM Stations 5,044	71 (1.4%)	35 (.7%)	3 (.1%)	3 (.1%)	112 (2.2%)
TV Stations 1,155	21 (1.8%)	9 (.8%)	1 (.1%)	0 (0%)	31 (2.7%)
Cumulative Totals 11,128	193(1.7%)	120(1.1%)	5(0%)	5(0%)	323 (2.9%)

Between 1943 and 1994, the Commission issued approximately 536 tax certificates; 419 were issued between 1978 and 1994. Approximately 359 of the total involved sales to minority-owned entities. Of these, 285 involved radio station sales, 43 involved television and low power television sales, and 31 involved cable television transactions.

Although FCC regulations require the buyer of a property for which a tax certificate is issued to hold that station for one year, the overwhelming majority of minority buyers retain their licenses for much longer. Of the 303 broadcast transactions in which tax certificates were granted between 1978 and 1993, the average holding period was approximately five years. We have not included 1994 tax certificate transactions in this figure because those licenses have been held for less than one year. In more than 100 cases in which minority tax certificates were granted, the station still is held by the original minority purchaser.

The great majority of the transactions in which tax certificates are awarded are relatively small, averaging a sale price of $3.8 million for radio. The 43 minority tax certificates transactions involving television station sales have a higher average sale price of $32 million. Data is not available for the 31 cable sales, although we know that cable transactions tend to be larger than broadcast transactions.

The Committee expressed an interest in use of the tax certificate program during the last five years. Between 1990 and 1994, the Commission issued 128 minority tax certificates: 17 for television sales, 91 for radio transactions and 20 for cable transactions. The following chart breaks down the activity in each service by year.

Year	TV	Radio	Cable	Total
1990	8	38	5	51
1991	3	19	1	23
1992	0	9	4	13
1993	4	13	4	21
1994	2	12	6	20
Totals	17	91	20	128

III. Conclusion

The minority tax certificate policy is the cornerstone of the Commission's policies to remedy the underrepresentation of minorities in the ownership of broadcast and cable television facilities. Many of the broadcast and cable television facilities acquired by minorities since 1978 were acquired with the benefit of the tax certificate policy. The tax certificate program has been remarkably effective in helping minorities surmount the greatest obstacle to ownership -- attracting the necessary capital. Moreover, the tax certificate program is not a set aside or quota program. Rather, it is a minimally intrusive market-based incentive to remedy the underrepresentation of minorities in the ownership of broadcast and cable facilities. The program does not seem to have suffered from rampant abuse, such as a lack of real minority control of licenses or quick "flipping" of facilities.

At the same time, the Commission has been constrained in its ability to subject the program to a comprehensive reexamination. As with any program, this one could benefit from periodic review and improvement. If given the authority by Congress to undertake a reevaluation of the tax certificate policy, I am confident that the Commission could improve the administration and cost effectiveness of the minority tax certificate program.

This concludes my formal remarks. Once again, thank you for inviting the FCC to testify this morning. I would be happy to answer any of your questions.

4/18/95
Delivered to
Chris Edley
as requested.
Brendan

REPRESENTATION OF MINORITIES AND WOMEN AMONG FCC AUCTION WINNERS

Auction No. 1 - Narrowband PCS (10 nationwide licenses)

Special Provisions	Winning Bidders	Minority or Woman Winners
25 percent bidding credit available to businesses owned by minorities and/or women on 3 of the 10 licenses	6	0

Auction No. 2 - Interactive Video and Data Service (594 local licenses)

Special Provisions	Winning Bidders	Minority or Woman Winners
25 percent bidding credit available to businesses owned by minorities and/or women on one-half of the licenses	178	Not immediately available. (Of 594 licenses, minority and/or woman-owned firms won 422, or 71 percent.)

Auction No. 3 - Narrowband PCS (30 licenses: 6 in each of 5 regions comprising USA)

Special Provisions	Winning Bidders	Minority or Woman Winners
40 percent bidding credit available to businesses owned by minorities and/or women on 10 of the 30 licenses (2 in each region)	9	4 (Of 30 licenses, minority and/or women-owned firms won 11, including the 10 on which bidding credits were available.)

Auction No. 4 - Broadband PCS (99 licenses: 2 in each of 48 regions, 1 in each of 3 regions)

Special Provisions	Winning Bidders	Minority or Woman Winners
none	18	1 (A woman-owned firm won one of the 99 available licenses.)

Future Auctions: Broadband PCS (1,972 licenses, 4 in each of 493 regions): FCC auction rules restrict large telecommunications companies from bidding on 986 of these licenses, except as investors in relatively small businesses. Special provisions were adopted to encourage investment in small businesses and in businesses owned by minorities and/or women. Auctions employing these rules have been stayed by U.S. Court of Appeals for the D.C. Circuit. Similar rules are currently under consideration for future narrowband PCS auctions.