Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-109445-00
Date:
1 September 2000

Company:

Programmer:

M:

Stations:

State:

Region:

a:
b:
c:
d:

Dear

This letter responds to a letter from Company dated April 28, 2000, and

subsequent correspondence, requesting a ruling that the income received by Company from a programming agreement is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code. Company represents the following facts.

Company was incorporated in State in a and elected under § 1362(a) to be an S corporation effective b. M is Company's president and majority shareholder. It has C corporation earnings and profits.

Company, under licenses from the Federal Communications Commission (FCC), owns and operates c radio stations (the Stations) in Region. It has entered into the Agreement with Programmer, an unrelated firm, by which Programmer will take over some of the day-to-day operations of the Stations, including the solicitation of advertising (Programming Agreement). Programmer has agreed to operate the Stations for a term of years, at the end of which time it may exercise an option to purchase the Stations along with the broadcasting licenses (Option Agreement). Programmer will pay Company a monthly fee and will reimburse Company for reasonable amounts spent by Company for station operation, engineering, maintenance, administration, and other general expenses. In exchange, Programmer will retain its profits from advertising and operating revenues. Programmer will pay a separate fee for the Option Agreement to purchase the Stations.

Company has agreed to broadcast programming designated and provided by Programmer, subject to Company's supervision and control. Company will continue to have full authority, control, and power over station policy, programming, and operation. Company must employ a sufficient number of employees in each of its d markets as required by the FCC, including a general manager who will be responsible for daily operations and accountable to Company. Company will be directly responsible for the salaries, taxes, insurance, and related costs for these employees. Company will be responsible, also, for legal fees, FCC fees, and janitorial expenses, as well as for transmitter site and main studio rent or mortgage payments.

Company represents that it will continue to own all of the assets subject to the Agreements and will continue to be the licensee, with all the obligations to the FCC that it had before entering into the Agreements with Programmer.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) terminates whenever the corporation (I) has accumulated earnings and profits at the close of each of three consecutive tax years, and (II) has gross receipts for each of such tax years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(A)(1) of the Income Tax Regulations provides that “royalties” means all royalties, including mineral, oil, and gas royalties, and amounts received for the privilege of using patents, copyrights, secret processes and formulas, good will, trademarks, tradebrands, franchises, and other like property. The gross amount of royalties is not reduced by any part of the cost of the rights under which the royalties are received or by any amount allowable as a deduction in computing taxable income.

Section 1.1362-2(c)(5)(ii)(A)(2) provides that “royalties” does not include royalties derived in the ordinary course of a trade or business of franchising or licensing property. Royalties received by a corporation are derived in the ordinary course of a trade or business of franchising or licensing property only if, based on all the facts and circumstances, the corporation (i) created the property; or (ii) performed significant services or incurred substantial costs with respect to the development or marketing of the property.

Section 1.1362-2(c)(5)(ii)(B)(1) provides that "rents" means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts as represented by Company in this ruling request, we conclude that Company’s income from the Programming Agreement is not passive investment income under § 1362(d)(3)(C)(i).

The ruling in this letter is based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company's eligibility to be an S corporation. In addition, no opinion is expressed regarding whether

the payments from the Programming Agreement are royalties, rents, or both. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, any rental activity remains passive for purposes of § 469.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Company.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,
/s/
Robert Honigman
Acting Assistant to the Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy for § 6110 purposes