

Tax Free Sales & Exchanges

By Gregg P. Skall

Prompted by the passage of the Telecommunications Act of 1996 and its increased limits on multiple ownership, the broadcasting industry is experiencing a substantial surge in station sales and station trading. As this occurs, broadcasters are looking for more ways to achieve the transfers without creating a taxable event that would give rise to realization of gain. This is particularly apt when the sale is for the purpose of "trading up" or reinvesting in another broadcasting property.

Until recently, one way to sell without realizing gain was to sell to a qualified minority entrepreneur and obtain from the FCC a tax certificate under former Section 1071 of the Internal Revenue Code. Unfortunately for the broadcasting industry and for the cause of minority ownership, Congress repealed Section 1071. So what else is there?

There is Section 1031 of the Internal Revenue Code, passed about a half dozen years ago, that provides for tax free treatment of like-kind exchanges of property, and further provides for deferred (i.e. non-simultaneous) exchanges.

A deferred exchange is one in which, by agreement, the taxpayer sells property used in a trade or business (the "Relinquished Property") and later receives other property used in a trade or business (the "Replacement Property"). The transaction must be an exchange of property for property, not a sale of property for money followed by a reinvestment of the proceeds in like-kind property.

To qualify, there are two requirements. First, the Replacement Property must be identified on or before the 45th day after the Relinquished Property is transferred. This identification requirement can be satisfied by a written document sent to the other party, or to an intermediary or escrow agent. Up to 3 properties can be identified as replacement properties, or any number so long as their aggregate value does not exceed 200% of that of the Relinquished Property.

Second, the Replacement Property must be received by the earlier of (a) 180 days after transfer of the Relinquished Property, or (b) the due date of the taxpayer's tax return for the year of transfer.

The regulations provide certain "safe harbor" mechanisms to facilitate the transaction and avoid "constructive receipt" of money or nonqualifying property. They allow the use of security or guarantee arrangements, qualified intermediaries and interest and growth factors. Thus, if the deal calls for the buyer to later secure and transfer like-kind property to the seller, that performance can be guaranteed by a mortgage, deed of trust, letter of credit (which does not allow the seller to draw upon it except upon default of the buyer to supply a like-kind Replacement Property), or the guarantee of a third party.

The Buyer may also secure its obligation to supply a Replacement Property with cash or a cash equivalent if it is held in a qualified escrow account or trust. The escrow holder or trustee must be unrelated to the taxpayer, whose right to obtain the cash is limited to certain circumstances described in the regulations.

Another "safe harbor" is the "qualified intermediary," a person unrelated to the taxpayer who agrees to acquire the Relinquished Property and transfer it to the buyer, and who will also acquire the Replacement Property and transfer it to the seller.

These are all interesting devices for avoiding taxable gain by creating a three way transaction, but be forewarned: If the deferred exchange fails to qualify as a like-kind exchange for some reason (for instance qualified Replacement Property is not acquired within the 180 day period), then gain would generally be recognized at the end of the replacement period.

Be careful, too, about the multi-asset nature of most broadcast properties. Whether station assets are treated by IRS as like-kind is determined by a rather subjective facts-and-circumstances test. A station which owns its tower, tower site real estate and studio building may not be "like-kind" in all respects with a station that leases all its real estate and tower space.