Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Numbers: 1397.00-00
1400B.03-00

Number: **200006016**
Release Date: 2/11/2000

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:6-PLR-108490-99
Date:
November 1, 1999

LEGEND:

Taxpayer =

Location 1 =

Location 2 =

District =

X =

Y =

Z =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

Dear

This letter responds to a request for a private letter ruling filed by you on behalf of Taxpayer dated April 29, 1999, and subsequent submissions. Taxpayer requested a ruling that the operations of Taxpayer meet, for purposes of qualifying as a DC Zone business as defined in section 1400B(c), the requirements under section 1397B(b)(1) and section 1397B(b)(2), as modified by section 1400B(c), of the Internal Revenue Code.

Taxpayer represents that the facts are as follows.

Taxpayer is a C-corporation incorporated under laws of Location 1. Y owns a percent of Taxpayer with the remaining b percent of Taxpayer owned by Z. Y is a closely held C-corporation incorporated under the laws of Location 2. Z is a C-corporation incorporated under the laws of Location 2 and is a wholly owned subsidiary of Taxpayer. Z is a holding company that owns the stock of various subsidiaries. Taxpayer utilizes the accrual method of accounting and reports income on the basis of a fiscal year accounting period. District has examination jurisdiction over the federal tax returns filed by Taxpayer.

Taxpayer's g and operational facilities are located within the DC Zone. Taxpayer operates in the h industry. Its only trade or business is the management and operation of X. The management and operation of X are substantially performed at Taxpayer's g and operational facilities. For example, X day to day operations, production of i, and the transmission of X to affiliated j operators all occur at Taxpayer's operational facilities within the DC Zone. In addition, the accounting, marketing, purchasing, billing, human resources, and executive decision making are all performed at Taxpayer's g and operational facilities within the DC Zone.

Taxpayer has over c people working in the operations of Taxpayer in the DC Zone. These include executive, managerial, professional, technical, and support positions. Substantially all of the operations of Taxpayer are performed within the DC Zone. The operations performed outside of the DC Zone are concentrated in a few cities at sales offices, whose function is to perform advertising sales and affiliate relationship management. Executives at Taxpayer's g located within the DC Zone control and direct the advertising, affiliate marketing, and affiliate relationship

management activities performed outside of the DC Zone.

Based on Taxpayer's representations in its submissions and at Taxpayer's Conference of Right, the sources of Taxpayer's programs for X are (1) acquired programming, where Taxpayer pays license fees to program producers to air their programs and (2) original productions, where Taxpayer produces its own programs for X. Most of Taxpayer's programming is acquired from third parties although Taxpayer or subsidiaries produce some original programming. In general, Taxpayer obtains rights to air certain programming by entering licensing agreements with third party and related vendors. In most cases, Taxpayer obtains the contractual right (i.e., the license) to air the programming for a specific time period after which the right to air the program reverts back to the owner of the program. At the Taxpayer's Conference of Right and in its post-Conference submission, Taxpayer described the editing of, for purposes of compliance with FCC content guidelines, and the arranging of the programming and the placing of advertisements that enable Taxpayer to "repackage" the acquired programming and its original programming into program formats for transmission to the j operators.

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Taxpayer's two primary sources of income are k revenue and l revenue from the operation of X. X currently earns approximately d percent of its revenues from k and approximately e percent of its revenues from l. X's k revenue is derived primarily from sales of national spot advertising, infomercial advertising, and direct response advertising to companies. Taxpayer contracts with j operators to provide its programming service for a monthly per l under long-term affiliation agreements.

LAW AND ANALYSIS:

Section 1400B(d) of the Code defines the DC Zone as all census tracts located in the District of Columbia for which the poverty rate is not less than 10 percent as determined on the basis of the 1990 census.

Section 1400B(c) of the Code defines a "DC Zone business," for purposes of the zero percent capital gains rate, as any enterprise zone business, as defined in section 1397B (with certain modifications).

Section 1397B(a)(1) of the Code defines an "enterprise zone business" as meaning any qualified business entity. With the modifications specified in section 1400B(c), section 1397B(b) defines a "qualified business entity" to mean, with respect to any taxable year, any corporation or partnership if for such year certain requirements set forth in section 1397B(b)(1)-(8) are met. Section 1397B(b)(1) requires every trade or business of the corporation or partnership to be the active conduct of a qualified business within an empowerment zone (that is, the DC Zone). Section 1397B(b)(2), as modified by section 1400B(c)(2), requires that at least 80 percent of the total gross income of such entity is derived from the active conduct of such business.

Section 1397B(d)(1) of the Code provides that except otherwise provided in section 1397B(d), the term "qualified business" means any trade or business.

Section 1397B(d)(4) of the Code, which is titled, "TREATMENT OF BUSINESS HOLDING INTANGIBLES," excludes from the definition of a qualified business "any trade or business consisting predominantly of the development or holding of intangibles for sale or license." See H.R. Conf. Rep. No. 213, 103d Cong., 1st Sess. 1, 707 (1993), 1993-3 C.B. 393, 585.

Section 1397B(b)(1) of the Code, as modified by section 1400B(c), requires that every trade or business of Taxpayer be the active conduct of a qualified business within the DC Zone. Based on Taxpayer's representations, Taxpayer has only one trade or business and Taxpayer's operation and management of X, Taxpayer's trade or business, is from a location within the DC Zone. Thus, it would appear that Taxpayer's activities should constitute the active conduct of a qualified business within the DC Zone. Section 1397B(b)(2), as modified by section 1400B(c), requires that at least 80% of the total gross income of Taxpayer is derived from the active conduct of a qualified business. Based on Taxpayer's representations, the k revenue and l revenue earned through the operations of Taxpayer, which is approximately f percent of Taxpayer's gross income, is derived from the active conduct of Taxpayer's trade or business within the DC Zone. Thus, it would appear that Taxpayer should meet the requirement that at least 80% of its total gross income is derived from the active conduct of a qualified business.

However, our view is that because of section 1397B(d)(4) of the Code, Taxpayer's trade or business is excluded from the definition of a qualified business. Section 1397B(d)(4) excludes from the definition of a qualified business "any trade or business consisting predominantly of the development or holding of intangibles for sale or license." Taxpayer's trade or business is h, which extensively involves the use of intangibles. Taxpayer acquires intangibles (i.e., licenses from third parties for their programming and its own self created programming) and "repackages" the programming into program formats for transmission to j operators. We view Taxpayer's program formats as being newly created intangibles and the "development or holding of intangibles for sale or license" language in section 1397B(d)(4) as encompassing Taxpayer's repackaging activities and Taxpayer's holding of the program format. [1]

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[1] Taxpayer represents that it produces its own programs for ultimate use in X as a result of its "repackaging activities." By implication from the principles of section 197 of the Code, which was created by the same legislative act, the Omnibus Budget Reconciliation Act of 1993, which created section 1397B(d)(4), we view Taxpayer's original programming as an intangible, for purposes of section 1397B(d)(4). Taxpayer's production of its own programs constitutes the development of an intangible. We see no difference in concept between the program formats created by Taxpayer for

We note that the language of section 1397B(d)(4) of the Code does not preclude the presence of some "development or holding of intangibles" activity in a taxpayer's trade or business. In order to avoid the effect of section 1397B(d)(4), it must be shown or demonstrated that a taxpayer's trade or business does not consist predominantly of the development or holding of an intangible for sale or lease (emphasis added). Taxpayer has failed to make such a demonstration.

We wish to make the following observations pertaining to the language of section 1397B(d)(4) of the Code. The "development or holding of intangibles for sale or license" language in section 1397B(d)(4) can include related performance of service activity by a taxpayer. Further, throughout the case proceedings, it was Taxpayer's position that section 1397B(d)(4) only excludes intangible holding companies from the definition of qualified business (that is, DC Zone business). [2] To some extent support for Taxpayer's position can be found in the title heading of section 1397B(d)(4), "TREATMENT OF BUSINESS HOLDING INTANGIBLES." However, the language of section 1397B(d)(4) is much broader in scope and applies, for example, to companies developing intangibles for sale or license.

CONCLUSION:

Based solely on Taxpayer's representations and submissions and the relevant law and analysis set forth above, we conclude that section 1397B(d)(4) of the Code excludes Taxpayer's trade or business from the definition of a qualified business and, thus, prevents Taxpayer from meeting the requirements under sections 1397B(b)(1) and (b)(2), as modified by section 1400B(c).

No opinion is expressed or implied as to the federal tax consequences of this

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transmission to j operators, as a result of the repackaging of the acquired programs and Taxpayer's original programs, and Taxpayer's original programming resulting from Taxpayer's production activity. Both products are intangibles resulting from Taxpayer's development activities.

For example, insofar as Taxpayer's activity encompassing "the development of intangibles for license" is concerned, we view the relationship between Taxpayer and a j operator, who is paying a monthly l to Taxpayer under a long-term affiliation agreement, as being in the nature of a non-exclusive license arrangement which imposes certain limitations on the j operator's use of the program formats and does not permit the j operator to sell or otherwise exploit the program formats.

[2] Taxpayer describes intangible holding companies as those companies that essentially hold only intangible assets, produce generally passive income (e.g., royalties), have few employees, and contribute very little to the economy.

transaction under any provision not specifically addressed herein.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this letter ruling have not yet been adopted. Therefore, this letter ruling will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, if the criteria in section 12.05 of Rev. Proc. 99-1, 1999-1 I.R.B. at 47, are satisfied, a letter ruling is not revoked or modified retroactively except in rare or unusual circumstances.

In accordance with section 8.05 of Rev. Proc. 99-1, 1999-1 I.R.B. at 34, Taxpayer must attach a copy of this letter ruling to any federal tax return to which it is relevant. We enclose a copy for that purpose.

In accordance with the power of attorney on file with this office, a copy of this ruling is being sent to Taxpayer.

Sincerely yours,

KATHLEEN REED
Senior Technician Reviewer, Branch 6
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures(2) :
copy of letter ruling
6110 copy