FCC MINORITY TAX CERTIFICATES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JANUARY 27, 1995

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CONTENTS

SUBMISSIONS FOR THE RECORD

FCC MINORITY TAX CERTIFICATES

FRIDAY, JANUARY 27, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:20 a.m., in room B-318, Rayburn House Office Building, Hon. Nancy L. Johnson (chairman of the subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

For Immediate Release
January 18, 1995
No. OV-2

CONTACT: (202) 225-1721

JOHNSON ANNOUNCES DETAILS OF HEARING ON FCC PROVISION

Congresswoman Nancy L. Johnson (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the subcommittee will hold a hearing to examine the operation and administration of a tax provision which allows the Federal Communication Commission to grant tax relief with respect to the sales of radio, television, and other properties under certain circumstances. This provision is known as Internal Revenue Code section 1071. **The hearing will be held on Friday, January 27, 1995, in room B-318 of the Rayburn House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

Code section 1071 was enacted in 1943 to address concerns with respect to involuntary conversions of radio stations arising from wartime restrictions on the purchase and availability of new radio property. Under section 1071, gain from the sale or exchange of broadcast facilities may be deferred in cases where the sale or exchange is certified by the Federal Communications Commission "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...."

In 1978, the FCC announced a policy of promoting minority ownership of broadcast facilities by offering a tax certificate to those who voluntarily sell such facilities to minority individuals or minority-controlled entities. Since that time, the FCC has issued over 300 such tax certificates. Recent press reports about the FCC's administration of section 1071, both in terms of the types of properties covered and the size of the tax benefits being granted, raise significant questions about this provision.

FOCUS OF THE HEARING:

The Subcommittee will examine: (1) whether the FCC's 1978 policy is consistent with the underlying intent of section 1071; (2) whether the FCC's administration of section 1071 constitutes an impermissible exercise of legislative authority; (3) whether the tax incentive provided in section 1071 in fact fosters minority ownership of broadcast facilities; and (4) whether the FCC policy is a necessary or appropriate means of achieving this goal.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business on Monday, January 23, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Oversight will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-7601.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Oversight office, room 1136 Longworth House Office Building, no later than noon, Thursday, January 26, 1995.** Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business on Tuesday, February 7, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

* * * * *

Chairman JOHNSON. Good morning, everyone.

I regret our late start, but we will try to move along. Today the Oversight Subcommittee will examine the operation of a provision in the Internal Revenue Code that allows the FCC (Federal Communications Commission) to grant tax benefits with respect to the sales of radio, television, and other broadcast properties. That provision, Internal Revenue Code section 1071, was enacted in 1943 to address concerns with respect to the involuntary conversion of radio stations arising from wartime restrictions on the purchase and availability of new radio properties.

Under section 1071, gain from the sale or exchange of property may be deferred in cases where the sale or exchange is certified by the Federal Communications Commission 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."

This provision has been significantly expanded by the FCC over the last 50 years. First, radio stations were expanded to include television stations. Then television stations were expanded to include cable television; more recently, personal communication services. The newest type of cellular phones have been added.

The policies which the FCC believes warrant the granting of tax breaks also have changed over the years. The original policy of the FCC was to allow tax benefits only in the cases of involuntary conversions of radio stations. In 1978, the FCC announced a new policy of promoting minority ownership of broadcast facilities by offering an FCC tax certificate to those who voluntarily sell such facilities to minority individuals and minority-controlled entities.

The size of transactions receiving tax benefits under section 1071 also has expanded. One proposed transaction recently in the news involves the sale by Viacom of cable television properties for approximately $2.3 billion. The total Federal and State tax benefits for this one transaction could well be in excess of $1½ billion. Clearly, this subcommittee has a responsibility to examine whether a policy which allows a Federal agency to hand out tax benefits of this magnitude is in the taxpayers' interest.

The subcommittee will examine the FCC's 1978 policy to see if it is consistent with the underlying intent of section 1071 or whether the FCC's administration of section 1071 represents the exercise of what can more properly be described as legislative powers.

The subcommittee also will examine whether the tax incentive provided in section 1071 in fact fosters minority ownership of broadcast facilities or whether the FCC policy is a necessary, appropriate means of achieving this goal. The FCC has a number of programs besides the tax break intended to promote diversity in the ownership of broadcast facilities. It is possible these other programs, programs augmented by other changes in the laws regarding the ownership of broadcast stations, would be a better way to promote diversity.

As far as I am concerned, this is not a hearing about the wisdom of promoting diversity. It is an inquiry into whether section 1071, as currently administered by the FCC, is a sensible way of doing so.

With that, I would like to yield to my colleague, Mr. Matsui, for opening comments.

Mr. MATSUI. Thank you very much, Madam Chairman.

I do not think there is any question that the issue of diversity in broadcasting, diversity in ideas, diversity in ownership, is a laudable, important goal of the United States. After all, we are an extremely diverse country. To have a free exchange of ideas on our airwaves is obviously essential for our country to remain unified with common goals, common visions, and common ideals.

I think, also, at the same time, we have to recognize that with the limited pie available in America today, we are already talking about eliminating the Corporation for Public Broadcasting and a number of other very important programs of the Federal Government. We must look at ways of making the system more efficient.

The real issue involved here, I believe, is whether or not using first the Tax Code to try to achieve the laudable goal of diversity in broadcasting is an appropriate vehicle; second, if in fact one should say it is, then what one must ask is whether the section 1071 is a further appropriate way to achieve these goals.

I think the purpose of this hearing will, hopefully, bring that out. I might just further point out that in my discussions with both the Treasury Department, Joint Tax Committee, and FCC, we find that there is a dearth of information available as to whether this program is in fact working. I think it is extremely unfortunate, but as many of you know, back in 1987, the Appropriations Committee, beginning on the Senate side, put in a rider prohibiting the FCC, the Treasury Department, and other agencies of the Federal Government from investigating, analyzing, and determining whether or not this program is working, the amount of benefits that are out as a result of this program, and, more importantly, from making any changes or alterations in this particular program.

As the chairwoman mentioned, this section was originally devised on involuntary transfers back during the wartime period of 1943. The FCC made the decision to expand it. The latest expansions were, as the chairwoman says, in the area of personal communications devices. So this is the first—well, one of the few times that Congress will be analyzing the results of this expansion of this particular section.

Let me also make one further observation. The ostensible reason this issue has come before us today was because of the recent news reports of the Viacom-TCI-Washington transaction that was apparently completed on January 20, 3 days after the press report sent out by Chairman Bill Archer that he wanted to do an investigation of this particular matter.

It is my hope this committee, subcommittee, and the full committee and the Members of the House and Senate, and the President, will make sure that if there are any changes made in the code, it should provide the changes be applied to the transaction that called the matter to our attention.

I have tried to review with some detail this transaction. It is a shame Viacom, TCI, and Mr. Washington are not here to testify today, but, apparently, as I understand, notices have been sent notifying interested parties that they were free to appear and make their case. If they would have come, perhaps we could change our mind, but until such time, I think that we need to make sure whatever changes we make apply to this particular transaction. They are on notice. There is no constitutional issue involved, as everyone knows.

Let me just, Madam Chairwoman, mention the Viacom transaction. In 1978, Mr. Washington was working for the FCC through the Carter administration. He, among others, devised this particular change to expand the use of section 1071. He has been involved in at least four other tax certificate transactions. Apparently, he still retains ownership interest in many of them.

In this particular transaction, we understand that his investment is anywhere from $1 to $2.3 million out of a $2.3 billion transaction. The total tax benefits, as the chairwoman says, to Viacom, exceed $460 million, because the deferral will be in excess of $1 billion.

That is the issue that we must discuss, whether or not this program works, not only in this case but in other cases, and we must really determine whether this is an appropriate use of taxpayers' money for an obvious laudable goal. So I welcome the chairwoman holding these hearings and I welcome the testimony of the witnesses.

Chairman JOHNSON. Thank you. Just for the record, we did invite Viacom to come and testify. They preferred not to, and I want to submit for the record a letter from Reed Hundt of the FCC that the members will receive shortly.

[The information follows:]

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON

OFFICE OF
THE CHAIRMAN

January 26, 1995

Honorable Nancy L. Johnson
Chairman
Subcommittee on Oversight of the Committee on Ways and Means
United States Capitol
Washington, D.C. 20515

Dear Chairman Johnson:

Thank you for inviting me to participate in the Subcommittee's hearing to examine the operation and administration of Internal Revenue Code section 1071, which allows the Commission to grant tax relief with respect to the sales of broadcast and cable facilities to minority buyers. With your indulgence, I will take advantage of the offer in Mr. Mosely's letter and designate the Commission's General Counsel, William E. Kennard, to testify at the hearing. Mr. Kennard, whose written statement is attached, is familiar with the background and operation of the tax certificate program, and will of course be happy to respond to the Subcommittee's questions.

I do want to note in advance of the hearing that statutory language currently in effect forbids the Commission from spending any appropriated funds to "repeal, to retroactively apply changes in, or to continue a reexamination of [its] policies with respect to . . . tax certificates granted under 26 U.S.C. §1071, to expand minority ownership of broadcasting licenses." Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1995, Pub. L. No. 103-317, 108 Stat. 1724 (1994). Congress has reenacted that language each year since 1987, when it directed the Commission to end a reexamination of minority ownership policies that the Commission had launched in 1986, and told it instead to "apply the policies regarding . . . tax certificates that were in effect before the inquiry commenced." S.Rep. 100-182, p. 76 (1987). See Continuing Appropriations for Fiscal Year 1988, Pub. L. No. 100-202, 101 Stat. 1329 (1987). Ever since, we have had no choice but to apply the tax certificate program as it existed in 1986.

Because of this ongoing statutory constraint on the Commission's discretion in implementing the tax certificate program, the Commission has been unable to subject the program to the kind of reexamination and reassessment that all administrative programs warrant. The Commission, for example, has not had the ability to collect and evaluate facts about the program to the same extent as with other programs in its regulatory jurisdiction.

I want to assure you that the Commission looks forward to cooperating fully with the Subcommittee in responding to questions about the history and current administration of the tax certificate program. Please let me know if, after the hearing, there is any further assistance we can provide.

Sincerely,

Reed E. Hundt

Mr. McDermott. Madam Chairwoman, will you not take any other opening statements?

Chairman Johnson. I can if the subcommittee would like. We do have a long list of witnesses, but I would be happy to yield to the gentleman from Washington.

Mr. McDermott. I guess I only raise it because I keep wondering why we are zeroing in on this program. I understand there is a large deal that is about to go through or has gone through, according to Mr. Matsui, and the chairman of the committee would like to stop it from happening. But the question I have to ask is are there not some other large tax breaks being brokered even at this very moment that we are having this hearing? It seems to me we are singling out this program while there are many other tax breaks on the books that we should also take a look at.

I have in hand a short list of more than half a dozen special interest tax breaks that are far more generous than this program, and I hope that we are also going to examine those. I hope that the chairwoman will look at taxing capital gains on inherited property, which is worth $20 billion; or reforming estate and gifts taxes, which is $8 billion over the next 5 years; or curbing the excessive depreciation writeoffs, which is $25 billion over the next 5 years; or ending the tax breaks on mergers and acquisitions, which is $9 billion over the next 5 years; or ending tax breaks for runaway plants, which is $1 billion in the next 5 years; or closing gas and oil tax loopholes, which is $7.6 billion.

The question you have to ask yourself is why is this the first thing that comes up? I am waiting to hear the answer. Why this one is—is it just because it was in the paper last week? I think that we ought to get to the bottom of that.

Chairman Johnson. Are there other members who would like to make opening statements?

Mr. Herger.

Mr. Herger. Well, Madam Chair, just very quickly, I just have to ask the question, in response to the gentleman from Washington, did you hear what the Chair and the gentleman from California mentioned? This is pretty major, isn't it? We are talking hundreds of millions of dollars involving one individual. Is the gentleman from Washington questioning the fact that this should be brought up?

Mr. McDermott. No. No, I am perfectly willing to look at any tax break as long as we do not stop with this hearing on this particular one.

Mr. Herger. Well, we are early in the session.

Mr. McDermott. There are a whole lot of other places where we could pick up a whole hell of a lot more money than we are going to pick up in this one, that are more egregious and have gone on for a longer period of time. From my standpoint, when it comes up that it happens to be this kind of deal that makes the first one out of the block, to me, that raises real questions about what is happening here.

Chairman Johnson. I would like to correct for the record the gentleman's comment that this chairman would like to stop it from happening. The chairman did not say she would like to stop it from happening.

In fact, in my opening comments I said, clearly, this subcommittee has the responsibility to examine whether a policy that allows a Federal agency such a free hand to hand out tax benefits of this magnitude is in the public's interest. That is the question before us.

Second, I regret the gentleman was not at the meeting of the Oversight Subcommittee, the bipartisan meeting, at which we reviewed our agenda because some of the things he suggested he could have offered at that time. We do have a full agenda. We will certainly be looking at many things, and we will be happy to add those things to the agenda as well.

Mr. MCDERMOTT. If the Chair would yield for 1 second, I was referring to the chairman of the full committee; I was not referring to you, who wants to stop this.

Chairman JOHNSON. Well, your reference appeared to refer to me.

Mr. MCDERMOTT. I was not precise.

Chairman JOHNSON. I have no indication from the chairman that he is interested in anything more than the exploration that I have been tasked to carry out for the oversight function, which is exactly what government ought to be doing: overseeing the way the law is being implemented and that is what we are doing here today.

Mr. HANCOCK. Madam Chair.

Chairman JOHNSON. Mr. Hancock.

Mr. HANCOCK. Just a real quick statement. There is a major difference between a $400 million tax credit to one corporation, than a $400 million or $1 or $10 billion that is spread out over thousands of people. There is a major difference.

Chairman JOHNSON. Mr. Kies, would you proceed, please.

STATEMENT OF KENNETH J. KIES, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION, ACCOMPANIED BY MARY SCHMITT, DEPUTY CHIEF OF STAFF

Mr. KIES. Thank you, Madam Chairwoman.

I am accompanied today by Mary Schmitt, the Deputy Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation to this subcommittee on the Federal Communications Commission tax certificate program.

My testimony will be in four parts. First, I will provide a brief overview of the Internal Revenue Code section 1071 issues; second, I will describe the legislative background of section 1071 and the FCC tax certificate program; third, I will describe the application of the tax rules in those cases where an FCC tax certificate is granted; and, fourth, I will describe briefly some of the tax policy issues the subcommittee may wish to consider in assessing section 1071.

Under present law, a taxpayer generally is required to include in gross income the gain recognized upon the sale or disposition of a business, including a broadcast business. An exception to this general rule under section 1071 provides that a seller of certain property who receives a tax certificate from the FCC may defer the recognition of gain on the sale indefinitely by either electing to purchase replacement property within 2 years after the taxable year in which the sale occurs, or electing to reduce the basis of depreciable property held by the seller immediately after the sale. The deferred gain may be recognized upon subsequent disposition, if any, of the replacement properties.

Section 1071 was originally enacted in 1943 to facilitate the sale of properties required to be disposed of because of certain prohibitions on ownership of multiple stations within the same market. The tax certificate program has been modified and expanded a number of times.

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 to minority-owned or controlled entities. 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.

The FCC subsequently expanded its policy to include the sale of cable television in 1993. The FCC further expanded the program to apply to personal communication services. Minorities within the meaning of the FCC policy include "blacks, Hispanics, American Indians, Alaskan Natives, Asian and Pacific Islanders."

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 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.

The FCC requires those who acquire broadcast properties with the help of the FCC tax certificate policy to hold those properties for at least 1 year. An acquisition can qualify if there is a preexisting agreement to buy out the minority interest at the end of the 1-year holding period.

In 1982, the FCC further diversified or 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 a minority entity.

Some recent news reports suggest that FCC tax certificates are not fostering real minority ownership of broadcast stations. In some instances, a minority investor purports to control the buyer often through a limited partnership or other syndication, but effectively does not because of the small economic interest of the minority investor. In other instances, minority buyers are reported to have resold the broadcast properties shortly after their original sale.

The FCC tax certificate program functions as an open-ended tax expenditure with the FCC as the authorizing agency. Since 1978, the FCC has issued 378 certificates under section 1071, 317 of which relate to the sale of broadcast properties to minority-owned or controlled buyers. The staff of the Joint Committee previously estimated that the tax expenditure relating to Code section 1071 over 5 fiscal years was $500 million; however, it is in the process of reviewing this estimate in light of new information it is receiving. The Treasury Department has estimated the tax expenditure at $1.6 billion for the same period.

Code section 1071 was originally enacted in 1943, as I indicated. Congress believed that the involuntary conversion rules at the time were inadequate and expanded those rules in the case of the sales of these properties due to the fact there was a lack of availability of radio stations for replacement properties at the time.

Apart from the FCC tax certificate program, there are other programs administered by the FCC to foster minority ownership. The FCC awards comparative merit in licensing proceedings to minority applicants in the interest of promoting minority entrepreneurship.

In addition, the FCC's distressed sale policy allows broadcasting licensees, whose licenses have been designated for a revocation hearing, prior to the commencement of a hearing to sell their station to a minority-owned or controlled entity at a price substantially below fair market value. The licensee, whose license has been designated for hearing, would ordinarily be prohibited from selling, assigning, or otherwise disposing of its interest until the issues have been resolved in the licensee's favor.

On January 20, 1995, Viacom and Mitgo, wholly owned by Frank Washington, and affiliates of InterMedia Partners, announced they had signed a definitive agreement under which Viacom will sell its cable systems serving 1.1 million customers to a partnership, of which Mitgo is the general partner, for approximately $2.3 billion in cash. A subsidiary of TeleCommunications Inc. is one of the limited partners of InterMedia. Recent news reports suggest that Tele-Communications will provide "nearly all" of the money for the cable system purchase. Mr. Washington will invest approximately $1 million of his own money according to recent reports. Mr. Washington is an African-American and apparently controls Mitgo for FCC purposes, which will be the general partner for the partnership acquiring the cable systems.

The sale is subject to customary conditions, approvals of local franchise authorities, and receipt of the FCC tax certificate. Viacom has said the proceeds from the transaction, which it expects to complete in the second half of this year, will be used to repay debts.

As designed, the sale appears to meet the standards articulated by the FCC to qualify for a tax certificate under section 1071, even though the actual investment by Mr. Washington may be as little as $1 million. News reports and other publicly available information indicate that the deferred gain on the Viacom sale can be reasonably expected to be in the range of $1.1 to $1.6 billion.

The tax deferral, including State tax benefits, would be in the range of $440 to $640 million.

Under generally applicable Code provisions, the seller of a broadcast business, or any other business, recognizes gain to the extent the sale price exceeds the seller's basis in the property. Under Code section 1071, a seller receiving a tax certificate can defer recognizing the gain on the sale indefinitely by making either one or a combination of two elections.

The seller may elect to treat the sale or exchange as an "involuntary conversion." If this election is made, the taxpayer will generally avoid recognizing gain on the sale to the extent it reinvests the sale proceeds in qualifying replacement properties within 2 years from the end of the tax year in which the sale occurs.

The IRS has issued private letter rulings holding that purchasing stocks or assets from a related party can qualify as replacement properties. Thus, it appears that in certain circumstances, related taxpayers may obtain significant tax deferral without any additional cash outlay to acquire new properties after a qualifying FCC tax certificate sale. The involuntary conversion election could provide greater flexibility as to the allocation of reduced basis than the alternative election to reduce the basis of depreciable property.

Let me just briefly review some of the tax policy issues raised by section 1071 and then I would be happy to take any questions.

Based upon our review of Code section 1071, and the manner in which it is administered by the FCC and the IRS, there are a number of tax policy considerations which we have identified and which the subcommittee may wish to take into consideration in reviewing what, if any, changes should be made to this provision. They are as follows:

First, the current law provision extends broad discretionary authority to an agency of the Federal Government to administer a tax provision which is substantially open-ended. The recent expansion of the program to personal communications service licenses is evidence of its open-ended nature. We have been unable to identify any other aspect of the Internal Revenue Code, other than the provision which grants the State Department the authority to designate combat zones, which extends this kind of discretionary authority.

Second, the manner in which the FCC administers this provision does not take into account the tax cost associated with granting an FCC tax certificate. Indeed, we have been advised that the FCC does not request the information as part of its tax certificate application program. As a result, there is no effort made to balance the cost to the Federal Government in the form of lost tax revenues with the benefit which is obtained from the granting of the FCC tax certificate.

Third, there is no cap on the amount of tax benefit which accrues on a per transaction basis. This raises concerns, particularly when considering a transaction like the proposed Viacom transaction, which appears to have the ability to confer a substantial tax benefit in the range of $440 to $640 million if it were to receive an FCC tax certificate. In addition, there is no requirement that the tax benefit accrue, in whole or in part, to the minority-owned or minority-controlled purchaser. In many transactions it is possible that the minority-owned or controlled purchaser is paying full fair market value for the property acquired even though the seller may be receiving a substantial tax benefit over and above the sale price for the broadcast property.

Fourth, it appears that as a result of IRS interpretation, the sellers of property qualifying for the FCC tax certificate may be able to utilize various planning techniques that enable them to obtain a tax deferral indefinitely without reducing the basis of existing properties or being forced to acquire new properties from unrelated third parties.

Fifth, the manner in which the FCC has administered section 1071 appears to allow transitory ownership by minority parties and ownership of very small actual interests in properties qualifying for the FCC tax certificate.

Sixth, programs like this one have typically been administered through the appropriation of direct spending amounts so that the Congress can have continuing oversight over the amount of money which is being spent for a particular program. As a result, Congress may wish to substitute a direct appropriation for section 1071.

These are all issues which the subcommittee needs to consider in assessing the merits of the current law and any proposed changes. I would be happy to take any questions that you might have.

Thank you.

[The prepared statement follows:]

STATEMENT OF KENNETH J. KIES, CHIEF OF STAFF JOINT COMMITTEE ON TAXATION

Thank you Madam Chairwoman. It is my pleasure to present the testimony of the Staff of the Joint Committee on Taxation at this hearing of the Oversight Subcommittee on the Federal Communications Commission's tax certificate program. My testimony will be in four parts: first, I will provide a brief overview of Internal Revenue Code section 1071 issues; second, I will describe the legislative background of section 1071 and the FCC tax certificate program; third, I will describe the application of the tax rules in those cases where an FCC tax certificate is granted; and fourth, I will briefly describe some of the tax policy issues the Committee may wish to consider in assessing section 1071.

Overview

Under present law, a taxpayer generally is required to include in gross income the gain recognized upon the sale or disposition of a business, including a broadcast business. An exception to this general rule under Code section 1071 provides that a seller of certain property who receives a tax certificate from the FCC may defer the recognition of gain on the sale indefinitely by either (1) electing to purchase replacement property within 2 years after the taxable year in which the sale occurs or (2) electing to reduce the basis of depreciable property held by the seller immediately after the sale or acquired by the seller in the taxable year of the sale. The deferred gain may be recognized upon the subsequent disposition, if any, of the replacement property. The purchaser of a broadcast business, whether or not pursuant to a tax certificate program, acquires a basis in the business equal to the purchase price paid, which may be eligible for depreciation or amortization deductions. The tax benefit provided by Code section 1071 is the ability to defer, in some cases permanently, what would otherwise be a current tax payment to later years. A long-term or indefinite deferral can constitute the equivalent of complete tax forgiveness.

Code section 1071 was originally enacted in 1943 to facilitate the sales of properties required to be disposed of because of certain prohibitions on ownership of multiple radio stations within the same market. This tax certificate program has been modified and expanded a number of times.

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-owned or controlled entities. 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. In 1993, the FCC further expanded the program to apply to personal communication services. The FCC is in the process of auctioning 2,000 of these licenses.

"Minorities," within the meaning of the FCC's policy, include "Blacks, Hispanics, American Indians, Alaska Natives, Asians, and Pacific Islanders." 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. 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. An acquisition can qualify even if there is a pre-existing agreement (or option) to buy out the minority interest at the end of the one-year holding period, provided that the transaction is at arms-length.

In 1982, the FCC further diversified 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.[1] Since 1987, 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. This limitation has not prevented an expansion of the existing program.

Some recent news reports suggest that FCC tax certificates are not fostering "real" minority ownership of broadcast stations. In some instances, a minority investor purports to control the buyer (often through a limited partnership or other syndication) but effectively does not because of the small economic interest of the minority investor. In other instances, minority buyers are reported to have resold the broadcast property (or their interest in the property) shortly after the original sale.

The FCC tax certificate program functions as an open-ended tax expenditure with the FCC as authorizing agency. Since 1978, the FCC has issued 378 tax certificates under Code section 1071, 317 of which related to the sale of broadcast properties to minority-owned or minority-controlled buyers. The staff of the Joint Committee on Taxation previously has estimated the tax expenditure

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[1] 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 licenses necessary to operate the property is issued to the minority. In these situations, the status of the divesting investor and the purchaser of the divested interest is irrelevant, since the goal is to increase the financing opportunities available to minorities.

relating to Code section 1071 to be $500 million over the five fiscal years 1995-1999, although it is in the process of reviewing this estimate in light of new information it is receiving. The Treasury Dpartment has estimated the tax expenditure at $1.6 billion over the same period.

Legislative Background

Code section 1071 was originally enacted as part of the Revenue Act of 1943 to help the FCC implement a new policy that prohibited licensees from owning more than one radio station per market. Congress believed that the involuntary conversion rules (which generally permitted gain on sales to be excluded from taxable income if the proceeds of a sale were reinvested in property similar to the property involuntarily converted) should be applied to these transactions but needed to be liberalized for the FCC-ordered sales because, "[d]ue to wartime restrictions, the purchase of new radio property [would have been]... difficult."

The term "radio broadcasting" was expanded to include cable television in 1973. The use of FCC tax certificates was recently expanded in connection with the auction of personal communication services.

Other FCC minority ownership programs

Apart from the FCC tax certificate program, there are other programs administered by the FCC to foster minority ownership. The FCC awards comparative merit in licensing proceedings to minority applicants in the interest of promoting minority entrepreneurship. In addition, the FCC's distress sale policy allows broadcasting licensees whose licenses have been designated for revocation hearing, prior to the commencement of a hearing, to sell their station to a minority-owned or controlled entity, at a price "substantially" below its fair market value. A licensee whose license has been designated for hearing would ordinarily be prohibited from selling, assigning or otherwise disposing of its interest, until the issues have been resolved in the licensee's favor.

Viacom transaction

On January 20, 1995, Viacom Inc. (a publicly-traded company) and Mitgo Corp., a company wholly owned by Frank Washington, and affiliates of InterMedia Partners announced that they had signed a definitive agreement under which Viacom will sell its cable systems serving 1.1 million customers to a partnership, of which Mitgo is the general partner, for approximately $2.3 billion in cash. A subsidiary of TeleCommunications Inc. (a national cable television operator) is one of the limited partners of Intermedia. Recent news reports suggest that TeleCommunications Inc. will provide "nearly all" of the money for the cable system purchase. Mr. Washington will invest about $1 million of his money. Mr. Washington is an African American and apparently controls Mitgo for FCC purposes, which will be the general partner for the partnership acquiring the cable systems.

The sale is subject to customary conditions, approvals of local franchise authorities and receipt of an FCC tax certificate. Viacom said proceeds from the transaction, which is expected to be completed in the second half of 1995, will be used to repay debt.

As designed, the sale appears to meet the standards articulated by the FCC to qualify for a tax certificate pursuant to Code section 1071 even though the actual investment by Mr. Washington may be as little as $1 million. News reports and other available information indicate that the deferred gain on the Viacom sale can be reasonably expected to be in the range of $1.1 billion to $1.6 billion.

<u>Application of Tax Rules</u>

Under generally applicable Code provisions, the seller of a broadcast business, or any other business, recognizes gain to the extent the sale price (and any other consideration received) exceeds the seller's basis in the property. Under Code section 1071, a seller receiving a tax certificate from the FCC can defer recognizing gain on the sale indefinitely by making either one or a combination of two elections on its tax return for the year of the sale.

The seller may elect to treat the sale or exchange as an "involuntary conversion" under Code Section 1033. If this election is made, the taxpayer will generally avoid recognizing gain on the sale to the extent that it reinvests the sale proceeds in qualifying replacement property within two years from the end of the tax year in which the sale occurs. If the taxpayer sells assets rather than stock, it may be required to recapture depreciation under certain circumstances.

Qualifying replacement property, within the meaning of this section of the Code, includes the following:

(1) <u>Stock</u> of corporations operating "radio broadcasting stations" (a term that the Internal Revenue Service ("IRS") interprets as including television stations and cable television stations). The seller may purchase any number of shares of a broadcast corporation, including a publicly-traded company (and may invest in more than one broadcast company).

(2) <u>Assets</u> "similar or related in service or use" to the property sold.

Under the "involuntary conversion" election and the general involuntary conversion rules, the taxpayer's basis in the acquired replacement property will generally be the "carryover" basis of the property that was sold, rather than a fair market value basis reflecting the full reinvested proceeds. If the replacement property is stock of a corporation conducting a qualifying business, the carryover basis would apply to the stock but generally would not change the basis of assets inside the corporation. Depending on the basis and remaining depreciable lives of the assets inside the corporation, this might result in significant deferral of any tax detriment resulting from the carryover basis, as long as the stock is not sold.

The IRS has issued private letter rulings holding that the purchase of stock or assets from a related party can qualify as a replacement purchase. Thus, it appears that in certain circumstances related taxpayers may obtain significant tax deferral without any additional cash outlay to acquire new properties after a qualifying FCC tax certificate sale. The involuntary conversion election could provide greater flexibility as to the allocation of reduced basis than the alternative election to reduce basis of depreciable property.

If the seller chooses not to purchase "replacement property" or would otherwise recognize gain (because it reinvested only a portion of its cash proceeds in qualifying replacement property), Code section 1071 allows the seller to elect not to recognize the gain to the extent it is applied to reduce the basis of depreciable property (within the meaning of Code section 167) that is either held by the seller immediately after the sale or acquired by the seller in the taxable year of the sale. Eligible property includes most tangible property (not just broadcast property), but does not usually include items such as inventories, stock in trade, and securities. Eligible property also includes goodwill and other intangible property that is depreciable under Code section 197 (which generally applies to intangible property acquired after August 10, 1993). A seller that elects to reduce its basis in depreciable property must reduce its basis in all of its depreciable property by reference to a regulatory formula--it cannot allocate the reduction disproportionately unless authorized by the IRS to do so.

Issues Raised by Code Section 1071

Based upon our review of Code 1071, and the manner in which it is administered by the FCC and the Internal Revenue Service, there are a number of tax policy considerations which we have identified and which the Committee may wish to take into consideration in reviewing what, if any, changes should be made to this provision. These considerations are as follows:

- First, the current law provision extends broad discretionary authority to an agency of the Federal government to administer a tax provision which is substantially open-ended. The recent expansion of the program to personal communication service licenses is evidence of its open-ended nature. We have been unable to identify any other aspects of the Internal Revenue Code, other than the provision which grants the State Department the authority to designate combat zones, which extends this kind of discretionary authority.
- Second, the manner in which the FCC administers this provision does not take into account the tax cost associated with the granting of an FCC tax certificate. Indeed, we have been advised that the FCC does not request this information as part of its tax certificate application program. As a result, there is no effort made to balance the cost to the Federal government with the benefit which is obtained from the granting of an FCC tax certificate.
- Third, there is no cap on the amount of tax benefit which accrues on a per transaction basis. This raises concerns, particularly when considering a transaction like the proposed Viacom transaction, which appears to have the ability to confer a substantial tax benefit in the range of $440 million to $640 million if it were to receive an FCC tax certificate. In addition, there is no requirement that the tax benefit accrue, in whole or in part, to the minority-owned or controlled purchaser. In many transactions it is possible that the minority-owned or

controlled purchaser is paying full fair market value for the property acquired even though the seller may be receiving a substantial tax benefit over and above the sale price for the broadcast property.

- Fourth it appears that as a result of IRS interpretation, the sellers of property qualifying for the FCC tax certificate can utilize various planning techniques that enable them to obtain a tax deferral indefinitely without reducing the basis of existing properties or being forced to acquire new properties with a reduced basis.
- Fifth, the manner in which the FCC has administered Code section 1071 appears to allow transitory ownership by minority parties and ownership of very small actual interests in properties qualifying for the FCC tax certificate.
- Sixth, programs like this one have typically been administered through the appropriation of direct spending amounts so that Congress can have continuing oversight over the amount of money which is being spent for the particular program. As a result, Congress may wish to substitute a direct appropriation program for Code section 1071.

These are all issues which the Committee needs to consider assessing the merits of current law and any changes that may be necessary. I will be happy to take questions.

Chairman JOHNSON. Thank you, Mr. Kies.

In regard to the Viacom transaction, to what extent has the purchase price to the purchaser been reduced to reflect a tax benefit which Viacom will enjoy if it receives an FCC tax certificate?

Mr. KIES. Well, it is difficult to know exactly because we do not have all the details on the transaction. However, in discussions with experts in the cable industry, we have been advised that typically the fair market value of cable properties is determined as a multiple of cash-flow.

In the case of Viacom, based on SEC documents, it appears that the cash-flow—net cash-flow from the cable properties—is in the neighborhood of $110 to $150 million per year. At 10 times cash-flow on the upper end, that would suggest a fair market value of $1.5 billion. The cash purchase price here is $2.3 billion. That would tend to suggest that Viacom is receiving at or above fair market value without regard to the tax benefits.

If that is the case, then it would not appear that the tax benefit is in any way benefiting the minority-controlled purchaser, just based on that analysis.

Chairman JOHNSON. So normally the sale price is 10 times cash-flow, roughly? In this case it is 15 to 20 times cash-flow?

Mr. KIES. It is in that neighborhood in this particular transaction.

Chairman JOHNSON. So there does not appear to be any benefit to the purchaser of the tax certificate?

Mr. KIES. Based on that analysis, no.

Chairman JOHNSON. Second, under section 1071, the seller is required to reinvest the proceeds of gain which are not subject to tax within a 2-year period or to reduce basis in existing properties. For those taxpayers who elect to reinvest the proceeds in existing properties, are they forced to reduce basis in those assets and, thus, give up some of the benefit of those assets?

In other words, since they got a great big benefit through the FCC certificate and are required to reinvest it, are they then required to give up some other benefit that they already have as they do that reinvestment process?

Mr. KIES. That is the general rule, although, as I alluded to in my testimony regarding the replacement property requirement, the IRS has ruled that a taxpayer can purchase the replacement property from a related party. As a consequence, it is possible, and it appears that because there have been a number of IRS rulings issued regarding this issue, that an entity would purchase replacement property from within its own consolidated group. If that were the case, for example, if a taxpayer purchased stock in a subsidiary, there might not be a reduction in basis of the assets subject to depreciation.

I might just say, though, even if there is a reduction in basis of assets, there is still a substantial tax benefit because the reduction in basis of assets causes a loss of depreciation that takes place over a long period of time, whereas the tax deferral occurs all in the first year. So there is still substantial benefit to the seller even if there is a reduction of basis.

Chairman JOHNSON. Thank you, Mr. Kies.

We have a large and inquisitive subcommittee, so I am going to defer the rest of my questions and we will go through the membership once. We will use the timeclock and then if there are further questions, since this is such an important matter, we will try briefly with a second round of questions.

Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

Mr. Kies, you indicated in your brief or your report that the total tax loss over the next 5 years could be up to $500 million. The Treasury Department has said that the total tax loss could be in excess of $1.6 billion over the next 5 years. I notice that in your addendum you mention that there may be further information that might result in a higher number.

Can you tell me whether you have reestimated this; and second, what that number is if you have reestimated this?

Mr. KIES. Mr. Matsui, we have not reestimated it yet. I can describe some of the additional information that is coming to our attention.

Mr. MATSUI. Let us do this. Perhaps you can get for the subcommittee and the full committee, after you have done your analysis quickly, I hope, what your view of the total tax loss will be to the Federal Treasury over the 5-year period with the additional information you have received.

Mr. KIES. We will be doing that.

Mr. MATSUI. Because we will need that obviously for whatever changes, if we make any in order.

[The following was subsequently received:]

#95-1 090
30-Mar-95

ESTIMATE OF FEDERAL TAX EXPENDITURE FOR INTERNAL REVENUE CODE SECTION 1071

Fiscal Years 1996 - 2000

[Billions of Dollars]

Provision	1996	1997	1998	1999	2000	1996-00
1. Deferral of gains from sales of broadcasting facilities to minority-owned businesses	0.2	0.4	0.4	0.4	0.4	1.8
NET TOTALS	**0.2**	**0.4**	**0.4**	**0.4**	**0.4**	**1.8**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Mr. MATSUI. Mr. Washington invested, according to news reports, anywhere up to $1 to $2.3 million. I understand maybe the $1.3 additional million is his obligation, his debt obligation, although no one really seems to have that information.

The total transaction is $2.3 billion. Now, Mr. Washington has in excess of a 20-percent interest; that qualifies him as a minority participant.

What are the rules—in other words, can somebody invest $10 or $20, and as long as his partnership interest is in excess of 20 percent, he will then be able to qualify? Is this an equity interest? In other words, will he have $400 million gain out of this with the $1 million investment? How does this work?

Mr. KIES. The reason you can have a relatively small investment but still have what qualifies as a 20-percent equity interest in the partnership is that the other investors who have put in the $2.3 billion probably are receiving what is referred to as a guaranteed payment or a guaranteed return. So they stand ahead of the profits interest. The 20-percent interest represents an interest in profits after the return to the $2.3 billion contribution by the investors.

Mr. MATSUI. So it is not an equity interest he acquires with this $1 or $2.3 million investment?

Mr. KIES. It is not an equity interest in the sense that you would normally think of 20 percent of the $2.3 billion. I think it is a safe bet that the people putting in the $2.3 billion are not going to let $400 million go out for the $1 million investment.

The answer to the first part of your question, whether or not you can put $10 in. We believe that an investor could put in what is referred to as sweat equity, which is his or her intention to work on the property and receive back a 20-percent equity interest under those circumstances.

Mr. MATSUI. I would find that much more palatable, if in fact he did not own four other businesses, two of which were with Jack Kent Cook. I understand Jack Kent Cook cannot be one of the easier persons to work with. So it would be my opinion that in fact he put in a lot of sweat equity. I don't know how he could manage to do it.

One last question, and I know other members have questions.

Could you tell me of the 317 such transactions with minority participants, the lengths of time in which the minority participants held on to the contract? You said under the 1071 rules they must exceed at least 12 months. Do we have any information on that? Do we have any information as to whether these 317 purchases resulted in a diverse set of ideas or diverse set of programming?

Is there any information that would show us what the result of all this effort has been in terms of achieving our goals of diversity, of minority participants and, second, in achieving our goals of diverse programming? I ask that because I am assuming that Mr. Washington—of the 317, 4 are his, so it is one ownership. So we cannot really tell if there are 317 new minority contractors out there. There may be a number, but there could be much less than that if there are a lot of transactions that one or two people have.

Mr. KIES. The information is a little bit spotty. There is a variety of witnesses who are going to testify about some of that, some of whom will tell you they own 100 percent of these properties and have owned them for a long period of time.

Mr. MATSUI. That is what we really want out of this, but some of the information provides otherwise, but go ahead.

Mr. KIES. Some clearly have not been held or they have been held for a transitory period. In terms of the effect of the program, the one statistic we do have is since 1978 when the program was put into effect, the minority-owned or controlled properties increased from, I think it was 0.5 to 2.9 percent. It is not possible to determine to what extent this program is responsible for that because the FCC does have other programs that play a role.

I think some of the witnesses will, and some of the scholarly pieces that have been written on this program suggest some skepticism as to how much it has impacted programming.

Mr. MATSUI. If I may just ask one further followup to that question, then. As far as these contractors are concerned, you do not have that information now. Is that because of the appropriation rider which prohibits any analysis or any reexamination of this program?

Mr. KIES. We have asked the FCC for information on the 317 deals that have been done. We have received some of it. Some of it is archived. In some cases, information from the IRS has been destroyed under their record disposition program. So we are in the process of trying to learn more about some of the things you have talked about. We had a limited amount of time to get ready.

Mr. MATSUI. Because you are not under this prohibition, it is the FCC, Treasury, and IRS.

Mr. KIES. That is correct.

Mr. MATSUI. So whatever information they provide you as raw data, it cannot be through a study or investigation?

Mr. KIES. That is correct.

Mr. MATSUI. Thank you.

Chairman JOHNSON. Thank you.

Mr. Herger.

Mr. HERGER. Thank you, Madam Chair.

Thank you very much for your testimony, Mr. Kies.

Let me see if I understand this: the policy was originally set up to help minorities become at least minority owners or owners within these types of enterprises. Let me see if I understand this particular case. Is it right, as far as the cost benefit, that the taxpayers are paying $400-plus million in this situation for a minority to own an interest for perhaps 1 year or less?

Mr. KIES. Well, in the case of the Viacom transaction, we do not know how long Mr. Washington plans to stay in the transaction. But we do know from a variety of reports that the amount of his investment is relatively small.

I want to clarify one thing. Our analysis of the total tax costs between $440 and $640 million also takes into account that States generally piggyback the Federal tax system for purposes of determining State tax liability. We have assumed an average State tax rate of 5 percent. So there is a State tax revenue loss in addition to the Federal revenue loss and that leads to the analysis of $440 to $640 million.

Mr. HERGER. These numbers are so large, it is hard to believe what we are hearing. In this one individual, to bring one individual and a minority member, we are talking about between State, and you mentioned this does have ramifications as far as State governments, who piggyback, but we are talking about taxpayers somewhere are having to make up for the $600 million for as little as 1 year of ownership in this one minority; is that correct?

Mr. KIES. That is basically correct. It is a substantial amount.

Mr. HERGER. I cannot believe anyone ever set up this program to work like this, and, Madam Chair, whether it was you or the chairman of the committee, I want to thank you for bringing this to our attention and having a hearing on this. If this situation can happen here, it undoubtedly can happen in other situations, and we certainly have to make a change and I thank you.

Chairman JOHNSON. Thank you. Mr. Hancock.

Mr. HANCOCK. Thank you, Madam Chairwoman.

In your testimony you mention that since 1978 the FCC has issued 378 tax certificates under this Code section; and then on the appendix table one, you show the numbers here.

Can we get further documentation of these various transactions? In other words, the total amounts of money of tax certificates that have been issued, how many times names are duplicated? Is it potentially a little select group of people that are familiar with this that have been using it over and over? Do we have that information? Can we get it documented?

Mr. KIES. Mr. Hancock, we have some information because we did get from the FCC copies of a number of the certificates that have been issued. But those tend to be relatively short, a two-page letter that says this transaction qualifies and it typically does not include the purchase price or any financial information.

We are in the process of asking the FCC for additional information so that we can do a little better analysis in terms of the dollar volume of the transactions and whether or not, for example, there have been multiple transfers of the same properties in these types of transactions.

So we are in the process of trying to gather that information right now.

Mr. HANCOCK. How long have you been trying to get this information?

Mr. KIES. We have been working on this for about 2 weeks now, and we have met with the FCC and they have been trying to pull it together. I think it is a fairly large amount of documentation that needs to be delivered to us.

Mr. HANCOCK. OK. Well, thank you very much. I will ask the same questions of the next panel.

Thank you.

Chairman JOHNSON. Thank you. Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman.

Ken, there are several things that concern me about section 1071. You have brought out the economics. But let me talk about the tax policy being controlled by an independent agency rather than by the Treasury or Congress or the Internal Revenue Service.

Is it your testimony that you can only find one other similar provision to this, which is the State Department declaring a war zone? That is the only other comparable provision?

Mr. KIES. That is the only provision we found where there is a giving away of substantial discretion to actually implement a tax provision. The States have some role, for example, in administering low-income housing credits, but the terms under which you can issue low-income housing credits are fairly defined in the code. So they are just administering the code.

The difference with 1071 is that the words of 1071 literally say that the FCC can implement any current or future policy that it adopts through the issuance of tax certificates, and that degree of discretion does not exist anywhere else that we are aware of.

Mr. CARDIN. During the 50-year history of this section, has there been any evidence of Treasury being directly involved with FCC in setting up how these certificates should be issued?

Mr. KIES. I think the Treasury representatives are going to testify later. I think they will tell you that basically they pretty much accept whatever the FCC issues as conferring the tax benefit because of the open-ended nature of the statutory provision. So I do not think there has been much in the way of Treasury or IRS involvement.

The only extent to which they have been involved, and I think it has been in conjunction with the FCC, is when the provision has been expanded. It originally applied to radio properties and then was expanded to television and cable and now to these personal communications services. But other than that, I think Treasury's involvement has been relatively modest.

Mr. CARDIN. There are other provisions in the Internal Revenue Code that deal with forced transactions and deal with minority preferences, and in those cases, if I understand correctly those provisions, there are Treasury regulations and IRS administrations who carry out certain policies. Are you aware of any effort made on this section of the code to adopt or to work with Treasury or IRS to see if there is some consistency in policy?

Mr. KIES. I am not aware. Again, the Treasury and FCC representatives are probably in a much better position to respond to that, but at least the information we have gathered to date indicates that Treasury and IRS have had a relatively hands-off involvement.

Mr. CARDIN. So that if the FCC issues the certificate, it is fairly well accepted? It is never challenged by Treasury and the taxpayer gets the break and there is no ability of Treasury to use their normal enforcement mechanisms to see whether the goals or regulations are being complied with?

Mr. KIES. That is correct.

Mr. CARDIN. Now, let me just see if I understand how the tax provisions work. The seller gets the tax certificate and can, therefore, defer the tax or avoid the tax by reinvesting the proceeds in other entities. If the taxpayer chooses that course, then there is no reduction in the basis. We get a stepped-up basis on the properties. The buyers would get the stepped-up basis?

Mr. KIES. Let me explain that and just take a quick simple example.

If I have a property that has a tax basis of $10 million and I sell it for $50 million, the buyer gets the stepped-up basis to $50 million. Under current law—intangibles legislation, which was enacted a couple of years ago—that taxpayer would be amortizing most of that basis over a 15-year period.

The seller has a deferred $40 million gain. If the seller chooses the route of buying replacement property, the seller, when it buys that replacement property, gets a basis of only $10 million in the replacement property. However, as I pointed out in my testimony, it is possible that you can buy within your own consolidated group. If you were to buy stock within your own consolidated group, it is possible that the basis reduction would only affect the stock basis and not the inside basis of the assets that would still be depreciated in their regular course.

But if you go outside and buy a replacement property from an unrelated third party, you only get a basis of $10 million. So you get a lower basis for depreciation.

Mr. CARDIN. But the buyer would get the full basis; the stepped-up basis?

Mr. KIES. The buyer gets the stepped-up basis; correct.

Mr. CARDIN. In this case it would be based upon the 2.3—in the Viacom deal it would be based upon the $2.3 billion price?

Mr. KIES. That is correct.

Mr. CARDIN. Then if the neutral cost recovery were to go into effect, it could take advantage of the neutral cost recovery on $2.3 billion. I am just trying to figure out another reason to be opposed to the neutral cost recovery.

Mr. KIES. No comment.

Chairman JOHNSON. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Madam Chair.

I think we would all agree that the intent of the minority tax certificate program from a policy standpoint is a worthy one. Certainly, we all want to increase minority influence in broadcasting, but I also think that it would be specious to argue if the minority involved in the program has no direct management of the purchased property, that that worthwhile policy objective is not attained.

My question is this, Mr. Kies: What constitutes an acceptable level of minority ownership to qualify for the tax certificate program?

Mr. KIES. Well, in the case of an entity that is a corporate entity, it requires that the minority own 50 percent or greater interest in the corporation. But in a partnership structure, which is the nature of the Viacom transaction, the only requirement is that the minority general partner own a 20-percent or greater profits interest in the partnership.

Because partnerships have a fair degree of flexibility in terms of structure, in this particular transaction it is possible to give Mr. Washington a 20-, 21-percent profits interest. But, as I said to the chairwoman, that does not mean he is receiving a 20-percent interest in $2.3 billion; rather, the $2.3 billion is probably structured as representing an interest that stands ahead of the profits interest.

Now, let me just say that we have not reviewed the transaction documents in this transaction. So we are making some judgment about how we believe the deal is structured based on what we have seen in the published news reports and the press release which Viacom issued.

Mr. RAMSTAD. But is the contention that a $1 million investment in a $2.3 billion transaction meets this threshold?

Mr. KIES. Apparently the FCC standard is that as long as the general partner owns a 20-percent or greater profits interest or equity interest in the partnership, then that satisfies their requirement. I believe they will tell you that the reason they take that position is because, under those circumstances, the general partner, they believe, is in control of the entity and can control broadcast or programming decisions and things of that nature, and that is the basis for their policy.

Mr. RAMSTAD. I thank you for that clarification.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you.

Mr. Zimmer will inquire.

Mr. ZIMMER. Thank you, Madam Chairman.

I would like to follow up on that line of inquiry. Mr. Ramstad has been inquiring as to the degree of ownership involved. But ownership, especially ownership where the profit is subordinated to senior debt and preferred stock, does not necessarily translate into control.

Does the FCC have a working definition of what actual control is above and beyond a mere ownership interest?

Mr. KIES. Well, their definition, and you may want to ask them about this with more specifics, but as we understand it, their definition is that control exists for purposes of section 1071 in those circumstances when a minority general partner has a 20-percent or greater interest in the partnership, because the minority is the general partner and general partner status confers the ability to control the decisionmaking of the business entity itself.

Mr. ZIMMER. That is a pretty legalistic definition. From my experience in the corporate world, control follows the golden rule, he who has the gold, rules. The FCC does not take into account the fact that here you have a multibillion dollar transaction where only $1 million of equity is being put up by a so-called control person. That is not taken into account, as far as you know?

Mr. KIES. As we understand it, they follow basically a mechanical rule rather than what I think you would refer to as more of a subjective rule. But that is the basis on which they administer this particular program.

Mr. ZIMMER. Here is a question you may not be able to answer, but could you give me your best estimate of how much of the financial benefit that is created by this tax certificate is going to Mr. Washington and how much of it is going to Viacom?

Mr. KIES. Well, our analysis, because it appears that Viacom is receiving a purchase price that is at or above fair market value, would lead to the conclusion that none of the tax benefit is going to Mr. Washington and all of it is going to Viacom.

There is testimony you are going to receive later this morning from one of the witnesses that has done some of these programs, and in his testimony he says that in these transactions none of the tax benefit goes to the minority purchaser and it all goes to the seller. I don't know if that is reflective of all the transactions, but at least that is the testimony of one of the witnesses you are going to hear.

In looking at this particular deal, it appears to us that the tax benefit is going to Viacom and not to the minority purchaser.

Mr. ZIMMER. I would point out that testimony to Mr. McDermott as a reason why maybe we should be investigating this tax provision.

It seems to me this is, in theory, trickle-down economics but it is not even that in practice because nothing is trickling down. I would like to commend the chairwoman for starting off our hearings in the very first month of the new Congress by looking at what has been called by the administration, corporate welfare.

I know that the Secretary of Labor and I know that the Democratic Leadership Council have expressed a great interest in this subject. I hope this is not the last issue that we investigate along these lines. I hope some of the loopholes that we investigate will be those that spark the interest of Mr. McDermott and the concern of Mr. McDermott, as well.

Thank you very much.

Chairman JOHNSON. Thank you. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Madam Chairman.

I find myself here trying to defend an entrepreneur. That is a little strange for me politically, but it seems like we ought to ask some questions.

One of the fascinating things, Mr. Kies—I know that you work for us, and so I know that what you have done is at the direction of somebody. It is amazing you can come up with this great big annotated study of all of the things—even with footnotes. I mean there are hundreds of footnotes in here about all these things, and have meetings with FCC and everything else, but you have no tax and revenue estimates on the Contract With America.

It seems like sort of an imbalance in your workload. I really feel sorry for you that they have spent your 2 weeks wasting your time on this issue when you should have been working on the Contract.

But I would like to ask a question, and that is this: In Chairman Archer's press release he said any changes—and this is a quote—"any changes in section 1071 may apply to transactions completed or certificates issued by the FCC on or after today, January 17, 1995."

Now, to what extent is that effective date retroactive?

Mr. KIES. Well, I would say retroactivity sometimes is in the eye of the beholder.

Mr. MCDERMOTT. I understand that, that is why I am asking the question. I want to know what I should see.

Mr. KIES. I would not purport to tell you what you should see, but I think that the effort or my guess is the intent of Mr. Archer was to try to put people on notice that if there is going to be action, it will apply to these transactions.

So I think it was an effort to avoid the situation that is deemed repugnant about retroactivity, and that is if people go forward in reliance on current law without being aware that there is a potential change of law that could change their result. In the case of the Viacom transaction, and, again, we have not reviewed the documents, but according to the press release, they themselves apparently recognize that the Archer press release has some significance because they have conditioned actually being able to close the deal on the ability to get the FCC certificate.

So I gather Mr. Archer was trying to fairly put people on notice that any action in this area could affect a transaction after that date.

Mr. McDERMOTT. So would it be your judgment, then, that this is not retroactive at all? It just starts on January 17, anything from this point on? Nobody else has a deal out there that should be worried?

Mr. KIES. Well, it would be, I think, our judgment from a tax policy perspective that for transactions that had not even been signed prior to January 17 clearly, to the extent they are impacted, this would not represent retroactivity because they are on notice.

Mr. McDERMOTT. I understand future and past, what I want to understand is when does the past begin. If they did a deal in December, would that—this would not hit them?

Mr. KIES. Well, no, it could, because if the deal was signed in December, according to—if the terminology of the press release were applied, there could be a transaction that was signed in December but the application for the FCC certificate might be pending, and not have been granted yet. So under the pure reading of that language, that transaction could be affected.

I think one of the decisions the subcommittee will have to make if they decide to enact this area is whether or not that situation would merit some kind of transition rule.

Mr. McDERMOTT. Are you aware of any other tax certificates which are pending?

Mr. KIES. We have not—let me put it this way. We have been kind of busy on this and the Contract With America, so——

Mr. McDERMOTT. I am glad to hear that.

Mr. KIES. So I have been getting a lot of phone calls I have not been able to return. Some of them may be from people who have transactions that are pending, and I have a feeling we will learn about those pretty quickly.

But we have not been able to compile a list. The FCC might be able to tell us how many FCC applications are pending for current deals. That is not information we have right now.

Mr. McDERMOTT. I want to understand this issue. What is it about the Viacom deal that makes this one so important or so flagrant? Has there never been a deal like this before? Are we looking at the first time that somebody got in for a little bit of money?

Mr. KIES. Well, again, we have a limited amount of information about other transactions just because we are in the gathering stage. But it has been reported—I think, as a matter of fact, Mr. Matsui alluded to another transaction Mr. Washington was in with Jack Kent Cook that I believe the press reports was a $600 million deal.

This is an issue that the subcommittee, the Select Revenue Measures Subcommittee actually took testimony on, I believe in 1993. It is an issue that has been written about in Fortune Magazine and other places, a number of times in the past couple of years. So it is not—it is not the first time anybody has raised the question of section 1071. This transaction, I believe, is larger than any other that has ever come through the FCC, although again, they would be better to ask about that.

But I think what has attracted a lot of attention to this transaction is its size and the fact that the minority investor does appear to have a relatively modest investment relative to the size of the transaction.

Mr. MCDERMOTT. I hope that in the testimony that we hear from other people, we will hear the answers to those questions, since I would grant you, you have had a few things to do since the first of the year and may not have all the data that is necessary on this.

It always seems to me that fairness is the issue. If you are going to do it to one person, you should do it to everybody. If you are going to do it here, in this place, you should do it in that place. You should not be picking and choosing.

I would like to know whether this is here because it is the worst deal that has ever been concocted with a Federal bureaucrat and some entrepreneur or is it just one of a whole series of things? As I pointed out before, there are all kinds of tax giveaways in this Tax Code of ours. This is not the only place where we have some egregious deals. We have oil and gas things that are totally unrelated to cost. The oil depletion allowance is a figment.

So I really—I want to know why this one is the one that triggers this great interest in roaring through here with something.

Thank you, Madam Chairwoman.

Chairman JOHNSON. Mr. Johnson will inquire.

Mr. JOHNSON of Texas. Thank you, Madam Chairman. I think in answer to your question, you might say that we have been trying to change some of these rules for some period of time and have not had the opportunity to do it and are doing it now.

I have two cases here in front of me which you may be aware of. One happened in Dallas, Tex., and the other in Washington with Jack Kent Cook which were deals where a minority put up some $30,000 for a deal over $600 million and got a certificate, because they, "gave him 51 percent." My question is, I guess, how many of these involve big companies? These two deals, the one in Dallas and here were Times Mirror. That is a pretty large company to be getting tax exemptions. It is not the minority that is benefiting, it is the big company that is benefiting.

If, in turn, the minority has 200,000 shares of stock that he can sell to a majority stockholder who is not a minority, does that tax exemption reduce the cost of the stock that he is selling, and then is it tax free? Is that money tax free from that point forward?

Mr. KIES. Mr. Johnson, are you asking whether the minority investor, if he sells his stock subsequently, whether that is tax free?

Mr. JOHNSON of Texas. Yes.

Mr. KIES. That transaction——

Mr. JOHNSON of Texas. You made a statement earlier that if the stock were, in fact, sold, the price would be reduced or could be reduced by the amount of the tax exemption.

Does that mean that if that happens, that the stock is sold at a lesser price, let's say; that that tax exemption then is wiped off the books?

Mr. KIES. If on January 1 a seller, like a Viacom, were to sell to this new entity and then have this deferred gain of let's say $1 billion, and it went and bought stock and got a lower basis and then were to sell that stock at its fair market value, that gain would be taxed, unless that was another transaction in which a 1071 certificate might be granted.

Mr. JOHNSON of Texas. But the original tax exemption is never recovered if that is applied to the stock sale and the price is reduced; is that true?

Mr. KIES. If the reinvestment of proceeds is in stock, the acquirer, like Viacom, will get a lower basis because of the rules that apply to the purchase of replacement property.

Mr. JOHNSON of Texas. Rightly.

Mr. KIES. So that when and if Viacom were to sell that stock interest, it would pay the tax, unless it was in another 1071 transaction. But it is likely——

Mr. JOHNSON of Texas. Or if there were no capital gains involved.

Mr. KIES. If the purchase price were so low that it was less than the basis. In most cases, people probably are not going to go out and sell the replacement property any time soon because they would have to pay the tax. But if they did, they would pay the tax at that point in time.

Mr. JOHNSON of Texas. OK. Are you aware of these two cases I mentioned?

Mr. KIES. I think the one you alluded to is the Jack Kent Cook.

Mr. JOHNSON of Texas. One of them is.

Mr. KIES. That I am aware of. I am not aware of the other.

Mr. JOHNSON of Texas. Well, there were two I think in Washington. But, nonetheless, it seems to me that we are talking about 40 and 60 million dollars' worth of taxes that were forgiven in those deals, and I know it is not as big as the one we are talking about now, but do you think that we should recover those dollars for the Federal Government as long as that tax is on the books and/or what is your opinion of the FCC having the sole authority to regulate that tax?

Mr. KIES. Well, as we said in our testimony, the discretion that is given to the FCC by the Internal Revenue Code appears to be fairly unique. I think from the standpoint of tax writing committees, that historically the tax writing committees have not been willing to give away the kind of discretion that is in this provision.

Mr. JOHNSON of Texas. Is that the only agency in the government that has that power?

Mr. KIES. It is the only one we are aware of other than the case where the State Department has the ability to designate combat zones, which only provides a benefit that allows military personnel that are stationed there to file their tax returns late. So that is relatively insignificant. But we are not aware of any other place where the code grants that kind of discretionary authority.

Mr. JOHNSON of Texas. Thank you. Thank you, Madam Chair.

Chairman JOHNSON. Thank you, Mr. Johnson, and thank you, Mr. Kies. Unless there are further questions.

Mr. HERGER. Madam Chair.

Chairman JOHNSON. Mr. Herger.

Mr. HERGER. Mr. Kies, just one further question. Putting this all in perspective, we are saying the only two examples that you know of in the Federal Government, one is where we have servicemen and women who are perhaps risking their lives in a combat zone, they can file their taxes a little bit later; and this situation where we see individuals, or at least the taxpayers losing out in this one case maybe as much as $600 million collectively, between State and Federal Government.

Also, it would appear that the major winners here are not really the minority, although it would sound like Mr. Washington is doing quite well, but it would really be the stockholders, who I am sure the vast majority are not minorities in these companies who are benefiting from all these hundreds of millions of dollars directly or indirectly; is that correct?

Mr. KIES. To the extent that the tax benefit is staying with the seller rather than the minority-controlled buyer, that is certainly correct.

I just might add one thing, and that is that this particular provision, when it was enacted in 1943 and all the way up to 1978, was really targeted at one very narrow problem and that was the situation where an owner had two broadcast properties in the same market that were competing against one another, and it was the FCC policy not to have that situation.

So from 1943 to 1978, it was administered in a fairly narrow fashion, although it was expanded to cable television and television properties. But at least up to that point, the discretion was not exercised to the extent it has been since 1978.

Mr. HERGER. One last quick question. It sounds like, at least under what we are allowing FCC to do right now, quite a good deal if you can get involved. I am curious, what is the FCC's criteria that they have established for a minority identity? How do we determine who qualifies for this?

Mr. KIES. Under the policy as adopted, a minority is defined as—I think I had it in my testimony—African-Americans, Asian-Americans, I believe Alaskan Indians, Asians—I may have left out one—and Hispanic Americans, thank you—they have also, in another expansion of the program, extended it to women, to some extent, as it relates to these personal communications systems. So there has been a little bit of an expansion there. I believe, not the tax certificate program but some other benefits are extended to rural telephone systems and small business.

But I do not think that is the tax certificate program. I think that is the rulings under which they are selling off these personal communications systems. They would be much better informed about that than I am.

Mr. HERGER. I just caught part of this, and maybe it is not pertinent, but in our bipartisan briefing yesterday afternoon you were mentioning something about an individual of Italian descent. Does that have anything to do with this?

Mr. KIES. There is a transaction that is reported in Forbes Magazine that indicates that the sale of a broadcast property from Storer Communications to—according to the article—the Liberman family qualified for a certificate because the Liberman family was able to demonstrate that their descendants had been driven out of Spain in 1492 by Ferdinand and Isabella.

Now, I believe the FCC, because we did ask the FCC about this particular transaction, will tell us that that particular family is very visible in the Hispanic community. So unlike what the Forbes Magazine article implies, the only basis under which they got it was an event in 1492. I think the FCC, because we did ask them about it, has told us that part of their decision as to whether or not those purchasers qualified as a minority was affected by the role that they do play in the Hispanic community. Again, you may want to ask them about that because they are much more familiar with the specific facts of that transaction than we are.

Mr. HERGER. This seems to become more and more bizarre the more we get into it.

Thank you very much. I have no further questions.

Chairman JOHNSON. Thank you very much for your testimony, Mr. Kies. We would like now to hear from William Kennard, general counsel for the FCC, and Glen Kohl, the tax legislative counsel for the Department of Treasury.

We welcome you. We are interested in what you have to say about the really unique and remarkable latitude that the FCC has under these provisions and particularly with regard to the billions of dollars of public tax money at stake.

Mr. Kennard, why don't you proceed.

STATEMENT OF WILLIAM E. KENNARD, GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION

Mr. KENNARD. Thank you very much, Madam Chair.

Thank you, and thank you members of the subcommittee for the opportunity to explain today the history and administration of the FCC's tax certificate policies.

Section 1071 of the IRS 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 FCC to be "necessary or appropriate to effectuate a change in policy of, or the adoption of a new policy by, the Commission."

We have heard a lot about the history of section 1071 from Mr. Kies, so I will not review the legislative history in detail. But I would like to clarify one statement made by Mr. Kies with respect to the use of tax certificates in the personal communications service, which is a fairly exciting new service that the FCC has authorized, and, in fact, as we speak today, we are auctioning off spectrum for that service.

The FCC was mandated by Congress to consider extending tax certificates to PCS to advance ownership by women and minorities. So I did want to clarify that was at the request of Congress and not something the FCC did on its own.

I would also like to provide a little history of the tax certificate policy as it has been used to promote minority ownership in broadcasting and cable. Promoting minority ownership has been a longstanding goal of both the FCC and the Congress. The Commission, the courts, and the industry began focusing in the late 1970s on the severe underrepresentation of minorities in the broadcasting industry. There was a feeling that this dearth of representation did not promote diversity over the public airwaves. So in 1978, the FCC, at the request of the National Association of Broadcasters, adopted a policy statement which, for the first time, extended the use of tax certificates to promote minority ownership in broadcasting.

Congress has made very clear to us its view that this is an important policy goal, and, in fact, since 1988 Congress has expressly prohibited the Commission from spending any appropriated funds to modify or repeal any of its minority ownership policies, including the tax certificate policy.

Essentially, this is how the program works from the FCC perspective. The FCC controls the transfer of licenses. In connection with the transfer or assignment of an FCC license, if there is a tax certificate request, the seller and the purchaser come to the FCC, submit a pleading, typically in connection with the application to assign the license, and they request a tax certificate.

The Commission staff requires that there be certifications of minority ownership and control. Typically, the staff of the FCC is presented with the various financing documents, which govern these deals, and the Commission then determines whether in the context of a particular deal there is sufficient minority ownership and control to justify the issuance of a tax certificate.

Under the statutory scheme of section 1071, the Commission is required to certify whether a transaction would promote the minority ownership policy. That certification is done in the form of a tax certificate which is given to the seller. The seller then is required to file that tax certificate with its tax return to get the deferral benefits that you have heard about.

The tax certificate became an important cornerstone of the Commission's policies to advance minority ownership in broadcasting. In 1982 the Commission, under the leadership of Chairman Mark Fowler, convened kind of an industry-government summit to examine ways to improve minority ownership, not only in broadcasting but in other technologies. It was at that time in 1982 that the Commission extended the policy to encompass cable television.

In terms of the numbers of tax certificates granted, since we provided information to the subcommittee staff yesterday, we have been in a continuing process of trying to respond to data requests. We did find that the Commission has issued a few more tax certificates than we had told the subcommittee yesterday, so I just wanted to get that on the record, and note that since 1978 the Commission has granted approximately 390 tax certificates. Approximately 330 of those involve sales to minority-owned entities. The vast majority are for radio properties, 260. There are 40 for television stations, and approximately 30 have been granted for cable television station transactions.

Questions were asked earlier about whether these certificates that have been granted reflect grants to a diverse number of buyers. We have not massaged all that data yet and we welcome the opportunity to do that, but our preliminary comparison of the number of tax certificates granted with the actual lists of the numbers of minority owners suggest that it is a fairly diverse group. There are some individuals and companies who have taken advantage of the program multiple times, but that does not seem to be the rule.

We also have done some analysis of the average period of time that minority buyers hold stations and cable systems subject to a tax certificate. In broadcasting we have determined that even though there is a 1-year holding period, most minority buyers retain the licenses for much longer. The average is about 5 years. About a third of the tax certificates that have been granted for minority ownership, that is for about 100 deals, the stations are still being held by the minority purchasers.

The great majority of these transactions are quite small. We have heard a lot today about the Viacom transaction. That would certainly be, by far, the biggest minority tax certificate request ever made to the agency. The average sales price, that is sales price, not tax deferral, but the average sales price for a radio transaction is $3.5 million. For the 40 tax certificates we have granted with respect to television stations, the number is higher, it is about $38 million, average sales price.

Data is not available for the 30 cable transactions that we have processed.

To summarize, the minority tax certificate policy was designed as a way to provide incentives for established holders of broadcast and cable properties to sell those properties to minorities. It has emerged as probably the principle policy incentive for the sale of existing properties to minorities as opposed to licenses granted through the initial licensing process.

I am certainly not here to tell you that the program is perfect. There is considerable room for improvement in the program. I do note that the Commission has been severely constrained in its ability to make changes and reevaluate the program because of the appropriations rider that we are subject to. That rider, just to summarize, requires that the Commission not reexamine, change, modify, or repeal the policy, so we have been forced to continue to grant tax certificates under the policy in effect since 1986, subject only to expansions or improvements of the policy.

If given the authority by Congress to reevaluate this program, I am confident that there are many ways it could be improved, both in its administration and cost effectiveness. I would like to thank you once again for the opportunity to testify this morning, and I would be happy to answer any of your questions.

[The prepared statement and attachment follow:]

STATEMENT OF WILLIAM E. KENNARD, GENERAL COUNSEL FEDERAL COMMUNICATIONS COMMISSION

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. 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. 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. 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.

Chairman JOHNSON. Thank you, Mr. Kennard. Your testimony was very, very interesting, particularly interesting that we would put something like that in the law as far back as 1988 and never do any oversight of the impact of that prohibition.

Mr. Kohl.

STATEMENT OF GLEN A. KOHL, TAX LEGISLATIVE COUNSEL, U.S. DEPARTMENT OF THE TREASURY

Mr. KOHL. Madam Chairwoman and members of the subcommittee, I am pleased to have this opportunity to present testimony on behalf of the Department of Treasury concerning section 1071 of the Internal Revenue Code. However, because the issues identified by the subcommittee relate primarily to the responsibilities assigned by Congress to the FCC, questions about section 1071 certificate program itself are more properly directed to Mr. Kennard. My testimony is intended simply to provide an overview of section 1071, including recent testimony on section 1071 and an explanation of the Internal Revenue Service's role in its administration.

In September 1993, the Ways and Means Subcommittee on Select Revenue Measures conducted a hearing on miscellaneous revenue measures, including an unspecified proposal "that would modify section 1017 by adding anti-abuse rules to ensure that tax incentives are available only for sales that actually foster minority ownership of broadcast stations." The assistant secretary for Tax Policy, Les Samuels, testified that we would not oppose a carefully targeted amendment to section 1071 that would prevent certain sellers, e.g., those who actually participate in sham transactions, from taking advantage of section 1071, provided the amendment did not deny such preferential treatment to innocent sellers, that is, taxpayers who participate in a sale that results in bona fide minority ownership.

Our position in this regard has not changed. Accordingly, we would be willing to work with the subcommittee or the FCC in attempting to craft anti-abuse provisions we could support. In addition, we would be pleased to consider in conjunction with the subcommittee and the FCC whether a cap or other limitations on the section 1071 benefits would be necessary and appropriate to target more precisely this tax provision to its desired objective.

Under section 1071, Congress has delegated authority to the FCC to issue section 1071 certificates. Under the statute, tax benefits under section 1071 are available if the taxpayer obtains a section 1071 certificate from the FCC. The IRS is not in a position to either participate in or exercise oversight over the FCC's determination that many a transaction waits a change in FCC policy. Consequently, as noted by Mr. Kies, the IRS's role is limited to administering, interpreting the technical requirements of section 1071 and section 1033, a provision which section 1071 incorporates by reference.

I would now like to address the potential for abusing section 1071. Please keep in mind, however, that because of, among other things, the lack of the IRS's participation in the certification process, my testimony should not be construed as commenting on any particular transaction, including recent transactions that have been covered in the press.

I should also point out that abusive transactions may arise in any statutory or regulatory context. As you are certainly aware, Treasury, the IRS, and the courts expend considerable energy and resources dealing with abusive tax transactions. Fortunately, the tax law, like other statutory regimes, is interpreted in a manner consistent with its spirit and purpose. Reflecting this rule of interpretation, tax doctrines have evolved in the common law to combat such abuse.

These doctrines include a prohibition against sham transactions, a rule that a transaction must be taxed in accordance with its substance and not merely how it is papered or its form, the substance-over-form doctrine; and a rule that certain related transactions are to be aggregated and treated as one overall transaction, the step transaction doctrine.

In addition, various provisions in IRS regulations have been adopted to address abuses because the common law doctrines have not been fully successful in combating abusive transactions. Certification under section 1071, however, is conducted by the FCC, not the IRS. I assume that, like any regulatory agency, the FCC deals with attempts to abuse its rules including the rules governing the issuance of section 1071 certificates.

In the absence of adequate safeguards against abuse, it is possible that an aggressive participant could devise a scheme that might enable parties to obtain a section 1071 certificate even in situations that do not meaningfully enhance the ownership of broadcasting properties by minorities or women. If such a scheme were to succeed, granting the section 1071 certificate would unfairly reward the participants of a tax avoidance scheme at the expense of both a bona fide minority ownership group and a nonminority ownership group that was unwilling to engage in an abusive transaction.

Once again, however, I am not in a position to comment on whether there in fact exists any transactions when the grant of a section 1071 certificate is not consistent with the intent or purpose of section 1071 or any regulations promulgated there under. Such a question is more properly directed to the FCC.

Nevertheless, as I previously stated, we would be pleased to consult with the FCC or this subcommittee in developing further safeguards against the abuse of the certification process, through anti-abuse provisions and/or specific measures, such as a more stringent holding period. We would also be pleased to work together toward other means of tailoring the section 1071 benefits, for example, some sort of cap, to more efficiently promote its objectives.

This concludes my remarks.

Thank you once again for affording me the opportunity to testify, and I am now available to answer any questions that the subcommittee may have.

[The prepared statement follows:]

STATEMENT OF
GLEN A. KOHL
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

Chairwoman Johnson and Members of the Subcommittee:

I am pleased to have this opportunity to present testimony today on behalf of the Department of the Treasury concerning section 1071 of the Internal Revenue Code. In convening this hearing, the Subcommittee indicated its desire to examine four issues: (i) whether the Federal Communication Commission's (FCC) 1978 policy of promoting minority ownership is consistent with the underlying intent of Section 1071; (ii) whether the FCC's administration of section 1071 constitutes an impermissible exercise of legislative authority; (iii) whether the tax incentive provided in section 1071 fosters minority ownership of broadcast facilities; and (iv) whether the FCC policy is a necessary or appropriate means of achieving this goal.

Because the issues identified by the Subcommittee relate primarily to the responsibilities assigned by Congress to the FCC, my testimony is intended simply to provide an overview of Section 1071 -- including recent Treasury testimony on Section 1071 -- and an explanation of the Internal Revenue Service's (IRS) role in its administration.

In September, 1993, the Ways and Means Subcommittee on Select Revenue Measures conducted a hearing on miscellaneous revenue measures, including an unspecified proposal "that would modify section 1071 by adding anti-abuse rules to ensure that tax incentives are available only for sales that actually foster minority ownership of broadcast stations." The Assistant Secretary (Tax Policy), Leslie B. Samuels, testified that we would not oppose a carefully targeted amendment to section 1071 that would prevent certain sellers (e.g., those who actively participate in sham transactions) from taking advantage of Section 1071, provided the amendment did not deny such preferential tax treatment to "innocent" sellers -- that is, taxpayers who participate in a sale that results in bona fide minority ownership. Our position in this regard has not changed. Accordingly, we would be willing to work with the Committee or the FCC in attempting to craft anti-abuse provisions that we could support and which would not reduce the effectiveness of the program. In addition, although the Administration has no position on this matter, we would be pleased to consider with the Committee and the FCC whether a cap or other limitations on Section 1071 benefits would be necessary and appropriate to target more precisely this tax provision to its desired objective. We will also coordinate with other offices within the Administration, including the Commerce Department's National Telecommunications and Information Administration.

Overview of Section 1071

Section 1071 provides certain tax benefits (described below) to the seller of property if the sale or exchange is certified by the FCC 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." Since 1978, the FCC's policy has been to certify transactions as meeting this requirement where a sale of broadcast facilities is made to a minority individual or a minority-controlled entity.[1]

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[1] We understand that the FCC defines (1) a minority-controlled corporation as a corporation in which more than 50 percent of the voting stock is held by minorities and (2) a minority-controlled limited partnership as a partnership in which (a) the general partner is a

In general, Section 1071 allows a taxpayer to postpone the recognition of gain realized upon the disposition of certain broadcasting property for which the taxpayer has obtained the necessary certificate from the FCC (Section 1071 Certificate). The tax-free treatment accorded by Section 1071 allows the taxpayer to defer the tax on the gain realized in the transaction (although in certain circumstances such deferral can be effectively permanent). In this regard, the benefits of Section 1071 are generally similar to the benefits accorded taxpayers who reinvest insurance proceeds following an involuntary conversion of property under Section 1033 (e.g., as the result of fire or flood), or, to a lesser extent, taxpayers who participate in tax-free exchanges of "like-kind" property under Section 1031.

To obtain the benefits of Section 1071, the taxpayer must file an election with its return that includes the Section 1071 Certificate. This election requires the taxpayer to choose one of three alternative methods for taking advantage of the Section 1071 deferral. The first approach is to apply a modified form of the involuntary conversion rules. Generally, gain is not recognized to the extent that replacement property which is similar or related in service or use to the property sold is acquired before the end of the second full taxable year after the year in which the disposition occurs. The second approach is to reduce the depreciable bases of other assets held by the taxpayer at the time of the disposition and acquired before the end of the taxable year in which the disposition occurs. Unless the taxpayer requests an alternative allocation, the bases of all depreciable assets are reduced on a pro rata basis. The third approach is to elect a combination of the first two approaches (i.e., defer a portion of the gain through the acquisition of replacement property and another portion through reducing the bases of other depreciable property).

The Limited Role of the IRS

Under section 1071, Congress has delegated authority to the FCC to issue Section 1071 Certificates. Tax benefits under Section 1071 are available only if the taxpayer obtains a Section 1071 Certificate from the FCC. The IRS generally accepts as valid any Section 1071 Certificate that is issued. The IRS neither participates in, nor exercises oversight over, the FCC's determination, and conducts no independent inquiry into whether, for example, minorities meaningfully participate in a purchasing group. Consequently, the IRS's role is limited to administering and interpreting the technical requirements of Section 1071 described above (including the rules of Section 1033 which Section 1031 incorporates by cross-reference).

Potential For Abuse

I would also like to discuss the potential for abusing Section 1071, but first I should reiterate that the Department of the Treasury does not participate in the FCC certification process. My testimony therefore should not be construed as commenting on the propriety of issuing Section 1071 Certificates in any particular circumstances or for any particular transactions, including recent transactions that have been covered in the press.

Abusive transactions may arise in any regulatory context. As you are certainly aware, Treasury, the IRS, and the courts expend considerable energy and resources dealing with abusive transactions. Fortunately, the tax law, like other statutory regimes, is interpreted in a manner consistent with its spirit and purpose. Reflecting this rule of interpretation, tax doctrines have evolved to combat such abuses. These doctrines include a prohibition against "sham" transactions, a rule that a transaction must be taxed in accordance with its substance and not merely its form (the "substance over form" doctrine), and a rule that certain related transactions are to be aggregated and treated as one overall transaction (the "step transaction doctrine"). In addition, various statutory provisions and IRS

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minority or minority-controlled and (b) minorities own at least a 20 percent interest.

We also understand that the FCC generally requires those who acquire broadcast properties under Section 1071 to retain those properties for at least one year.

regulations have been adopted to address abuses because the common law doctrines have not been fully successful in combating abusive transactions.

Certification of transactions under Section 1071, however, is conducted by the FCC, and not the IRS. I assume that, like any regulatory agency, the FCC deals with attempts to abuse its rules, including the rules governing the issuance of Section 1071 Certificates. In the absence of adequate safeguards against abuse, it is possible that an aggressive participant could devise a scheme that might enable parties to obtain a Section 1071 Certificate even in situations that do not meaningfully enhance the ownership of broadcasting properties by minorities. If such a scheme were to succeed, granting the Section 1071 Certificate would unfairly reward the participants of a tax avoidance scheme, possibly at the expense of a bona fide minority ownership group and/or a non-minority ownership group that was unwilling to engage in abusive tax planning. Because the Treasury neither participates in nor reviews the certification process, however, I am not in a position to comment on whether there, in fact, exist any transactions where the grant of a Section 1071 Certificate is not consistent with the intent or purpose of Section 1071 or any regulations promulgated thereunder.

The issuance of Section 1071 Certificates is designed to further an FCC objective. Nevertheless, as I previously stated, we would be pleased to consult with the FCC or this Committee in developing further safeguards against abuse of the certification process (through anti-abuse provisions or specific measures such as a more stringent holding period requirement). We would also be pleased to work together towards other means of tailoring the Section 1071 benefits to more efficiently promote its objectives.

This concludes my remarks. Thank you once again for affording me the opportunity to testify. I am now available to answer any questions that the Committee may have.

Chairman JOHNSON. Thank you both for your testimony and also for your willingness to work with us on this issue to provide it with the oversight I believe it has needed and recreate for ourselves the authority that the legislature has traditionally had to oversee and adjust and clarify and modernize the law as circumstances change.

I would like to ask you, Mr. Kennard, in the background materials there is a chart that shows the number of FCC tax certificates issued for broadcast stations and cable television facilities from 1978 to 1994.

Up until 1987, there were, on average, something from the midteens to the low twenties in transactions. In 1986, there were 24. In 1987, there were 34. Then there were 34 for a couple of years and then it popped up to 42 and 43. Then it dropped back down in 1991 to 20 and the 11 and the high teens, a pattern of transactions that reflects the period from 1978 to 1986.

It is also interesting that the minority ownership data parallels the overall data. Would you comment on that explosion of transactions from 1987 to 1990?

Mr. KENNARD. I think it was a reflection of what was happening in the marketplace at the time. I was not in government at the time but was involved in a number of broadcast transactions, and I know there was a flurry of transactions that started in the mideighties and continued to the late eighties. Then, of course, we have had problems of recession in all of the communications industries and broadcasting was certainly not exempt.

I think those transactions that did take place in the early nineties, many of them were workout and foreclosure situations where there was no gain. So, accordingly, there would have been no need for a tax certificate. That is my best guess as to why there was a fall-off in the early nineties.

Chairman JOHNSON. Actually, it is in the late eighties you see this real explosion.

Mr. KENNARD. Then it fell off in the early nineties.

Chairman JOHNSON. So your response is that the activities of the late eighties was the consequence of the recession.

Mr. KENNARD. Yes, I think a lot of these deals were put into the pipeline starting in 1986 and 1987 and they were closing in 1988 and 1989. Then I think you see the effects of the recession hitting from 1990 to 1993 and there is a pretty significant dropoff after 1990.

Chairman JOHNSON. All right. Now, the FCC has a number of other ways of promoting minority ownership programs, and one of the ones that seems most interesting is their distress sale policy that allows a license that is approaching revocation hearings to be sold for substantially less than the fair market value if it is sold to a minority party.

How powerful has this been? How many transactions have there been under this distressed sale policy?

Mr. KENNARD. I think there have been approximately 30 or 35 transactions. We can get you the exact number in a moment.

Chairman JOHNSON. Over how many years?

Mr. KENNARD. Since 1978. I would say that it is an important—I was handed the exact number. It is 40 since 1978.

I would say that it is an important program but it has been of marginal effectiveness, principally because the only way that this program is triggered is if there is a licensee that gets in trouble with the FCC. Its license is designated for hearing. That licensee has a choice; either go through a full-scale administrative hearing, with all the expense and uncertainty that that process entails, or opt out for a distress sale to a minority owner at a below market price.

Two reasons why the program, I think, has had only marginal effectiveness: One is because there are just not that many designations of licenses for hearing; and second, those that get designated tend to be more marginal stations and not those that are the more attractive properties that would be important in promoting minority ownership.

Chairman JOHNSON. Thank you. That seems logical. It is interesting in that in the distressed sales situation, it is the licensee that takes the loss not the taxpayer. In other words, the person selling the station sells it below the market value, and so the minority incentive comes from the profit of the former owner rather than from the taxpayers. I think that is a significant and interesting difference.

What is your definition of minority?

Mr. KENNARD. Well, the FCC relies on the Federal statistics——

Chairman JOHNSON. Excuse me, minority control, I should say.

Mr. KENNARD. Oh, minority control, I am sorry. It is essentially the FCC looks at both de jure, that is legal, and de facto, factual control. The FCC has a lot of experience with this particular issue that far preceded the minority ownership policies with respect to the tax certificate. A lot of what the FCC does is license telecommunications facilities. So one of our central regulatory responsibilities is to ensure that we know who is controlling these licenses. So there are 60 years of case law and precedent that we rely on in determining whether a company or individuals are in control of a license.

Chairman JOHNSON. Well, generally, a minority-controlled corporation is one in which the minority owns 50 percent of the voting stock. A minority-controlled limited partnership is one in which the general partner must have at least 20 percent equity interest.

Now, if the Viacom deal that has received so much publicity is like other deals that have gotten tax certificates, there is neither the equity position nor the control position that are common to other minority-controlled transactions in other areas. Really, this has only been possible since 1978. So in this particular area, as distinct from other areas, how do you judge that minority control; and why is it that you have no statistics or data about what has happened as a consequence in however long control lasted?

You apparently have no information about whether when you granted a tax certificate the minority interest was sold 1 year after, 2 years after, 3 years after. So you have no oversight information from which we can evaluate the long-term impact on the goal of minority involvement in our communications system of this really very expensive, flexible policy of the FCC.

Mr. KENNARD. Let me answer your last question first. As I mentioned in my opening statement, we have looked at the average holding periods of transactions involving the tax certificate. The average holding period is 5 years in most broadcast transactions. We do not have that information for cable. Again, we have been precluded by Congress from undertaking a wholesale reexamination of this policy. The legislation is quite clear on that point.

Chairman JOHNSON. Just for clarity, Mr. Kennard, what number of cable transactions have there been? What percentage of the transactions currently are cable?

Mr. KENNARD. Through the history of the cable tax certificate program, since 1982, there have been 30 cable transactions involving tax certificates.

Chairman JOHNSON. So it would not be an impossible task to research those and get appropriate information?

Mr. KENNARD. No, in fact the subcommittee has asked us and we are working on that matter right now.

Chairman JOHNSON. OK. Back to the issue of control.

Mr. KENNARD. Yes, the issue of control. To give you a little bit of historical perspective, when the Commission first adopted its minority ownership program in 1978, we adopted a very simplistic definition of control. We provided that if you are a corporate entity, you had to show that more than 50 percent of the voting stock was held by minorities.

When the FCC, under Chairman Fowler in 1982, convened another examination of the tax certificate policy, the marketplace had changed significantly and the FCC was kind of behind the times. A lot of deals were being done with limited partnerships, they were more highly leveraged transactions than we had been used to, so we adopted the policy with respect to limited partnerships to allow the policy to encompass and address the situation where you had a minority general partner who was in control of the enterprise but did not have over 50 percent of the equity. From that evolved this minimum 20 percent equity requirement in limited partnerships.

Now, that being said, I think that our knowledge of these deals has become increasingly more sophisticated, and in our minority ownership policies outside the tax certificate area, because again we have not been able to reexamine the tax certificate policy. But in other areas of our minority ownership policy, we have taken a far more sophisticated look at equity and defined minimum equity requirements for participating in these programs, looking at such things as profit and loss allocations as a determinant of equity ownership, liquidation preferences, and the like.

So it is an evolving concept, I think.

Chairman JOHNSON. It appears it does need to evolve in regard to these transactions.

We are going to start using the timeclock lights now, if we have that system lined up. It would be useful to us and I yield to Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

Mr. Kohl, you have a $1.6 billion 5-year revenue loss for the program, apparently. It is my belief, and I would like you to perhaps take this back to Treasury, if you would not mind, and reestimate these numbers. Because it is frankly my belief that this is going to explode over the next 5 years, these kinds of transactions. I noticed on a year-by-year basis that that is not necessarily demonstrated.

The reason I say this is that Viacom purchased Paramount Pictures and also Blockbusters. My understanding, again, because I do not have the ability to question the people involved in these transactions, Viacom had a cash-flow situation problem and that is why this transaction occurred. I would imagine with telecommunications exploding as it is, and with the whole deregulation of the industry, you will probably see a significant increase. So perhaps you might want to go back and reexamine this.

I have asked Mr. Kies to look at it as well. So I would just like you to do that. I have no further questions with respect to you.

Mr. Kennard, you indicated that in terms of broadcast, the average transaction is about $3.2 million; is that correct?

Mr. KENNARD. For radio, it is $3.5 million; for television, it is about $38 million.

Mr. MATSUI. For television, 38, but you have nothing on cable yet?

Mr. KENNARD. No.

Mr. MATSUI. You are able to do this even though you have the prohibition, appropriations prohibition?

Mr. KENNARD. Well, what we have done is we have just provided information that is a matter of public record.

Mr. MATSUI. I see just broad data. There is no analysis to it.

Mr. KENNARD. Right. We are providing the raw data.

Mr. MATSUI. OK, I would like to get back to the issue of control because that is a very important—by the way, do you have discretion to deny these certificates, or is it if they comply with whatever happens to be the regulations of the moment, you are obligated then to issue the certificate? Is that the correct understanding?

Mr. KENNARD. Yes, our understanding is that under our statute, Congress made it very clear that they did not want this policy to change from the way it was in effect in 1986. So since that time we have been applying the policy consistent with that congressional directive.

Mr. MATSUI. But you are obligated—as long as the minimum qualifications of the regs are fulfilled, you are then obligated to issue the certificate? You have no discretion once the terms are fulfilled; is that correct?

Mr. KENNARD. That is correct. Now, within those constraints, typically in these transactions, particularly the ones that are somewhat complex, the FCC staff spends quite a lot of time just trying to understand the transaction. So it is not a situation where someone comes in the door and certifies that he complies with the policy and a tax certificate is granted.

Mr. MATSUI. OK. Obviously, since the Viacom application is still pending, you have no idea whether you could or could not deny them a certificate, or whether you are obligated to grants it; is that correct?

Mr. KENNARD. My understanding is it has not even been filed with the agency as of this time.

Mr. MATSUI. OK. Let me get into the issue of control, because you said this is an evolving process.

I am trying to understand this, because, again, I hate to ask you, particularly, since you have the obligation of reviewing these things, but with respect to the Viacom situation, at least from what Mr. Kies has said, the 20-percent interest is satisfied but he was talking about a profit issue. In other words, he was talking about profit and losses. He was not talking equity interest, he was not talking about capital investment. It was basically the profit or losses he was speaking about in terms of the 20-percent interest.

Is that your understanding or do they have to have, the individual, have to have controlling interest or some kind of controlling interest or management interest in the venture?

Mr. KENNARD. Our threshold review is to determine whether the minority principals have control of the enterprise. That is, we start by analyzing the documents to make sure that the documents vest legal control in the enterprise in the minority principals. If it is a corporation, such things as the ability to hire and fire, elect a majority of the board of directors, things such as that.

Now, when it comes to equity, in a limited partnership——

Mr. MATSUI. If I can just finish off and ask a further question. I don't mean to interrupt you.

Mr. KENNARD. Certainly.

Mr. MATSUI. In other words, then, the individual, the minority participant must have a controlling interest. He or she will be in a position to fire, hire, make all of the decisions of that company that is purchased or that is——

Mr. KENNARD. That is our requirement. We look at such things as the ability to control budgets, to select programming, hire and fire key personnel. Those are kind of the bedrock attributes of control that we look to.

Mr. MATSUI. So the transactions that Mr. Johnson referred to, presumably the minority contractor has absolute control over all those management decisions, the programming and all that, as well.

Mr. KENNARD. Yes.

Mr. MATSUI. OK. You wanted to finish in terms of the equity interest.

Mr. KENNARD. Yes, I did just want to clarify that when it comes to equity, it is often difficult and I think the tax lawyers in this room would probably confirm this, it is often very difficult to define what equity means, particularly in the context of a complex partnership.

So what we have done at the FCC is we have required that individuals requesting tax certificates for a limited partnership deal demonstrate that the minorities in the deal control not less than 21 percent of the equity in the venture. In some of the other areas of our minority ownership policies, we have started bringing more sophistication into this analysis looking at such things as profit/loss allocations and liquidation values and the like.

Mr. MATSUI. If I may follow up on that, because you say, then, that if—I will use a hypothetical—if the minority contractor put $1 million on a $2.3 billion transaction, he then presumably, in order to fulfill your requirements of a 21-percent-plus equity interest in the venture, would then automatically have a $400-plus million equity interest? So if he sold the venture 13 months later, he would be able to reap a profit of——

Mr. KENNARD. Not under the tax certificate policy, no.

Mr. MATSUI. I thought that is what you said. Maybe I misunderstood you.

Mr. KENNARD. I am sorry if I am confusing you. Under the tax certificate policy, the Commission looks to see whether the minority principals have control, No. 1, and No. 2, in a limited partnership that they control—usually it is through a corporate general partner—that corporate general partner controls not less than 20 percent of the equity in the venture.

That does not mean that the minority individual has personally a 20-percent stake in the venture. But they control an enterprise which in turn controls not less than 20 percent.

Mr. MATSUI. That is why—now I kind of understand why this deal was structured the way it was. There was a number of different corporations and a number of different limited partners—well, there was a major limited partnership. But that is the way to maintain the control over the entity itself but not have necessarily an equity interest in the investment.

Mr. KENNARD. Yes.

Mr. MATSUI. OK.

Mr. KENNARD. In another context where we have defined minority ownership more recently, we have departed from that and said tell us how much equity the minority principals personally have in the venture. So it is a slightly tougher and different standard.

Mr. MATSUI. Well, it sounds to me like—well, I have nothing further.

Thank you very much.

Chairman JOHNSON. Before I recognize the next member of the subcommittee to question, I had not quite coordinated in my own mind the relationship between the Appropriations Committee language and the chart reflecting increased activity in 1987. The statutory language prohibited the spending of any appropriated funds to repeal, to retroactively apply changes in, or to continue a reexamination of its policies with respect to tax certificates granted under 1071.

So, apparently, we suspended any review that you were doing. The very year we did that, the number of tax certificates exploded.

Now, you had suggested that the explosion was the consequence of the recession and the deals that came to fruition, which undoubtedly was a factor. But it is very interesting that the Appropriations Committee action and the number of deals done do relate, and if you do not have the detail on the interrelationship now, it is certainly necessary for this subcommittee to understand that relationship.

Can you point to issues that were being reviewed by the Commission at that time that might have had to do with fraud and abuse or with an appropriate use of tax certificates, that when denied the right to exercise any judgment over whether the policy you had in place was reasonable and necessary or appropriate by the Congress, the numbers of deals exploded?

Mr. KENNARD. Well, I don't know if there was a causal relationship between those two events. It is really hard to speculate. I was not at the agency at the time. I have researched the history and I know in 1986 the Commission commenced a proceeding to reexamine and reevaluate this particular policy.

Chairman JOHNSON. Do you know why the Commission commenced that reexamination?

Mr. KENNARD. From what I can gather at the time, the Commission wanted to take a look at both the constitutional and policy justifications for the policy in a rulemaking proceeding that was commenced in 1986.

Chairman JOHNSON. Would you look back on that in greater detail and report back to us?

Mr. KENNARD. I am not sure I understand precisely what your question is, Congresswoman.

Chairman JOHNSON. I want to know what were the red flags that led the Commission to realize that they perhaps ought to look at this. Is there a relationship between the questions that they were asking, the decision of the Congress to stop the reexamination, and the increased number of tax certificates granted? Because in earlier testimony, it has been clear and it has been your policy that if a deal meets the minority participation standards, you do not look at the tax consequences as a factor. That does not weigh in as to whether the deal is eligible.

Mr. KENNARD. We are not permitted to.

Chairman JOHNSON. Right. But it is important for us to know what the controversy was at that time that led to an appropriations rider and the relationship between that rider and the activity in this program. So if you could look back on that in greater detail and get back to us, I think it would be useful to us.

Mr. KENNARD. I would be happy to. At this point I am speculating, but there were a number of events in the industry at the time that contributed to an increase in the number of broadcast transactions. One is the one I mentioned, that the economy was stronger and the broadcast industry was feeling the effects of that.

Also, the Commission at the time had deregulated a number of its ownership rules. It had, for example, repealed a rule that required owners of broadcast stations to hold them for 3 years or more, and that contributed to a lot of interest in the broadcast marketplace by the lending community. I think that may explain why those numbers spiked, but we will be happy to look into that and report back to you.

Chairman JOHNSON. Thank you, I appreciate that.

[The following was subsequently received:]

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

June 23, 1995

OFFICE OF GENERAL COUNSEL

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VIA COURIER

Ms. Traci Altman
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Traci:

Per your fax to my office of June 12 concerning information promised to the Committee during my testimony on January 27, 1995, I am enclosing the following materials:

1) Chairwoman's Johnson request

Chairwoman Johnson requested greater detail on the circumstances resulting in the FY 1988 appropriations rider that barred the Commission from examining or changing its policies fostering ownership of broadcasting licenses by women and minorities. I enclose the relevant pages from the Senate Report and the Conference Report on the appropriations bill, Senator Lautenberg's comments on the Senate floor concerning the bill, and the applicable provisions from the Public Law. These documents should help to illuminate Congress's thinking when it enacted the ban.

2) Congressman Hancock's Request

Congressman Hancock requested information to assess whether certain individuals had repeatedly used the Commission's minority tax certificate program. Between 1978 and 1994, we have identified 44 sellers of broadcast and cable facilities who benefitted more than once from the tax deferral conferred through the program. Also during that period, we have identified 46 minority individuals who on more than one occasion purchased broadcast and cable facilities with the assistance of the tax certificate program.

3) <u>Congressman Zimmer's Request</u>

Congressman Zimmer requested information on the number of tax certificate transactions involving former Commission personnel. As I explained during the hearing, the Commission does not ask for the personal histories of those requesting tax certificates.

I trust this information is responsive to the Committee's request for further information. Should you have additional questions, please call me on 418-1700.

Sincerely,

Robert Calaff for

William E. Kennard
General Counsel

Enclosures

cc: Judy Harris
Anthony Williams
Robert Calaff
Brian Browdie

[Attachments retained in Committee Files.]

Chairman JOHNSON. I will now recognize Mr. Herger.

Mr. HERGER. Thank you very much, Madam Chair.

Mr. Kennard, if I could follow up on a question I asked earlier of Mr. Kies having to do with how you adopt your policies on how the FCC determines which minority group should be entitled to tax certificates or other preferences.

To be specific here, according to a recent article in Forbes Magazine, Storer Communications recently sold one of its stations to the Liberman family. Apparently, this family qualified as a minority because it was able to demonstrate that the family had been expelled from Spain by King Ferdinand and Queen Isabella during Spain's purge of its Jewish population in 1492.

The FCC represented to us that it approved the tax certificate because the family was able to demonstrate that it was actively involved in the Hispanic community. Could you comment on that, please?

Mr. KENNARD. Certainly. I think that article is somewhat misleading. I am familiar with the case. First of all, the FCC relies on the definitions of minority promulgated by the Office of Management and Budget. These are the definitions that OMB uses for all of the Federal statistics and program administration in this area.

With respect to the Storer case, the article is a little misleading because OMB defines a Hispanic as someone of Hispanic origin. It is true this family apparently had origins in Spain many years ago, but the family emigrated to Mexico in the 1920s and then to the United States. They were able to demonstrate to the FCC that they were of Hispanic origin, they were active in the Hispanic community, they spoke Spanish in the home. The FCC got evidence from the Department of Commerce's Minority Business Development Agency to determine that, in fact, this family was a recognized, leading family in the Hispanic community.

So there was—the article is a little misleading to suggest only that they had origins in Spain in the 15th century.

Mr. HERGER. Well, I appreciate your clarifying. That does make it a little better. But again everything we are hearing today does indicate or would appear to indicate some, to say the least, some very poor policies, I would say, in being fair with all taxpayers. As I travel around my district, constituents who come to me indicate over and over again that they do not mind taxation so much as long as they are treated fairly, as long as everyone is treated the same way.

I would have a question of you, Mr. Kohl, if I could, and that is, in your opinion, when we begin—when we hear of some of the outrageous examples, as we have been hearing throughout this morning, throughout the testimony on this particular issue that we are on, I guess my question is are we not leading up to this—do we not lead our Nation's tax attorneys into creating these type situations when we set up policies that would somehow set out one group over another as dealing with them, say in a more positive way than others?

Mr. KOHL. Mr. Herger, I have been a tax lawyer for a long time, mostly in private practice, and I do not think the problem is section 1071. I am personally thrilled to hear you mention that issue, because some tax lawyers have a real problem with distances—you give them an inch and they take a mile.

We have reports of many abusive transactions. Rent-a-partner schemes, which I cannot comment on whether they exist in the FCC context, but rent-a-partner schemes that exist in the law that we are trying to combat exist everywhere. There are reports of business ventures where you bring in a foreign partner for a year or two, accelerate and allocate the income to a foreign partner, and then the foreign partner leaves and you are left with a business venture that did not pay any U.S. tax, plus they are left with deductions.

So I am thrilled to hear that we have to deal with a tax abuse problem, because I do think it is a matter of fairness and I think if we do not address it, I do think it affects ordinary citizens, who start to feel like chumps, as other people who are willing to be aggressive take aggressive positions.

So I agree wholeheartedly, but it is certainly not limited to section 1071. There are many areas where we should look at this and we would love to work with the subcommittee to address these.

Mr. HERGER. Well, I want to thank you. Again we have heard specifically one individual. I have to believe there is more, specifically Mr. Washington. It is not just his deal here.

We are hearing there are other deals as well where this one minority individual, not an entire minority but one individual, I could see where other minorities would feel like, boy, this is not fair. Why is this one individual making millions? We are not able to.

Again, I get back to the question, perhaps the policy where somehow we are setting one group out, favoring them over another, are we not setting up an environment where we are actually either purposely or nonpurposely creating an environment where this becomes the norm rather than an exception?

Thank you.

Chairman JOHNSON. Thank you. Mr. Hancock.

Mr. HANCOCK. Thank you very much.

Mr. Kennard, did I understand you when you mentioned a 21-percent minority ownership, but not necessarily any equity investment by that minority individual? He qualifies as long as he has control of that 21 percent, even though he did not put any equity in himself?

Mr. KENNARD. That is essentially correct. The FCC staff, based on our case law under section 1071, looks to see that the minority principals do have a meaningful or significant economic stake in the venture. But that has not been defined precisely and the Commission, again, has not been permitted to go back and commence a rulemaking proceeding to flesh out in more detail what that means.

Mr. HANCOCK. Well, from what you are telling me, it means that if an individual wanted to get a tax certificate of some type, all he has to do is just find a straw partner that happens to be a minority.

Mr. KENNARD. Well, one, I don't think there is rampant abuse of this policy; and, second, there are incentives here. The purpose of the policy is to create incentives to get minority individuals into business.

Mr. HANCOCK. I understand the purpose but I also know the use of the minority situation can benefit people that are not minorities, and it seems in this situation that that is what is happening.

Mr. KENNARD. The only point I wanted to make, sir, is if you were to require the minority principals to make pro rata contributions based on their equity holdings, that amount of money would be prohibitive for most minorities in this country and you would not—the policy would be useless because you would not be able to bring many minorities into these deals.

Mr. HANCOCK. All right. Well, we can discuss that one for quite a while, too.

I asked Mr. Kies earlier about the information on the 378 tax certificates that have been issued since 1978. He indicated that he had been trying to get information or had started trying to assemble the information on that in the past 2 weeks, and I would appreciate it if your organization would assist him in assembling that information so we can get some specific details, case by case, if nothing else a random sampling, say, of 20 percent of them, or let us go 21 percent, that sounds like a good round figure, of just a random sampling of those so we can look and see. I want to know if there has been duplication. In other words, have there been cases where certain individuals have repeatedly used this same program.

I think we have one example, but I want to know if there are some other examples, and I would appreciate it if you could work to get that information available for him or for us as quickly as possible.

Mr. KENNARD. We would be happy to continue to work with the subcommittee in that regard.

Mr. HANCOCK. Thank you.

[Refer to the responses on page 58 of this hearing.]

Chairman JOHNSON. Mr. McDermott will inquire.

Mr. MCDERMOTT. Thank you, Madam Chair.

Mr. Kennard, I looked at the statutory language and it says radio broadcast systems. How did we get into television?

Mr. KENNARD. Well, in 1958, as I recall, the Congress specifically defined that term to include telecasting.

Mr. MCDERMOTT. So, something was done elsewhere in the Tax Code?

Mr. KENNARD. I believe there were some technical amendments to the code.

Mr. MCDERMOTT. Let me ask you another question. In your testimony, you have four categories: minority ownership, owners of AM radio, microwave licensees, licensees to come into compliance. These are the other areas where you grant these tax certificates.

Mr. KENNARD. Yes.

Mr. MCDERMOTT. How many of those have you granted?

Mr. KENNARD. Approximately 115.

Mr. MCDERMOTT. In those other three categories?

Mr. KENNARD. Yes, that is correct.

Mr. MCDERMOTT. If we wipe out 1071, we take them with us?

Mr. KENNARD. Certainly if 1071 were to be repealed, the Commission would not be able to grant tax certificates in these other areas as well; that is right.

Mr. McDERMOTT. There have been a couple of terms thrown around here, and I have gotten to listening to words: Sham and abusive, sham relationships, abusive relationships. Do you have definitions either at Treasury or at FCC about what is a sham relationship or what is an abusive relationship?

Mr. KENNARD. Well, I think it is the same thing, but we define it more in terms of an abuse of process or an unauthorized de facto transfer of control. That is, if someone represents to us that one entity or individual controls an enterprise and really somebody else does, we define it as a de facto transfer of control. It is a violation of our rules, and we have the ability to take punitive enforcement action against that situation.

Mr. McDERMOTT. Is that arguable in court? If I have one of these certificates and you come in and say, no, you are violating the rules, where do I go for adjudication of that?

Mr. KENNARD. Well, if it is discovered that someone sought a minority tax certificate and it was based on misrepresentations, that licensee's license would be at risk. They would subject themselves to the full panoply of the Commission's enforcement authority. That includes fines and forfeitures, designation for hearing, and eventual revocation of license and such.

Mr. McDERMOTT. OK. Let me ask another question. I am interested in this business about who owns something. Let us suppose that a Southeast Asian came into this country as a legal immigrant—I emphasize the word legal—so they are now legally an immigrant and they gather together some money and they want to get involved in buying a radio station or want to get in one of these deals. How do you decide whether or not they have enough money invested in this to do it?

Mr. KENNARD. Well, we do not look to see whether they have enough money invested in the deal. We look to see whether they have sufficient equity to satisfy our control requirements. As I was saying earlier, in many of these deals, both in the minority and nonminority context, the promoters, the people who put the deal together often bring little money to the table, but they are able to leverage their ideas and their willingness to work hard and to put the deal together into an equity position. There is nothing unique about minority ownership.

Mr. McDERMOTT. Being a legal immigrant would not be a problem? You do not have to be a full citizen to own a radio station?

Mr. KENNARD. Well, yes, you do, under a section in our act, the FCC cannot grant broadcast licenses to foreigners or representatives of foreign governments.

Mr. McDERMOTT. If they are a legal immigrant, they are not eligible to own a station?

Mr. KENNARD. They would have to be U.S. citizens.

Mr. McDERMOTT. Some, if they are in the process—if they get to be a naturalized citizen, then they can own?

Mr. KENNARD. That is correct. That is the case of Rupert Murdoch, who became a U.S. citizen to buy broadcast properties here in the United States.

Mr. McDERMOTT. Can he be a citizen in more than one place?

Mr. KENNARD. I suppose so, but I am not sure. As long as you are a U.S. citizen, I believe you comply but I am not certain.

Mr. McDERMOTT. You do not look beyond that. You do not look at whether he has three citizenships, one in Britain, one here, and one in Australia to qualify for things in three different places?

Mr. KENNARD. It has not come up in my practice, no.

Mr. McDERMOTT. Now, let me ask about this equity business. If I come to the table with $1 million in cash, and there are probably some members here who could get into one of these deals.

People have said this deal is not very substantial. A million bucks sounds like a lot of money. I could not get into a deal, bring in $1 million to the table. I also could bring a tax certificate in my other pocket worth $400 million to the people who were buying it, or selling it to me. How do you evaluate that as what I am bringing to the table in the deal?

Mr. KENNARD. Well, we would want to make sure that in a deal like that we would very carefully scrutinize all of the documents to make sure that you had, if you were representing that you controlled a 21-percent equity interest in the deal, that you really did control it.

We cannot really get into valuing your relative contribution versus the investors, because that is a determination I don't think an administrative agency is really equipped to do.

Mr. McDERMOTT. How do you decide that I have 21 percent of control? Is it that on Mondays I make the decisions and they make them on Tuesday through Friday?

Mr. KENNARD. No, you have to—control to us means that you have to have all the indicia of someone who controls the business. That is you elect the members of the board, you make the hiring and firing decisions. That cannot be diluted by clever supermajority provisions that give the investors the ability to effectively dilute your ability to make those decisions.

Mr. McDERMOTT. But 20 percent is not enough to control everything. That is obviously one-fifth; right?

Mr. KENNARD. We draw a distinction between equity ownership and control.

Chairman JOHNSON. Excuse me. Would the gentleman yield?

Mr. McDERMOTT. Yes.

Chairman JOHNSON. I am going to recess the subcommittee when the gentleman is done questioning. He can proceed as long as he feels he can. But in order to minimize the recess, I am going to go vote.

Mr. McDERMOTT. OK. The control issue—it is 100 percent control.

Mr. KENNARD. Right; 100 percent control but not less than 20 percent equity. Control of equity. So we draw a distinction——

Mr. McDERMOTT. Not being a lawyer, I have a lot of fun trying to figure out how your minds work because you can really slice a piece of baloney in some real thin slices.

I see that I am in charge of the subcommittee here and I will adjourn it for 10 minutes.

Mr. KENNARD. Thank you.

[Recess.]

Mr. ZIMMER [presiding]. Please be seated. We are reconvening the session. The chairwoman has asked me to continue the hearing until she gets back from the vote, so I will ask a couple of questions at this point.

We will start off with Mr. Kennard. Mr. Kennard, how many of the tax certificates you discussed today involve participation by current or former FCC staff members? Mr. Kies told us that Mr. Washington, who is involved in the Viacom transaction, actually devised the current policy. How many other former FCC staff members or Commissioners have been involved?

Mr. KENNARD. Well, it is difficult to say definitively because we do not compile information when people come in and ask for a tax certificate. We do not ask them if they have worked for the agency before. So all I will say is what I know kind of anecdotally.

I know Mr. Washington did work at the FCC for a time in the early eighties. I think he left before the current policy came into being. That is with respect to cable television and limited partnerships that we are talking about today. I am only aware of one other individual who benefited from the policy, that is a minority principal who benefited from the policy, who had some former contact with the FCC, and that was a gentleman by the name of McKee, Clarence McKee.

But I might add that having worked at the FCC now for a little over 1 year, I am finding it is not at all unusual for people who come to the FCC, learn about our rules and policies, become expert to go out in the private sector and basically take advantage of the knowledge. That is certainly their right.

Mr. ZIMMER. It certainly is. I am concerned about, however, the problem of the revolving door in government in general, and I have introduced legislation dealing with the problem in Congress specifically, where people come back and it is not on the basis of what they know, but rather who they know that they are able to get access and influence, so I do believe it is a serious concern.

You had mentioned in passing in your own testimony that you had some involvement in FCC transactions before you came to the Commission. Were you involved in any that had tax certificates as part of the——

Mr. KENNARD. Yes, before I went into government, I was a communications lawyer in Washington for a dozen years or so, and like many communications lawyers in this town, I was involved in tax certificate deals both from the buyers' and the sellers' perspective.

Mr. ZIMMER. Is it possible for you to get us information at a later date in writing as far as the number of those tax certificate transactions that did involve former FCC personnel?

Mr. KENNARD. Congressman, really, I do not know if we have that data. Again, we do not ask for a personal dossier on people who come in and request tax certificates, nor do I think that we could actually identify every principal who was involved in one of these deals.

Are you asking for information with respect to just the minority participants or the nonminorities who may have benefited from the tax certificate as well?

Mr. ZIMMER. Both.

Mr. KENNARD. Both.

Mr. ZIMMER. Because the testimony here has been that the nonminorities get the major benefit.

Mr. KENNARD. Again, I don't believe that we have all that information, but I will confer with the staff to see if we can provide it.

[Refer to the responses on page 58 of this hearing.]

Mr. ZIMMER. In your initial testimony, you also said that you thought there was room for improvement in the program. I know you are constrained in some respects by the appropriations rider. How would you like to see the program improved?

Mr. KENNARD. Well, I think there are a number of things that we have done in other contexts at the Commission that would certainly benefit the tax certificate program. One area that I think bears some looking at is the holding period, perhaps extending the 1-year holding period to something longer than that. As I mentioned earlier, we developed a lot more sophistication about assessing equity and minimal equity requirements, and I think that probably bears some study.

In some of the other areas, we have also taken a hard look at how options and warrants are treated and we don't allow, for example, minority principals to option or sell a future interest in their equity in the deal. That is one area that I think bears some further study.

Mr. ZIMMER. Thank you.

Do you have any studies that indicate that minority ownership has resulted in different programming by the stations that are minority owned as a result of that ownership, empirical evidence shows that there is different programming?

Mr. KENNARD. There is actually a lot of empirical data developed by both government and the academic community. Probably the most notable one was a study that was done by the Congressional Research Service in 1988. With the cooperation of the FCC there was a survey taken of some 8,000 broadcast stations to determine whether there was a nexus between minority ownership and programming directed to a minority audience. They found a strong correlation between those two factors.

Mr. ZIMMER. Did that study focus on the type of ownership by the minority, for instance, what Mr. Kohl referred to as rent-a-partner situation? Was there a difference between owners that were only nominal owners where the vast majority of the capital came from nonminorities versus owners who had not only nominal or legal control but the majority of the equity?

Mr. KENNARD. As I recall, Congressman, the study focused on minority control, and they looked at stations that were, or certified they were, minority controlled and compared the amount of minority oriented program developed by those stations or aired by those stations compared to stations that did not have minority control. They found that with respect to African-American stations, for example, 65 percent of those stations that were controlled by African-Americans provided significant minority programming, whereas only 20 percent of stations that were nonminority controlled provided significant minority programming. Similar numbers were developed with respect to Hispanic ownership as well.

There have also been a number of studies to show that minority-owned stations tend to employ minorities in higher numbers, which is also an important policy goal of the Commission.

Mr. ZIMMER. Mr. Kohl, do you have your most current estimate of the tax expenditure involved with this tax certificate program?

Mr. KOHL. I believe Treasury comes in at about $300 million a year, Joint Committee comes in at $100 million a year.

That was, I think, referred to in the preparation of last year's budget.

Mr. ZIMMER. You don't have any more current information?

Mr. KOHL. No.

Mr. ZIMMER. The Viacom transaction aside, you don't have any reason to doubt the magnitude of those estimates?

Mr. KOHL. I think estimates are just that and they are based on information available at that time. I think as new information develops and if there were an unprecedentedly large transaction to occur, or perhaps in light of Mr. Matsui's observations over time, I think the estimates could change but I really can't comment on the estimate made at that time.

Mr. ZIMMER. Do you know if your estimate takes into account the FCC's recent expansion of the tax certificate program to include personal communications services?

Mr. KOHL. I do not know if it does. I do think the estimate is prepared in consultation with the FCC, but I don't know if it does or not.

Mr. ZIMMER. A final question of Mr. Kennard. I can understand how programming considerations would be important with respect to minority ownership of radio and TV. What is the social purpose behind the same incentives being given for personal communications services?

Mr. KENNARD. Well, in the personal communications service, there again Congress mandated in the 1993 Budget Act that the FCC ensure that there were opportunities for four categories of licensees to get into this business—minorities, women, small businesses, and rural telephone companies.

I think the concern there was that Congress was authorizing the FCC to conduct spectrum auctions for the first time. Prior to that, as you may know, the FCC gave away licenses for free, and commencing last year the FCC decided, with the authority of Congress, to auction spectrum for the first time. There was concern that if the FCC didn't have some sort of incentives to diversify ownership because people were paying for licenses, they would all end up in the hands of the established industry giants. So it is more diversification of ownership as an economic basis as opposed to a programming diversity rationale.

Mr. ZIMMER. So it was a different philosophical basis, more of a standard set-aside, rather than to have diversity in communications?

Mr. KENNARD. It would not have been a set-aside because the Congress did not mandate a set percentage of minority or women ownership.

Mr. ZIMMER. More like an affirmative action program then?

Mr. KENNARD. Yes. Right.

Mr. ZIMMER. Thank you.

Mr. Levin.

Mr. LEVIN. Thank you.

You were asked what recommendation you might have. Could I probe a little further than that. You mentioned several areas. You work with the laws and you see how they are implemented.

Do you have any other suggestions? For example, should there be some changes relating to the size of the transaction, the amount of the tax advantage that would be created?

Mr. KENNARD. First, let me say that I am constrained because of our appropriations language in my ability to conduct here or at any time a wholesale reexamination of this program. All I meant to suggest to Mr. Zimmer was that there are differences between the minority ownership program that we administer here and elsewhere, and the comparison might suggest ways to improve the tax certificate policy.

But to get to your specific question, I think that it is certainly a legitimate issue to put on the table and examine to see—kind of analyze the cost-benefit relationship between the benefits of diversity and the cost to the U.S. Treasury.

Mr. LEVIN. Obviously, I don't want to press you beyond your discretion here and you will be very discreet about that, but I think I hear you. It is legitimate for this subcommittee and committee and the Congress to look at cost-benefit analyses which would include taking into account the size of the transaction and how much that might be relevant to the benefit of the stated purposes of the program.

Mr. KENNARD. I think those are all legitimate questions to ask.

Mr. LEVIN. Do you think from the experience within the Commission there is legitimate reason for us to have concerns in that regard?

Mr. KENNARD. No, I really don't because I think that by and large these transactions are quite small, and I think if you are going to ask the question of getting into the cost-benefit analysis, you are really talking about a handful of deals and certainly not the majority of tax certificate transactions.

Mr. LEVIN. Well, but that I think is even more of a reason to look at the large ones.

Mr. KENNARD. Perhaps so.

Mr. LEVIN. I will leave it at that. Thank you.

Mr. ZIMMER. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. I came here for the sole purpose of introducing my dear friend Percy Sutton to the Ways and Means Committee, but I am so fascinated by the accomplishment of this Frank Washington who seems to have been so successful in allowing viewers to get a view of all Americans, including African-Americans, and it seems as though he has caused quite a bit of disturbance among some Members of Congress, this gentleman, Mr. Washington.

How many of these tax certificates have been issued to him in these so-called deals that we have been talking about?

Mr. KENNARD. I believe that he has participated in five such deals.

Mr. RANGEL. Now, in those five deals, how many of those deals is he the minority controller and in charge of?

Mr. KENNARD. All five. Presumably if he received tax certificates in five deals, the Commission certified that he controlled all of those deals.

Mr. RANGEL. So he has not been a front for anybody. He has done what the legislature tried to do, that is, to get diversity in terms of the ownership of broadcasting?

Mr. KENNARD. That is correct. At the time that the FCC looked at his deals, they were able to certify that they were minority-controlled deals.

Mr. RANGEL. Now, most of the time that I ask questions I know the answer, but this time if this Frank Washington got five deals and he is in charge of five majority holdings—and I assume they are sensitive to the needs of minorities—what is the big deal about Viacom?

Mr. KENNARD. Congressman, I really can't answer that question today because the Viacom transaction has not been filed at the FCC. We anticipate that it will be, based on the press reports that we have seen. When it is filed, the FCC will closely scrutinize it, as it does all the tax certificate requests, and I really don't think it would be appropriate for me to prejudge what the agency would do or what I would do, because I may be a decisionmaker in the matter.

So I really don't think it would be appropriate for me to answer the question.

Mr. RANGEL. Up to now there is not a scintilla of evidence, in your opinion, that Mr. Washington abused the system?

Mr. KENNARD. That is correct.

Mr. RANGEL. Thank you.

Chairman JOHNSON [presiding]. Thank you. I know Mr. Matsui has a question.

Mr. MATSUI. I know these gentlemen have to leave in 1 minute.

Mr. Kennard, I am still on the control issue because I think that is a significant issue. You were saying that it is an evolving matter as well.

How do you determine the control? I understand that 50 percent—you have to have management control of programming, programming control, the individual minority participant. How do you make that determination? Is it on the four corners of the paper, the application that is submitted, or is there an interview process with, for example, TCI in this case, or how does that actually—how was that done?

Mr. KENNARD. Typically, the parties file the request and the FCC staff asks for all the documents governing the deal. The purchase agreement for the systems, all the various financing documents, the limited partnership agreement is always key; and they analyze those documents and invariably in the more complicated ones the parties come in and they are questioned by the staff, and there is kind of a give and take so that the FCC can understand how the documents work and who has control.

Mr. MATSUI. I would imagine the financial interest of the minority applicant or participant is a consideration as well; in other words——

Mr. KENNARD. It is typically a prime consideration, yes.

Mr. MATSUI. Sorry.

Mr. KENNARD. It is typically a prime consideration.

Mr. MATSUI. That is interesting. So, in other words, it is—when you say "prime consideration," that means that it is a—again, I am trying to understand this—it is a significant issue in terms of the variables that you decide before you make the determination that the minority participant is in fact in control of the programming, the hiring and firing, and members of the board of directors, the purchase of other outlets or whatever the issue may be.

Is that correct?

Mr. KENNARD. That is correct.

Mr. MATSUI. So if a person has a 1/260th—no, 1/2600th of an investment, that would be a significant consideration?

Mr. KENNARD. It is a little bit confusing because you have to separate debt from equity. Often in a transaction that is fairly highly leveraged, a lot of the money will be coming in in the form of debt. You can't really assess what the equity holdings are until you look at that separately from the debt. So you can't just look at—if the total amount of the deal is $10 million, you can't look at what the general partner's contribution is and say it is $1 million, and it is a one-tenth interest.

Mr. MATSUI. I understand that, but you would have to assess what that individual's debt obligation is as well.

Mr. KENNARD. Yes. That is correct.

Mr. MATSUI. If the press reports show he has a $1.3 million obligation and the other partner, limited partner, has a $2.1 billion obligation, I would imagine that that would also be a factor in your ultimate determination about controlling interest as well.

Mr. KENNARD. That is right. Another thing we look at is how the minority principals are getting the money to put into the deal. If, for example, a minority principal is putting in, say, $10 million into a deal but borrowing it from the investors and there might be some restrictions in that loan agreement that effectively allow the investor to control the minority principal, that is something we would not permit and would look at very closely.

Mr. MATSUI. Are these parts of the regulations? In other words, you have specific language in the regulation, or is this very discretionary?

Mr. KENNARD. It is based on some decisions and all the various tax certificates we have granted, but also internal staff guidelines that have been developed.

Mr. MATSUI. Are those in writing?

Mr. KENNARD. I don't believe so. Some of them may be, but I would have to check on that.

Mr. MATSUI. I guess, in addition to the amount involved here, another consideration has to be—again, when you answered my question at the outset, it was that you have no discretion once the terms are complied with, it becomes a ministerial function on the agency's behalf.

On the other hand, there seems to be so much discretion built in, particularly if they are not in writing, that it is a discretionary action on behalf of the FCC.

I guess what troubles me is that, is that a proper delegation of a function of the legislative branch of the government? It would be one thing if we are talking about 1 or 6 million dollars' worth of tax breaks, but potentially $600 million, it becomes a very, very interesting issue for us. Is that properly delegable?

I appreciate this, and I just hope that we are going to be able to allow you to do some analysis and investigation of this matter. I appreciate the fact that you are hamstrung now because you can't even give us any data or analysis as to whether this program is successful or unsuccessful or moderately successful because of the appropriations letter.

It is a shame that a group of attorneys must have gone to the Senate and had this provision put in the appropriations bills over the last few years.

Mr. KENNARD. I hope we will have that opportunity as well.

Mr. MATSUI. Thank you.

Chairman JOHNSON. I thank the panel for your input. I look forward to working with you. This represents an opportunity for us all, and we do need you to get back to us promptly both with the information that we have talked about over the course of the hearing and that you have been talking about with the staff, and also any recommendations you would want us to consider as a proposal to amend this law.

Mr. KENNARD. I'd be happy to do that.

Chairman JOHNSON. Thank you.

Chairman JOHNSON. We are going to go to the next panel and because of the timeframe and the fact that floor votes will conclude by 3 o'clock and many members have planes thereafter, we are going to try to move right along.

I am sorry that the initial panels have taken so long. I apologize to those in the latter panels but it is our opportunity to get the fundamentals firmly in mind.

On this panel, we have Bruce E. Fein, Great Falls, Va., attorney in constitutional, civil rights, and telecommunications law, and former general counsel of the FCC; J.D. Foster, executive director and chief economist, The Tax Foundation; James Gattuso, vice president for Policy Development for Citizens for a Sound Economy; and Bruce R. Wilde, Esq., Rogers & Wells.

I am going to recognize as the panel assembles, our colleague, Mr. Rangel, who has had the opportunity to join us for a few minutes here and would like to exercise a point of personal privilege before he has to return to his own hearing before the Human Resources Subcommittee.

Mr. Rangel.

Mr. RANGEL. Madam Chairlady, let me thank you for this courtesy that you have extended to me to introduce my long and dear friend Percy Sutton.

When I first started getting calls from constituents that a minority ownership in broadcasting was going to be in jeopardy, I tried to find out what subcommittee it was; and when I found out you were the chairperson, it reminded me of your freshman year here when one of the first pieces of legislation that you introduced was a bill to provide a monument for the black patriots of the American Revolution.

Since that time, I have had an opportunity to serve with you on problems that concern the poor, the aged, the disabled, and clearly you have gained a reputation of voting for your conscience and not by party.

So as we come here with the Contract With America, I am impressed that the majority party intends to save money, build equity, and move forward to create jobs to make America more productive.

One of the more interesting pieces of legislation before our subcommittee is the capital gains tax cut which would allow us, if passed into law, to be more competitive and to involve and encourage savings and to create competition and to get jobs and praise the standard of living for all Americans. Unfortunately, the Treasury Department gives us figures that this is going to cost us $183 billion over a 10-year period. Sometimes I think when I go back to my other subcommittee that the reformation we are going through, those that have the benefits of the changes, get the benefits of the changes; but the SSI hearings I am holding, which involve the aged, the blind, the disabled, which involve the children—some born from irresponsible parents, they would be the losers in society and in this subcommittee.

But the issue before us, we don't have to discuss the cost because compared to the other costs, this is about 100 million a year lost revenue. But we can discuss the tax policy, and that is why Mr. Sutton is here, because as a kid the only thing I knew about people who looked like me was that they sang, they danced and shuffled, and they made people happy; and the only thing I knew about Africans is that if it were not for Tarzan and his significant other, why Africans would not be able to survive. Sadly, today, the portrayal I see on the news and documentary police force stories is that those creators of violence, of drug abuse, of irresponsible behavior, are really African-Americans.

I don't see students that work hard and achieve. I don't see men and women who try to make this a better America on television. That is why Ronald Reagan enacted and expanded a program that allows us, if we are not in the rooms to make the decisions as to what goes into the newspapers, if we are not there to make the decision as to what really goes on television, at least we should have a better-than-equal chance to be able to display all of America. I am a drum major for America; no country in the world would allow a poor guy like me from Lenox Avenue to even dream about sitting on this august subcommittee.

But, Mr. Sutton is, too. Mr. Sutton can trace his ancestry to slavery. He can say that he served as a fighter pilot in the U.S. Air Force and he was a lawyer for the poor, a civil rights leader. I might admit that the reason I care for him the most is that as he succeeded in politics, he made certain to look back and bring me along behind him—long behind him, but I was brought up, too.

He left as the chief executive elected official of the Borough of Manhattan—which some of us think is New York City, but it is not—and went into the broadcasting business to make us feel so proud that if we couldn't get on every station, at least we would be heard on his station. Owners, minority owners, Asian minority owners, all look to him as what can be done in America if given an opportunity.

So with you as the Chair and with witnesses like this, I feel pretty secure I can go back and try to protect those people who have nobody to testify for them.

Thank you, Madam Chairperson.

Chairman JOHNSON. Thank you very much, Mr. Rangel. It has been a pleasure to have you here for a few minutes. I appreciate your appearing to introduce your longtime friend and also to speak in support of affirmative action efforts. We both know what a difference they have made in the communications industry, without question. If you are not in the room, your perspective is not going to be heard by others.

So we do now see on programs like "Wall Street Week" as many black economists as white economists, as many women economists as men economists, so we are changing the world, and enlightened public policy is a part of that.

As I said in my opening remarks, this hearing is not aimed at the underlying policy of minority preference. It is aimed at an evaluation of the wise use of tax dollars. Part of our concern has been raised because unlike in the distressed sale policy of the FCC where the minority purchaser benefits because they get the asset at a lower cost, under this policy as it has evolved, the minority purchaser is not necessarily helped and may not necessarily have the voice and control the law requires.

I do think it is very interesting it has come out so clearly in this hearing that rather arbitrary legislation impeded the natural development of a sound policy in this area; and I am very pleased that there is going to be the opportunity for the FCC and the Treasury Department and this subcommittee to work together to make sure that abuse is not a problem, but that opportunity is the consequence.

So we look forward to your input as we move along. Thank you.

Mr. RANGEL. Let me join with you in that effort to make certain that we reach the objectives that the Congress wanted.

Thank you so much, Madam Chairman.

Chairman JOHNSON. First, we will have Bruce Fein.

STATEMENT OF BRUCE E. FEIN, ESQ., GREAT FALLS, VA., AND FORMER GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION

Mr. FEIN. Thank you, Madam Chairman, and members of this subcommittee.

The racism fostered by the tax certificate policy of the Federal Communications Commission under section 1071 of the Internal Revenue Code is thoroughly pernicious and should be prohibited by Congress.

Chief Justice Harlan Fiske Stone lectured in *Hirabiyashi* v. *United States* that "Distinctions between citizens solely because of their ancestry are by their very nature odious to a free people whose institutions are founded upon the doctrine of equality."

On that score, the Chief Justice was echoing the stirring words of Justice John Harlan penned as a dissent in *Plessy* v. *Ferguson,* "In view of the Constitution, in the eye of the law, there is in this country no superior, dominant, ruling class of citizens." There is no caste here. Our Constitution is colorblind and neither knows nor tolerates classes among citizens.

In respect to civil rights, all citizens are equal before the law. The humblest is the peer of the most powerful. The law regards man as man and takes no account of his surroundings or of his color when his civil rights, as guaranteed by the supreme law of the land, are involved.

Martin Luther King is heralded for his "I have a dream" speech in which he blessed the principle that "a person should be judged by the content of his character not by the color of his skin."

Congress itself has embraced the consensus of that rainbow coalition of civil rights deities in prohibiting any racial discrimination in the making of private contracts under 42 United States Code 1981. Senator Trumbell, sponsor of the bill, explained, "This bill applies to white men as well as black men. It declares that all persons in the United States shall be entitled to the same civil rights, the right to the fruit of their own labor, the right to make contracts, the right to buy and sell. The very object of the bill is to break down all discrimination between black men and white men."

The tax certificate policy of the Federal Communications Commission makes a mockery of equal justice and the constitutional imperative of color blindness. It rewards sellers of broadcast properties with lavish tax savings if the purchaser satisfies racial or ethnic criteria reminiscent of apartheid. In other words, the FCC bribes sellers to discriminate against buyers whose only sin is to have been born white. That bribery is an insult to the venerable standard of color blindness enshrined in both the Constitution and Federal statutes.

The justification for the racially discriminatory bribery is not help for the disadvantaged. If that were the case, buyers would be required to show disadvantage and there would be no color bar to eligibility. Neither is past racial discrimination a justification. If that were the case, the beneficiaries would be required to demonstrate they have been so victimized, and whites who have suffered from discrimination would not be excluded. Nor can the tax bribe be justified by enriching program diversity. Purchasers are not required to promise or implement programming changes; politically correct skin color, or ethnicity, simpliciter is sufficient to trigger the tax benefits of section 1071.

Within the human breast the craving for profit is colorblind. It thus wars with intuition and experience to assert that the race or ethnicity of a broadcaster is pivotal to programming content. Programming is driven by profitability, thus Hallmark Cards did not revamp the programming of stations purchased from Hispanic owners in markets with substantial percentages of Hispanic viewers.

The FCC itself has never been able to document any correlation between broadcast ownership and programming content. The reason for the failure is simple, there is no such thing as a "black," "Hispanic," "Asian" or other racially or ethnically identifiable viewpoint except perhaps in the eyes of racists.

Blacks in the United States, for instance, are emphatically not ideologically fungible. Associate Justice Clarence Thomas holds views sharply discrepant from Jesse Jackson and Barbara Jordan; the views of Gary Franks clash sharply with many in the Congressional Black Caucus. Tom Sowell's views are not the echoes of Benjamin Hooks or Louis Farrakhan, and black ideological pluralism is no novelty. Booker T. Washington and W.E.B. Dubois were ideological antagonists for long years around the turn of the last century.

Ward Connerly, a black California businessman on the Board of Regents of the University of California, recently voiced objection to affirmative action programs as inequitable and unfair to certain people. He also expressed chagrin at the reflex encouraged by affirmative action to be viewed first and foremost as a member of a racial group rather than as an individual. Do Mr. Connerly's opinions reflect a black viewpoint in the mind of the FCC? To assert existence of such a viewpoint is to portray racial stereotyping that is more to be denounced than imitated.

Chairman JOHNSON. Your time has expired—I am sorry—because we have so many panelists.

Mr. FEIN. I think this is important, if I could say, it was Justice Clarence Thomas who recently voiced, I think, disgruntlement with the racial stereotyping encouraged by the idea that blacks think alike and therefore they can either be gerrymandered or treated as alike for diversity purposes.

I have gone on in my testimony to suggest that in my judgment, it is dubious under one Supreme Court decision, the *Metro Broadcasting* case, that the current composition of the Court would uphold the section 1071 racial preference program as constitutionally sufficient. There is, I think, a clear pronouncement by the U.S. Supreme Court that simply to increase representation of minorities in any profession or occupation for the sole purpose of increasing representation is not constitutionally satisfactory.

Let me conclude very quickly here.

The fact that tax certificate policy elicits hallelujahs within the business community is not surprising. It is a coveted tax avoidance device, and when money is at stake, Constitution or moral principles receive short shrift from the typical businessman. I do not recall that businessowners played heroic roles in the ugly days of Jim Crow, the Freedom Riders, and Bull Conner's dogs and horses.

Putting aside its constitutional deficiencies and entrenchment of racism, section 1071 seems a wildly profligate tool for advancing policies of the FCC. There is no limit on the amount of tax savings for racially favored transactions.

Chairman JOHNSON. I really do have to ask you to conclude, Mr. Fein.

Mr. FEIN. Yes.

Chairman JOHNSON. Your entire testimony will be placed in the record and it will be available for review by the members.

Mr. FEIN. I understand.

I think the reason why this kind of approach to entrusting to agencies the authority to give tax certificates is exceptionally unwarranted and unwise is because the Commission has not been asked, like other agencies, to recover the tax revenues lost through their own administration of the program. That is why I think it has—I think, extravagantly expanded the program beyond broadcast into cable and PCS without, in my judgment, any clear directive from Congress.

In sum, in my judgment, section 1071 is twice cursed, fosters racial polarization and stereotyping, and promotes fiscal profligacy in an era of austerity.

[The prepared statement follows:]

STATEMENT OF BRUCE FEIN
FORMER GENERAL COUNSEL OF THE FEDERAL COMMUNICATIONS COMMISSION AND ASSOCIATE DEPUTY ATTORNEY GENERAL

Ms. Chairperson and Members of the Subcommittee:

The racism fostered by the tax certificate policy of the Federal Communications Commission under section 1071 of the Internal Revenue Code is thoroughly pernicious and should be prohibited by Congress. Chief Justice Harlan Fiske Stone lectured in Hirabiyashi v. United States (1943) that: "Distinctions between citizens solely because of their ancestry are by their very nature odious to a free people whose institutions are founded upon the doctrine of equality." On that score, the Chief Justice was echoing the stirring words of Justice John Harlan penned as a dissent in Plessy v. Ferguson (1896): "[I]n view of the Constitution, in the eye of the law, there is in this country no superior, dominant, ruling class of citizens. There is no cast here. Our Constitution is color-blind, and neither knows nor tolerates classes among citizens. In respect of civil rights, all citizens are equal before the law. The humblest is the peer of the most poweful. The law regards man as man, and takes no account of his surroundings or of his color when his civil rights as guaranteed by the supreme law of the land are involved." And Martin Luther King is heralded for his "I have a dream" speech in which he blessed the principle that a person should be judged by the content of his character not by the color of his skin."

Congress has embraced the consensus of that rainbow coaltion of civil rights deities in prohibiting any racial discrimination in the making of private contracts under 42 U.S.Code 1981. Senator Trumbell explained: "[T]his bill applies to white men as well as black men. It declares that all persons in the United States shall be entitled to the same civil rights, the right to the fruit of their own labor, the right to make contracts, the right to buy and sell...[T]he very object of the bill is to break down all discrimination between black men and white men."

The tax certificate policy of the Federal Communications Commission makes a mockery of equal justice and the constitutional imperative of color-blindness. It rewards sellers of broadcast properties with lavish tax savings if the purchaser satisfies racial or ethnic criteria reminiscent of apartheit. In other words, the F.C.C. bribes sellers to discriminate against buyers whose only sin is to have been born white. That bribery is an insult to the venerable standard of color-blindness enshrined in the Constitution and section 1981.

The justification for the racially discriminatory bribery is not help for the disadvantaged. If that were the case, buyers would be required to show disadvantage and there would be no color bar to eligibility. Neither is past racial discrimination the justification. If that were the case, the beneficiaries would be required to demonstrate that they have been so victimized, and whites who have suffered from discrimination would not be excluded. Nor can the tax bribe be justified by enriching programming diversity. Purchasers are not required to promise or implement programming changes; politically correct skin color or ethnicity, simpliciter, is sufficient to trigger the tax benefits of section 1071.

Within the human breast, the craving for profit is color-blind. It thus wars both with intuition and experience to assert that the race or ethnicity of a broadcast owner is pivotal to programming content. Programming is driven by profitability; thus, Hallmark Cards did not revamp the programming of stations purchased from Hispanic owners in markets with substantial percentages of Hispanic viewers. The F.C.C. itself has never been able to document any correlation between broadcast ownership and programming content. The reason for the failure is simple: there is no such thing as a "black," "Hispanic," "Asian," or other racially or ethnically identifiable viewpoint, except perhaps in the eyes of racists. Blacks in the United States, for instance, are emphatically not ideologically fungible. Associate Justice Clarence Thomas holds views sharply discrepant from those of Jesse Jackson and Barbara Jordan. The views of Congressman Gary Franks clash with many in the Congressional Black Caucus. Tom Sowell's views are not echoes of Benjamin Hooks or Louis Farrakhan. And black ideological pluralism is no novelty. Booker T. Washington and W.E.B. Dubois were ideological antagonists for long years around the turn of the last century.

Ward Connerly, a black California businessman on the Board of Regents of the University of California, recently voiced objection to affirmative action programs as inequitable and unfair to certain people. He also expressed chagrin at the reflex encouraged by affirmative action to be viewed first and foremost as a member of a racial group, rather than as an individual. Do Mr. Connerly's opinions reflect a "black" viewpoint in the mind of the F.C.C.?

To assert the existence of such a viewpoint is to betray racial stereotyping that is more to be denounced than imitated. To paraphrase the eloquence of Justice Clarence Thomas in Holder v. Hall (1994), the programming assumptions behind the F.C.C.'s section 1071 tax certificate policy "should be repugnant to any nation that strives for the ideal of a color-blind Constitution." They presume all blacks think alike. There may be better ways to inflame race relations, but if there are, they do not readily come to mind.

It is arguable that the tax certificate policy would pass constitutional muster under the Supreme Court's narrow 5-4 precedent in Metro Broadcasting v. F.C.C. (1990). But three members of the Metro majority have since departed the High Court, and I believe that the precedent is destined for overruling. In any event, a racist policy that passes constitutional scrutiny is still repugnant and should not be tolerated. That is a lesson the nation learned from its odious treatment of loyal citizens of Japanese ancestry during World War II which received the constitutional blessing of the Supreme Court. Congress later made partial amends for the racism in the Civil Liberties Act of 1988 which granted $20,000 to the victims or their families.

It seems clear under the Supreme Court's ruling in Regents of University of California v. Bakke (1978) that the F.C.C.'s tax ceertificate policy cannot be constitutionally justified by a desire to increase minority ownership of broadcast properties, without more. As Justice Lewis Powell elaborated in Bakke, to seek some specified percentage of a particular group in a student body, occupation or otherwise "merely because of its race or ethnic origin...must be rejectd...as facially invalid. Preferring members of any one group for no reason other than race or ethnic origin is discrimination for its own sake. This the Constitution forbids."

The fact that the tax certificate policy elicits hallelujahs within the business community is unsurprising. It is a coveted tax avoidance device, and when money is at stake constitutional or moral principles receive short-shrift from the typical businessman. I do not recall that business owners played heroic roles during the days of Jim Crow, the Freedom Riders and Bull Conner's dogs and hoses.

Finally, putting aside its constitutional deficiences and entrenchmant of racism, section 1071 seems a wildly profligate tool for advancing policies of the F.C.C. There is no limit on the amount of tax savings for a racially favored transaction; indeed, neither the F.C.C. nor the Department of Treasury makes any effort to calculate the tax loss of a section 1071 sale. Thus, the section probably confers monetary benefits vastly exceeding the amount needed to catalyze a sale to a minority-controlled investment group. The gold-plated tax certificate of Viacom is exemplary.

The prodigality of the F.C.C. under section 1071 is predictable. The Commission is not tasked to discover new sources of revenue to offset section 1071 tax losses, unlike Congress. When the cost to the F.C.C. of granting tax certificates is zero, a healthy incentive for frugality is lost. That seems at least a partial explanation of the Commission's extension of section 1071 to cable properties in the face of statutory language confining its scope to "radio broadcasting stations." The section is an extravagance that the nation cannot afford when cries for a balanced federal budget is the voice of the people.

In sum, section 1071 is twice-cursed: it fosters racial polarization and stereotyping; and, it promotes fiscal profligacy.

Chairman JOHNSON. Thank you.
Next is Mr. Foster.

STATEMENT OF J.D. FOSTER, PH.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, TAX FOUNDATION

Mr. FOSTER. Thank you, Madam Chairman. I am J.D. Foster; I am the executive director and chief economist of the Tax Foundation, a nonprofit, nonpartisan research and education organization.

I am going to restrict my remarks to the economic aspects of this issue and leave the debate about social and communication policies to others more qualified. I am not going to try and argue for or against the program or any changes to the program. I intend simply to present the underlying economics as best I have been able to determine them.

The situation is this, as I understand it: We have a transaction, specifically, the sale of a broadcast facility; and as the result of the sale, the FCC has authority to give tax relief intended to benefit the seller or buyer. In this case, the form of the relief is not particularly relevant; the question is really whether the tax relief can be justified on economic grounds.

A fundamental tenet of good tax policy is that taxation should be neutral and should not micromanage the economy. Tax neutrality is important because when taxes distort how resources are employed, the result is almost always lower wages, fewer jobs, and lost output. The Federal tax system is replete with nonneutralities, and some impose a very heavy tax burden on the economy, such as the tax burden on savings. However, others are much narrower, such as the FCC tax certificate program, the subject of this hearing.

These certificates allow the taxpayer to reduce or defer capital gains tax liability, in general, and in most cases the taxation of capital gains is highly distortionary. There is a direct tax on capital, reducing the incentive to save and invest, and broad-based reductions in the base improve the neutrality of the Tax Code. Targeted reductions in the capital gains improve neutrality of the system by reducing distortion against savings and investment. On the other hand, targeted reductions distort allocation of capital by shifting capital to tax-favored uses.

In general, such a targeted tax benefit is only warranted on economic grounds if it compensates for particular shortcomings in the marketplace, called an externality. Increasing minority ownership of broadcast facilities is a social policy and not a response to an economic externality. Therefore, the FCC tax certificate program is an instance of micromanagement of the economy which cannot be supported on the basis of the need to offset a peculiar economic condition.

Another possible economic justification has to do with private property rights. I think this probably goes back to the history of the original FCC program. To the extent FCC policy results in the involuntary sale of a broadcast facility, even if at fair market price, some form of compensation is appropriate. Thus, whenever the FCC requires the sale of a facility and the transfer is purely voluntary, then the tax benefits conferred by the tax certificate could be considered an appropriate form of compensation.

The problem, however, is that the tax benefit is only partly enjoyed by the seller of the asset. In the marketplace, since buyer and seller are both aware of the possible tax benefit, the value is considered by both parties in establishing a sales price.

For example, suppose the value of a facility in the absence of the tax certificate was $50 million and the value of the certificate is $5 million. The final sales price could fall anywhere between $45 and $50 million, depending on which side gets most of the tax benefit. The share of the benefit enjoyed by each party will vary by case, but it is almost certain that in every case there will, in fact, be a sharing. Therefore, the just compensation argument supports the program only to the extent the entire benefit of the tax is conferred on the sellers of the facilities since it is their loss of control of the asset which justifies the benefit.

Therefore, it appears that this program is either largely or entirely a tax subsidy to the transfer of an asset—in this case, the broadcast facility—and therefore, the program is equivalent to any other designed to benefit a special interest such as our financial markets or merchant shipping subsidy, except the beneficiary group is determined by race or gender rather than industrial classification.

Many Federal programs ultimately have a significant rent seeking quality, that being the expression for actions of an individual or group that seeks a special benefit from the government. Whether a particular group should be granted a special benefit is again a social policy and not an economic policy. Common sense, however, provides a simple test of the extent to which a program has a significant rent-bestowing character: who favors the program and do they receive a financial benefit from the program? In the case of the FCC tax certificate, this hearing and the testimony given offers the clearest evidence of who may be rent seeking.

In conclusion, the program to expand minority ownership of broadcast facilities reflects three policy decisions, the first of which is to increase the number of minority-owned broadcast facilities and, as such, is almost entirely a social policy.

The second is to compensate the former owners of the facility for the loss of control of their property when the sale is made involuntarily. This compensation, however, only arises to the extent the purchase price of the facility is not reduced to reflect a sharing of the tax benefit.

The third policy reflected is to subsidize the purchase of broadcast facilities through shared tax benefits granted by the certificates. There is no economic justification for such a subsidy program, which, like all attempts to subsidize or penalize economic activities, distorts the allocation of precious resources.

Therefore, the subsidy, too, must be regarded purely as a social policy decision.

Thus, I conclude that the policy is a social policy which carries a cost in the form of a tax distortion; and the political question and not the economic question is whether the price is worth what you are getting for the policy.

Chairman JOHNSON. I think you phrased it very well, Mr. Foster.

[The prepared statement follows:]

Statement of

J.D. Foster, Ph.D.
Executive Director and Chief Economist

Tax Foundation

on

The Economics of Section 1071: The FCC Tax Certificate Program

January 27, 1995

Madam Chairwoman and Members of the Committee, my name is J.D. Foster and I am the Executive Director and Chief Economist of the Tax Foundation. The Tax Foundation is a non-profit, non-partisan research and public education organization that has been monitoring fiscal policy at all levels of government since 1937. I would like to emphasize to the Committee that the Tax Foundation is not a "grass-roots" organization, a trade association, or a lobbying organization. We do not take positions on specific legislation or legislative proposals. Our goal is to explain as precisely and clearly as we can the current state of fiscal policy and the consequences of particular legislation in the light of specific tax principles so that you, the policy makers, may make informed decisions.

I appreciate the opportunity to appear before you today to discuss Section 1071 of the Internal Revenue Code which allows the Federal Communications Commission (FCC) to grant tax relief with respect to the sales of radio, television, and other properties under certain circumstances. This demonstrates, I think, that even at a time when such fiscally colossal issues like a balanced budget amendment and the "Contract with America" dominate our attention, there remain many important issues that should not be neglected, even though they may never appear above the fold on the morning paper. I commend the Committee for taking the time to address this issue.

Madam Chairwoman, I will restrict my remarks to the economic aspects of this issue and leave the debate about the social and communications policy to others more familiar with those aspects. It is not my purpose today to argue in favor of or against the program, or for or against any changes in the program, but rather to present its underlying economics as best as I have been able to determine them.

The FCC Tax Certificate Program

Under Section 1071, the FCC has the authority to grant a tax certificate to the former owners of certain broadcast facilities when the sale or exchange of those facilities is certified by the FCC "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..." Since 1978, the FCC has used this provision as a tool for its announced policy of promoting minority ownership of broadcast facilities. The tax certificate gives the taxpayer the right to elect to treat the sale or exchange as an involuntary conversion under Code Section 1033. The tax benefit generally is to allow the former owner to defer the realization of capital gain on the sale or exchange of the asset if the proceeds from the sale are used to purchase similar property. To the extent the taxpayer does not utilize the involuntary conversion rules, the capital gain resulting from the sale or exchange of the asset shall nevertheless not be recognized, if the taxpayer so elects, because the taxpayer may reduce the basis for determining gain or loss on sale or exchange of property if the property would qualify for depreciation under I.R.C. Section 167.

Tax Neutrality

Madam Chairwoman, when it was founded some 58 years ago the Tax Foundation established six Principles of Taxation to guide its analysis. One of these principles was that the tax code should not be used to micro-manage the economy. That is, the tax code should be as neutral as possible with respect to economic decision making. Tax neutrality is important because when taxes distort how resources are employed, the net result is almost always a lowering of wages, fewer jobs, and lost output. Thus, a non-neutral tax removes resources from the private sector in two ways: through the collection of the tax itself and through the income lost because of the mis-allocation of resources--what is called the deadweight loss.

Border tariffs offer a classic example of the deadweight loss from taxation. Tariffs are external taxes and, as such, distort the prices of foreign goods and services relative to domestic goods and services, thereby distorting the allocation of domestic resources like capital and labor. The history of modern trade policy is a nearly continuous effort to reduce tariffs because to do so results in an expansion of trade and an expansion of national output through the more productive use of resources.

Another example of a non-neutral tax and its deadweight loss involves the taxation of capital. Some states, for example, impose a specific tax on plant and equipment located within the state. These taxes on real capital reduce the amount of capital employed. Consequently, the workers in those states have less capital with which to work. We know that workers are generally paid more as the tools they work with improve (a fisherman generally will catch more fish with a net than with a single line, for example), so one consequence of this tax is that wages in these states are depressed relative to what they would otherwise be.

The federal tax system is replete with non-neutralities, almost all of which result in less output, fewer jobs, and lower wages. Some of these, such as the heavy tax burden on saving, are very broad in application and carry steep price tags. Others are much narrower, such as the FCC tax certificates which are the subject of this hearing.

It is important to note that there are occasions when the tax code is non-neutral by design. In many instances, the underlying policy is an attempt to address an economic externality through the tax code. An externality arises when the individuals involved in an activity are unable to enjoy all the economic benefits or do not bear all the economic costs of an activity. An example of the former would be a software manufacturer whose products are pirated; an example of the latter would be a restaurant which has a band that plays music so loud that it drives away customers from the restaurant next door.

The Research and Experimentation Tax Credit exemplifies a tax provision enacted in recognition of a positive externality. Even with patent and copyright protection, many of the economic benefits that follow from R & E activity cannot be captured through product sales or pricing by the company doing the work. As a result, a lower level of R & E activity is performed than would be socially desirable. This is an externality which the tax credit seeks to offset.

There are also many examples of taxes imposed to address negative externalities. One such is the gasoline excise which attempts to force the users of gasoline to pay for the amount of the resource they consume through the product's price, but also for the economic cost of the pollution that is thereby generated through the gasoline excise.

To summarize, through its non-neutralities the current tax code severely distorts the allocation of national resources, thereby reducing output, wages, and employment. While most of the non-neutral provisions in the tax code are the by-products of other policy choices (a desire for a progressive tax system, the choice of income as a tax basis, and so forth), some are deliberate attempts to use the tax code to capture economic externalities. Good tax policy should seek to eliminate the former and to target the latter most carefully.

The Taxation of Capital Gains

In general and in most cases, the taxation of capital gains is highly distortionary. Except in instances in which the capital gain arises directly as a result of reinvesting income, such as corporate retained earnings, the capital gains tax is a levy on capital and not on the income accruing to capital. As a direct tax on capital, the capital gains tax reduces the incentives to save and invest. Therefore, broad-based reductions in the tax improve the neutrality of the tax code.

The capital gains tax can be reduced in three ways: by reducing the tax rate which is applied to taxable gains, by reducing the amount of a taxable gain that is subject to tax (either through a percentage exclusion, by indexing the basis for inflation, or by a simple increase in the basis), or by allowing the taxpayer to defer the recognition of the capital gain. Deferral arises most notably when home owners sell one home and buy another, though it also arises in private saving arrangements such as Individual Retirement Accounts. The deferral of tax is one of the tax benefits conferred on qualifying sales of broadcast stations. A step-up in basis, which occurs in the tax code most notably in levying the estate tax, is a second tax benefit recipients of FCC tax certificates enjoy.

Targeted reductions in the capital gains tax on the one hand improve the neutrality of the tax system by reducing the distortion against saving and investing. On the other hand, however, targeted reductions in the capital gains tax can distort the allocation of capital by shifting capital to tax-favored uses. In general, such a targeted tax benefit would generally only be warranted on purely economic grounds if it were used to offset some externality as discussed above.

To the extent the FCC tax certificate program is attempts to capture an externality, and in this regard is similar to attempts to address other externalities such as polluting emissions, it must be recognized that the program seeks to address a <u>social condition</u> and not an <u>economic externality</u>, in which case economic arguments do not apply. Increasing minority ownership of broadcast facilities is social policy and not a response to an economic externality. Lacking any externality aspects, therefore, the FCC tax certificate program represents an instance of micro-management of the economy which cannot be supported on the basis of the need to offset an anomalous economic condition.

Property Rights and the Certificate Program

Property rights are the very backbone of our economic system. Much of our judicial system exists to protect private property from confiscation or loss of value through the actions of either individuals or governmental entities. Whenever an individual believes his or her private property can be taken without due process and just compensation, their economic energy and vitality diminishes.

The FCC tax certificate program is intended, in part, to diversify ownership of broadcast facilities to encourage greater minority control. To the extent this government policy goal results in the involuntary sale by private individuals of broadcast facilities to any other party, even if at a fair-market price, some form of compensation is appropriate. Thus, in any case where the FCC requires that a private individual or group sell a broadcast facility, for whatever reason, to another individual or group, and the transfer is truly involuntary, then the tax benefits conferred by the FCC tax certificate program could be considered an appropriate form of compensation.

Sharing The Benefit

The tax benefits are conferred on the former owners of broadcast facilities by the FCC tax certificate in the sense that the tax benefits are theirs to claim. In the marketplace, since both the buyer and the seller are aware of the possible tax benefit, the value of the benefit will be considered by both parties in establishing the sales price. For example, suppose the value of a broadcast facility in the absence of capital gains tax deferral is $50 million, and that the value of the deferral to the seller is deemed to be $5 million. The final sales price could fall, therefore, anywhere between $45 million, in which case the buyer gets the full benefit of the deferral, or $50 million in which case the seller gets the full benefit. The share of the benefit enjoyed by the seller and the buyer will vary case-by-case, but, it is likely that in nearly every case both the buyer and the seller will enjoy some portion of the tax deferral benefit.

Therefore, the argument that the FCC tax certificate is just compensation for the involuntary nature of the sale or exchange, to the extent it was in fact involuntary, supports the program only to the extent the entire benefit of the tax is conferred on the sellers of the broadcast facilities since it is their loss of the control of the asset which has given rise to the need for the benefit. However, since in most markets it is not possible to guarantee the entire amount of the tax benefit will be retained by the former owner, the tax benefit loses its character of compensation for involuntary conversion and becomes a simple subsidy to the new owners.

Rent-Seeking and the FCC Tax Certificate

The foregoing discussion leads to the conclusion that the FCC tax certificate program can only be justified on economic grounds in those cases in which the sale of the broadcast facility is truly involuntary and in which the entire tax benefit is enjoyed by the seller of the facility. In the absence of any other economic rationale, the tax certificate program becomes the equivalent of any number of subsidy programs designed to benefit some special interest. In other words, except under the narrow conditions described above (involuntary conversion and seller beneficiary), as an economic matter the FCC tax certificate program becomes indistinguishable from farm subsidies or merchant shipping subsidies, except that the beneficiary group is determined by racial rather than by industrial classification.

There are many federal programs which ultimately have a significant rent-seeking quality. (Rent seeking is the economic expression for the actions of any individual or group that seeks special benefits from a governmental entity). Strictly speaking, whether a particular group should be granted special benefits a matter of social policy, rather than economic policy, and to this extent outside the purview of economic analysis.

Common sense provides a simple test, however, of the extent to which a program has a significant rent-bestowing character. This test is unnecessary in most cases since, like farm subsidies, it is easy enough to determine who the rent seekers are, namely the farmers. In the case of the FCC tax certificate program, however, the existence and definition of the rent-seekers is less clear and so the test is more helpful.

The simple rent-seeking test is this: Who favors the program and do they receive a financial benefit from the program? In the case of the FCC tax certificates, this hearing and the testimony given may offer the clearest evidence of who may be rent-seeking, a matter I will leave to the Committee to decide.

Conclusion

The FCC tax certificate program to expand minority ownership of broadcast facilities reflects three policy decisions. The first is to increase the number of minority owned broadcast facilities and, as such, is almost entirely a social policy. The second policy is to compensate the former owners of the facility for the loss of control of their property when the sale was made involuntarily. This compensation arises, however, only to the extent that the purchase price of the facility is not reduced to reflect a sharing of the tax benefit between purchaser and seller.

The third policy reflected by the program is to subsidize the purchase of broadcast facilities through the shared tax benefits granted by the tax certificates. There is no economic justification for such a subsidy program which, like all attempts to subsidize or penalize particular economic activities, distorts the allocation of precious resources. Therefore, the subsidy, too, must be regarded purely as a social policy decision.

Chairman JOHNSON. Mr. Gattuso, I would appreciate if you could focus your remarks very tightly so that we could dismiss this panel before we have to leave to vote in about 10 minutes.

STATEMENT OF JAMES GATTUSO, VICE PRESIDENT, POLICY DEVELOPMENT, CITIZENS FOR A SOUND ECONOMY

Mr. GATTUSO. I will do my best.

Thank you for inviting me here today. I am James Gattuso, vice president, Policy Development at Citizens for a Sound Economy, a 250,000-member nonpartisan, nonprofit consumer advocacy group that promotes market-based solutions to public policy problems.

I want to first summarize the points I want to make.

I believe the FCC's tax certificate program is a failed program. It has benefited the rich and well-connected, not the disadvantaged. It has failed to increase diversity in programming. It raises some troubling questions regarding the government's role in matters of speech.

First, the beneficiaries of this program are not people whom one usually thinks of as being in need. Rather, the individuals who benefit from the current FCC program are those who already have substantial resources or connections. Simply put, the poor do not buy communications companies. Those who have been beneficiaries of this program include not only large corporations such as Viacom, but also include individuals such as Bill Cosby, outfielder Dave Winfield, and even talk show host Oprah Winfrey. These are not people trapped by economic disadvantage or their ethnic heritage. They are not people who require compensation for past wrongs. They are not people the American taxpayers should be asked to help. Yet these are the types of people who have benefited the most.

There is also little evidence this program has increased diversity in programming. The FCC's policy is based on the premise that change in ownership will lead to a change of programming. The evidence for such a connection is tenuous at best. Common sense tells us the demands of consumers, not the owner, is the primary determinant of programming.

Madam Chairman, communication executives are business people; regardless of color, race, or ethnicity, they provide programming that generates the largest profits. Conversely, white-owned firms can and do offer diverse programming when that is what consumers demand.

I would like to mention one well-known example of this, the growing Fox Network. This network owes much of its success to its ability to attract minority audiences. Several of its shows now rank in the top ranks of black viewership, for example. Fox's diverse programming is not due to any government program, but instead to a recognition of the economic benefits of providing what consumers want to see. This issue is discussed in more detail in my written statement.

I would like to point out, however, that more information would be available on this point but for Congress itself. Several years ago when the FCC decided to research this matter, Congress forbade it from acquiring the information. I understand it has continued that prohibition every year thereafter.

The FCC policy also has some serious First Amendment implications. How did the FCC determine that the term "minorities" should be limited to blacks, Hispanics, American Indians, Alaska Natives, Pacific Islanders? The lack of Polish polka radio stations, Pakistani sitcoms, and Australian documentaries is quite apparent in the United States. Yet these groups don't meet the minority standards set by the FCC.

I don't mean to trivialize this issue. I just want to point out that in making these decisions, the FCC is forced to make decisions as to the relative merits of different types of speech.

The FCC is saying certain types of speech are favored and other types are not favored. Such a role for the government is troubling even if meant to advance a good cause.

Ending this program doesn't mean the government should not work to increase program diversity and opportunity for minorities in telecommunications. I would suggest that there are several steps the Congress could take to lower existing barriers to minority ownership and diversity in communications. One such step would be a tax reduction, across-the-board tax reduction, perhaps in the area of capital gains which would help spur investment in small and medium size companies, a category that includes most minority-owned firms.

Congress should also look at communications regulations which hinder the growth of programming diversity. A good place to start, although it is outside the jurisdiction of this subcommittee, would be the Cable Act of 1992. The reduction in industry investment caused by that Act threatens to curb the growth of the small, specialized cable channels which have helped increase program diversity so much in recent years.

Madam Chairman, the results of last November's elections were clear: The American people want an end to special interest politics as usual. Repeal of the FCC tax certificate program would send a signal that Congress has heard that message. Created with good intentions, this program serves as a welfare program for some of the wealthiest members of society, while utterly failing to help disadvantaged minorities.

Congress should put an end to it.

Thank you for the opportunity to speak to you, and I will be open to any questions you may have.

[The prepared statement follows:]

STATEMENT OF JAMES GATTUSO
VICE PRESIDENT FOR POLICY DEVELOPMENT
CITIZENS FOR A SOUND ECONOMY

Good morning. Madame Chairman and Members of the Subcommittee on Oversight. My name is James Gattuso, and I am Vice President for Policy Development at Citizens for a Sound Economy, a 250,000 member non-partisan, non-profit consumer advocacy group that promotes market-based solutions to public policy problems. Thank you for inviting me here today to discuss the Federal Communication Commission's (FCC) tax certificate program. As you know, this provision allows broadcasting and cable firms to defer payment of capital gains taxes when their property is sold to a minority-owned entity. This deferral can be made permanent if profits from the sale are reinvested in "qualified" media properties within two years and if the minority owner maintains controlling power for a least one year .

This program was established seventeen years ago to boost minority ownership of broadcasting and communication businesses. The goal was to increase broadcast and cable "diversity," and increase the amount of broadcast and cable programming serving the needs and interests of minorities.

The program, however, has failed. It has benefitted the rich and well-connected, not the disadvantaged; it has failed to increase diversity in programming; and it raises serious questions regarding free speech.

FROM RICHES TO RICHES

The tax certificate program has helped bring in some minority owners in particular cases. However, the beneficiaries are not people that one usually thinks of as being in need. Rather, the individuals that benefit from the current FCC program are -- almost by definition -- those who already have substantial resources. Simply put, the poor do not buy communications companies. A potential buyer must be financially well-endowed and well-supported just to be considered a serious purchaser. This financial position places most potential buyers in the high income brackets of society.

Thus, in addition to large corporations such as Viacom, the beneficiaries of this program have included the likes of comedian Bill Cosby, outfielder Dave Winfield, and talk show host Oprah Winfrey. These are not people trapped by economic disadvantages or their ethnic heritage. These are not people who require compensation for past wrongs. These are not people whom the American taxpayer should be asked to help. Yet these are the type of people who benefit the most.

One extreme example of the problems of this program was the 1987 sale of WTVT in Tampa, Florida. The FCC granted WTVT owner Gaylord Broadcasting Co., a $116 million tax break on the sale. Gaylord had sold WTVT to communications investor George Gillet, Jr. and to black lawyer Clarence V. McKee, a former FCC staffer who helped write the tax certificate rules and who had no television operations experience. McKee maintained controlling power of WTVT for one year, after which he sold his share to Gillet for $1 million. The end result was a $116 capital gains deferment for Gaylord Broadcasting Co., large profits for McKee and other investors, but no increase in minority ownership. Gillet was also involved in a similar deal with Alaskan Eskimos during the sale of a Nashville TV station in winter of 1988 and 1989.

This is not to say that these men and women do not have the right to own and sell communications companies. What is wrong is federal support for their investments.

BUT WHAT'S ON T.V.?

One of the goals behind the FCC's incentive package was to increase programming "diversity". A change is ownership would, the FCC believed, lead to changes in programming. The evidence for such a connection is tenuous at best. To the contrary, common sense tells us that the demands of consumers, not the race of the owner, is the primary determinant of programming decisions. If there were a market for Eskimo music or shows about Pacific Islanders, then these programs would be offered.

This is the essential idea behind the concept of supply and demand. Producers will supply what consumers demand. Communication executives are businesspeople, regardless of color, race, or ethnicity. They will provide programming that draws the largest audience and generates the largest profits. When an Hispanic man takes over a previously white owned company, he will not automatically start showing more Hispanic soap operas. At least, he won't if that's not what his audience wants.

Conversely, white-owned firms can and do offer diverse programming when that is what consumers demand. For example, the growing Fox network owes much of its success to its ability to attract minority audiences, with several of its shows in the top ranks of black viewership. Fox's diverse programming is not due to any government program, but instead stems from a recognition of the economic benefits of providing what consumers want to see.

There is little academic evidence showing a correlation between an owner's ethnicity and programming. Speaking on the relationship between minority-owned communication companies and minority programming, Christopher H. Sterling of George Washington University reports that "what research has been done so far comes up showing no significant difference[s]."

It is noteworthy that more information would be available on this point but for Congress itself. Several years ago, when the FCC decided to research this matter Congress forbade it from acquiring the information, and has continued the prohibition every year thereafter.

WHAT IS GOOD SPEECH?

The FCC policy also has some serious First Amendment implications. How did the FCC determine that "minorities" should be limited to "Blacks, Hispanics, American Indians, Alaska Natives, Asians, and Pacific Islanders?" The lack of Polish polka radio stations, Pakistani sit-coms, and Australian documentaries is apparent in the United States. Yet these ethnic and racial groups do not meet the "minority" standards set by the FCC. Are the diversity needs of these sub-groups less important than those certified by the FCC?

In making these decisions, the FCC is forced to make decisions as to the relative merits of different types of speech. It is saying that certain types of speech are favored, and that other types are not favored. Such a role for the government is troubling, even if meant to advance a "good cause".

BETTER SOLUTIONS

Ending the FCC tax certificate program does not mean that the government should not work to increase program diversity and opportunities for minorities in telecommunications. There are, in fact, a number of steps which Congress could take which would be both fairer and more effective than this program. An across-the-board tax reduction, especially a reduction in capital gains taxes, would help spur investment in small- and medium-sized companies, a category which includes most minority-owned firms.

Congress should also look at communications regulations which hinder the growth of programming diversity. A good place to start -- although it is outside the jurisdiction of this committee -- would be the Cable Act of 1992. The reduction in industry investment caused by this act threatens to curb the growth of small, specialized cable channels, which have helped increase program diversity tremendously in recent years.

CONCLUSION

The results of last November's elections were quite clear: the American people want an end to special interest "politics as usual." Repeal of the FCC's tax certificate program would send a signal that Congress has heard that message. Created with good intentions, this program has served as a welfare program for some of the wealthiest members of society, while utterly failing to help disadvantaged minorities. Congress should put an end to it. Thank you for allowing me this opportunity to speak, and I am open to any questions you may have.

Chairman JOHNSON. Thank you. We appreciate it. Very good remarks.

Mr. Wilde.

STATEMENT OF BRUCE R. WILDE, ESQ., ROGERS & WELLS, NEW YORK, N.Y.

Mr. WILDE. Thank you, Madam Chair, and members of the subcommittee. I make my living as a corporate and securities lawyer at a Wall Street law firm. I want to state I am not here on behalf of my employer or any client. I am here stating personal views.

Several years ago when I was in law school, I became interested in the policies the FCC had adopted to promote minority ownership of broadcasting facilities. I studied those policies, including the tax certificate program under section 1071.

I came to the conclusion then that the existing policies, especially the certificate program, are not very well designed and are vulnerable to abuse. I wrote an article in the University of Pennsylvania Law Review criticizing the tax certificate program, which was published in 1990. I am submitting a copy of that piece for the record and for the subcommittee's use. I would like to summarize the points I made back in 1990, which I think are still valid criticisms today, and most, indeed, have already been referred to by some other witnesses.

[The University of Pennsylvania Law Review article is retained in committee files due to its size.]

Mr. WILDE. I believe that the tax certificate program is constitutional today by virtue of the Metro Broadcasting decision (497 U.S. 547 (1990)), but I think it should be understood that its constitutionality is dependent upon the continued blanket endorsement that the Congress provided through the appropriations rider. Were that to be withdrawn, I think that a different level of scrutiny would apply to the program, and I doubt that it would survive the scrutiny which would then be applied.

Tax certificates are, as has been mentioned earlier, an uncontrolled, open-ended drain on tax revenues. It is like an entitlement program. We really don't know what it is costing us or what it might cost us in the future. Also, the benefit that the seller gets is determined by the amount of capital gain realized; the benefit may be far more than would be necessary to encourage the sale to the minority enterprise, which is what we want, and that, of course, is a waste.

The best answer, I think, would be to replace the program with a direct spending program such as loan subsidies to help qualified minority entrepreneurs get into the broadcasting business. That way, Congress could determine how much to spend on the program and the FCC could direct the aid where it would do the most good in terms of increasing minority ownership.

If the program is to be kept within the tax system, there are several improvements that should be made. The amount of deferred capital gains should be limited to no more than 30 percent of the selling price of the broadcast property. I think that would be ample incentive.

Another problem is that the seller can get a tax certificate without showing that the minority persons will direct the day-to-day operation of the station after the sale, or that viewpoint diversity actually will be increased. If we want minority viewpoints on the air, we would have to require that the buyer have minority management, as well as ownership, as well as some kind of showing of how viewpoint diversity would be increased by the transaction. This is a reform the FCC can and should adopt.

I also see a danger that after a station is sold to a minority buyer and the seller gets the tax certificate, the station may not stay minority owned. If minority ownership is only temporary, we may have paid a big tax price for very little social benefit. The FCC should adopt a policy that after a tax certificate sale, it won't approve another sale or transfer of that facility except to another minority owner for a good, long period—I suggest 5 years—unless the seller has made a diligent effort and cannot find another minority buyer.

I hope the Congress will encourage the FCC to reexamine its minority preference programs in light of some of the criticisms that have been made over the last several years. If the FCC does not act, I think Congress should adopt reforms through appropriate legislation.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF BRUCE R. WILDE
BEFORE THE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
January 27, 1995

My name is Bruce Wilde. I make my living as a corporate and securities lawyer at a Wall Street law firm, but I am here today in my individual capacity, stating personal views, not those of my employer or any client. Incidentally, I worked as a news broadcaster in radio and television for 13 years before I became a lawyer.

I have always regarded myself as a liberal in political matters. I support color-blind action by government to protect civil rights and promote equal opportunity for all citizens of our country. However, I am troubled when the government uses race-conscious remedies in pursuit of social goals. Several years ago, when I was in law school, I became interested in the policies the FCC had adopted to promote minority ownership of broadcasting facilities. I studied these policies -- the tax certificate program under section 1071 of the tax code -- distress sales to minority buyers -- and the minority preference in choosing among competing applicants for broadcast licenses. I am not sure the FCC should have such policies at all. They violate the constitutional principle of equal protection, and it's always a question whether such violations are justified by the policy they seek to advance -- in this case increasing minority viewpoints on radio and television.

I came to the conclusion that the existing policies -- especially the tax certificate program which is the subject of this oversight hearing -- are not well designed and are vulnerable to abuse.

I wrote an article criticizing the tax certificate program which was published in the University of Pennsylvania Law Review. I am submitting a copy for the record and the Subcommittee's use. I would like to summarize the points I made then, which I think are still valid criticisms today, and the suggestions I made for reform of the program. I would like to point out that I do not currently practice communications or constitutional law, and therefore I do not hold myself out as a expert in these fields.

I believe the constitutionality of the program is doubtful. It was saved only by the blanket endorsement provided by Congress in the 1987 supplemental appropriation. I believe Congress should now withdraw that endorsement -- which I think would expose the program to much stricter due process scrutiny and encourage the FCC to adopt reforms.

Tax certificates are an uncontrolled, open-ended drain on tax revenues -- like an entitlement program. We really don't know what it's costing in lost tax revenues or what it might cost in the future. Also, the benefit the seller gets from a tax certificate is determined by the amount of capital gain realized by the seller. The benefit may be far more than would be necessary to encourage the sale to a minority enterprise -- and that's a waste.

The best answer, I think would be to replace the program with a direct spending program -- such as loan subsidies to help qualified minority entrepreneurs buy broadcast stations. That way Congress could determine how much to spend on the program and the FCC could direct the aid where it would do the most good in terms of increasing minority ownership.

If the program is to be kept in the tax system, there are some improvements that should be made.

The amount of deferred capital gain should be limited to no more than 30% of the selling price. I think that's plenty of incentive.

Another problem is that a seller can get a tax certificate without showing that minority persons will direct the day-to-day operation of the station after the sale or that viewpoint diversity will be increased. If we want minority viewpoints on the air, we need to require that the buyer have minority management as well as ownership as well as some showing of how viewpoint diversity will be increased. This is a reform the FCC should adopt.

I also see a danger that after a station is sold to a minority buyer and the seller gets a tax certificate, the station may not stay minority-owned. If minority ownership is only temporary, we've paid a big tax price for very little social benefit. The FCC should adopt a policy that after a tax certificate sale it won't approve a another sale or transfer of control of the station except to another minority buyer for a long period -- say five years -- unless the seller has made a diligent effort and can't find a minority buyer.

I hope that Congress will encourage the FCC to re-examine its minority preference programs in light of the criticisms that have been made and, if the FCC does not act, I think Congress should adopt reforms through appropriate legislation.

Thank you.

Chairman JOHNSON. Thank you very much.

I have only about 4 minutes to vote, so I am going to forgo questions of this panel and allow us to move on to the next.

But your testimony on the various points has been very clear on both the economics of this deal and some of the ways in which it could be restructured to overtly serve a social purpose, but in a way that was far more responsible economically.

Thank you. I appreciate it.

[Recess.]

Chairman JOHNSON. The subcommittee will come to order.

I appreciate the next panel being settled, and if the room will quiet down, please. I have to say I have a plane at 3:07. The Congress is adjourning at 3 o'clock, so we do want to have a chance to hear everyone's testimony.

Mr. Sutton, if you will begin, please. Welcome particularly on behalf of my colleague, Mr. Rangel, and his kind introduction of you.

I welcome you, sir.

STATEMENT OF PERCY E. SUTTON, CHAIRMAN EMERITUS, INNER CITY BROADCASTING CORP., NEW YORK, N.Y., ON BEHALF OF THE NATIONAL ASSOCIATION OF BLACK-OWNED BROADCASTERS, INC.

Mr. SUTTON. Thank you very much, Madam Chairperson. I am delighted to be here. I am most appreciative of my colleague, Congressman Rangel, who was here to introduce me. He is our Congressperson where I live, in the heart of Harlem, and I have come here because I think it important that this tax policy be sustained. I had a speech I wanted to deliver, Madam Chairperson, but I should now just place it in the record.

Chairman JOHNSON. Without objection, we certainly will do that.

Mr. SUTTON. I will deal with some of the issues, because I have heard fairness stated many times here. May I give you some background? I come from a place called Texas, and as a child I used to walk around on a farm with my 14 brothers and sisters, mother and father, and I used to talk into a corn cob: Good afternoon, ladies and gentlemen, this is Percy Sutton from high in the clouds of the Smith/Young Tower in San Antonio, Tex.

That was a dream. I could not even go into that radio station in San Antonio. I could not walk in. I could not walk on the sidewalk.

There is a river that runs through San Antonio now called the San Antonio River. It was just a creek when I was a child, but there was a large brown bear that swam in that creek known as the San Antonio River every day. But I could only visit that bear and that creek one day out of the year. That was called June-teenth. June-teenth, June 19, was when blacks in Texas were notified of the emancipation proclamation. So we were allowed to go there.

It is against that background that I grew up; segregated schools. My father was my junior high school principal. My mother was my first grade teacher and six of my older brothers and sisters were my teachers before I graduated from high school. I was the youngest of the Suttons. My father and mother believed every little Sutton was going to learn through here, if possible; through here, if necessary.

We learned. My father said if you speak properly, do not put your elbows on the table while you eat, do not pick your nose in public, you will be accepted. I don't and I never did put my elbows on the table while I ate, don't pick my nose in public, and I try to speak the American English.

That, however, did not keep me from serving in the military for my country in World War II, as the Congressman described, but in a segregated unit, being put in jail because I sought to go into an officers' club, though I was an officer, and sought to exercise my right working to save the world for democracy.

I returned to the military after finishing law school and entered into the Korean conflict. I have a son, who is the present chairman of our company now, who served in Vietnam. I mention all of this because we talk about fairness.

I have spent enough years in government, both in the State legislature of New York, and as a chief executive of The Borough of Manhattan in New York City; we have made enough grants; I have participated in enough tax abatements to special groups, for the good of the whole, it was said. I participated, Madam Chairperson, in developing this policy that is before us now. I helped create the climate for it.

I want to talk about role models. I can attest to you, Madam Chairperson, that every owner, every black owner of a radio or television station in this country, whether gained by tax certificates or otherwise, is a role model in the community.

In my own community in central Harlem, across from Harlem Hospital, I live in a middle-income development. I have chosen not to move from Harlem. I live next door to a low-income development. Every morning there are at least five supplicants at my door who see me as a role model. Much of my time, three-quarters, I have evaluated my time, is spent working as a surrogate parent, participating in group discussions or otherwise seeking to advance my neighbors. I suggest to you that this is the role of all minority owners.

Now, I don't know Mr. Frank Washington. I know of him. I have seen him once. But I can say this to you, the focusing on Mr. Washington or an Oprah Winfrey or someone of that consequence, of that circumstance, is to injure the process. Why? Because that is indeed an aberration. One billion some-odd-dollar purchase price? Mr. Washington, I am proud of him. I am proud of him as someone from my community.

Why am I proud? Because it took me 8 years to buy my first radio station because no one would lend me money. I went to 67 institutions, including insurance companies.

In your State and in my State of New York and in Texas, I toured this country trying to raise $2.5 million to buy my first radio station. My first cable television station, my only one, it took me 7 years to raise the money. Why? Because blacks and minorities as a whole do not have access to money.

The purpose of this legislation, or the rule, was to see that minorities would have greater access and there would be diversification, if you will. I am tonguetied. However, with regard to the tax policy, this is minuscule. The amounts of money invested here in the public policy issue is minuscule compared to the other tax benefits and losses that occur to this treasury.

[The prepared statement follows:]

STATEMENT OF PERCY E. SUTTON
CHAIRMAN EMERITUS
INNER CITY BROADCASTING CORPORATION
ON BEHALF OF THE NATIONAL ASSOCIATION
OF BLACK-OWNED BROADCASTERS, INC.

GOOD MORNING CHAIRMAN JOHNSON, AND MEMBERS OF THE SUBCOMMITTEE ON OVERSIGHT. ON BEHALF OF THE NATIONAL ASSOCIATION OF BLACK OWNED BROADCASTERS, INC. ("NABOB"), I THANK YOU FOR THE OPPORTUNITY TO PRESENT TESTIMONY TODAY.

I AM A LAWYER AND A BUSINESSMAN.

I WORK AND LIVE IN THE VILLAGE OF HARLEM IN NEW YORK CITY. HARLEM, THE HOME OF THE SCHOMBURG COLLECTION, THE APOLLO THEATRE, AND THE ANCESTRAL HOME FOR AFRICAN-AMERICAN CULTURE.

I AM A TRIAL LAWYER, AND I OPERATE A NUMBER OF BUSINESSES AROUND THE COUNTRY; SOME OF THAT BUSINESS IS IN RADIO OWNERSHIP AND OPERATION, TELEVISION PROGRAMMING AND CABLE TV OWNERSHIP.

I HAVE BEEN FASCINATED BY THE FIELD OF COMMUNICATIONS SINCE I WAS A CHILD IN TEXAS, LIVING WITH A MOTHER AND FATHER AND 14 BROTHERS AND SISTERS ON A FARM OUTSIDE OF SAN ANTONIO, TEXAS -- AND PRETENDING, OFTTIMES, THAT I WAS A DISC JOCKEY ON A MAJOR RADIO STATION IN SAN ANTONIO. IN WHICH AS A BLACK

PERSON, I WAS NOT EVEN ALLOWED TO ENTER.

NEVERTHELESS, I PRETENDED BY HOLDING A CORN COB TO MY MOUTH, AND STATING: "GOOD AFTERNOON LADIES AND GENTLEMEN, I AM PERCY SUTTON FROM HIGH IN THE CLOUDS IN THE SMITH/YOUNG TOWER IN SAN ANTONIO, TEXAS."

THOUGH I PRETENDED TO BE A DISK JOCKEY, I COULD NOT; AS THERE WERE NO OPPORTUNITIES FOR BLACKS (NEGRO, COLORED, OR AFRICAN-AMERICAN) TO BECOME DISK JOCKEYS IN SAN ANTONIO, TEXAS.

IN SPITE OF THE ABSENCE OF OPPORTUNITY, MY DREAM CONTINUED UNTIL AFTER SERVING IN BOTH WORLD WAR II AND THE KOREAN CONFLICT, I GAINED ACCESS TO AN ON-THE-AIR, VOLUNTEER POSITION WITH A LOCAL RADIO STATION, WLIB, IN HARLEM -- WHICH I LATER, THROUGH THE COURTESY AND ASSISTANCE OF THE OWNER, WAS ABLE TO BUY.

I AM HERE IN SUPPORT OF SECTION 1071 OF THE INTERNAL REVENUE SERVICE CODE WHICH HAS BEEN UTILIZED BY THE FEDERAL COMMUNICATIONS COMMISSION IN ITS TAX CERTIFICATE POLICY SINCE 1943, AND IN ITS OVERALL MINORITY OWNERSHIP POLICIES SINCE 1978.[1] AS THE OSTENSIBLE PURPOSE OF THIS HEARING IS TO ADDRESS THOSE ASPECTS OF THE COMMISSION'S TAX CERTIFICATE

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1 SEE, STATEMENT OF POLICY ON MINORITY OWNERSHIP OF BROADCAST FACILITIES, 68 F.C.C. 2d 979, 42 RR 2d 1689 (1978).

POLICIES THAT ARE INTENDED TO PROMOTE DIVERSIFICATION OF OWNERSHIP THROUGH MINORITY PARTICIPATION, I SPEAK FIRMLY IN SUPPORT OF A POLICY THAT HAS PROVIDED SOME DESIGNATED BENEFITS TO MINORITIES. HOW CAN I SAY "BENEFITS"? HOW CAN SUCH TALK BE JUSTIFIED? I HOPE TO MAKE THAT POSITION CLEAR TO YOU THIS MORNING.

MY TESTIMONY TODAY IS PRESENTED IN TANDEM WITH THAT OF MR. JAMES WINSTON, THE EXECUTIVE DIRECTOR OF THE NATIONAL ASSOCIATION OF BLACK-OWNED BROADCASTERS (NABOB), AN ASSOCIATION OF WHICH I WAS A CO-FOUNDER AND REMAIN A STAUNCH SUPPORTER. I MENTION THIS BECAUSE I WILL ADDRESS THE BROAD POLICY CONSIDERATIONS, WHILE MR. WINSTON WILL ADDRESS THE LEGAL CONSIDERATIONS.

AS A VETERAN OF THE CIVIL RIGHTS ERA, I REMAIN VERY ACTIVE IN THAT COMMUNITY AND TRAVEL THIS COUNTRY SPEAKING TO VARIOUS ORGANIZATIONS, MANY OF WHICH ARE PROFOUNDLY TROUBLED BY WHAT ARE PERCEIVED TO BE VERY UNSUBTLE ATTEMPTS TO "ROLL BACK THE CLOCK" ON AFRICAN-AMERICANS. I OWN A TALK RADIO STATION IN THE CITY OF NEW YORK, AND I AM VERY UNSETTLED BY THE NUMBER OF OUR CALLERS WHO SINCERELY FEAR THAT THE MUCH TOUTED "CONTRACT WITH AMERICA" IS REALLY A VEILED "CONTRACT ON MINORITIES."

IT'S NO SECRET THAT MINORITIES, SPECIFICALLY MINORITIES OF

AFRICAN DESCENT, HAVE NOT HAD THE "TRADITIONAL" OPPORTUNITIES MADE AVAILABLE TO THEM HISTORICALLY. IN FACT, IN THE PAST I HAVE REFERRED TO THIS AS OUR "BLACK TAX." WHEN I SAY "BLACK TAX" I DO NOT SAY THIS TO BE OFFENSIVE. NO, I SAY THIS SADLY BECAUSE IT IS A SIMPLE REALITY THAT AFRICAN-AMERICANS, AND PERHAPS CERTAIN OTHER GROUPS IN AMERICA, LIVE IN VASTLY DIFFERENT WORLDS. BUT THIS IS ESPECIALLY TRUE OF AFRICAN-AMERICANS, BECAUSE WE ARE ALWAYS "DISTINGUISHABLE" AND WE HAVE YET TO ESCAPE THAT STATUS OF BEING FIRST AND ALWAYS DISTINGUISHED BY THE COLOR OF OUR SKIN. HISTORICALLY, THAT DISTINCTION HAS DETERMINED WHERE WE LIVED, WHAT TYPE OF JOBS WERE OPEN TO US, AND WHAT OPPORTUNITIES MIGHT BE AVAILABLE TO US.

RECOGNITION OF THE EFFECT THAT CERTAIN HISTORICAL DISTINCTIONS HAD UPON MINORITY REPRESENTATION IN BROADCASTING LED THE COMMISSION TO ATTEMPT IN 1978 TO ADDRESS THE NEED FOR DIVERSITY OF OWNERSHIP BY ISSUING ITS POLICY STATEMENT ON MINORITY OWNERSHIP OF BROADCAST FACILITIES (THE "POLICY STATEMENT"). IN THAT STATEMENT, THE COMMISSION ACKNOWLEDGED THE "DEARTH OF MINORITY OWNERSHIP IN THE BROADCAST INDUSTRY" AND SOUGHT TO PROMOTE OWNERSHIP PRINCIPALLY THROUGH RELIANCE UPON THE TAX CERTIFICATE. WHAT THE COMMISSION TRIED TO ACCOMPLISH WAS

THE CREATION OF A CLIMATE IN WHICH THE INDUSTRY WOULD FIND IT ATTRACTIVE TO DO BUSINESS WITH MINORITIES, JUST AS THE INITIAL USES OF §1071 MADE IT ATTRACTIVE TO FURTHER OTHER COMMISSION POLICIES, SUCH AS THE BAN ON CROSS-OWNERSHIP. THE GOVERNMENT HAS ALWAYS USED INCENTIVES OF ONE FORM OR ANOTHER TO MOVE BUSINESS. WHETHER IT IS THE INTEREST RATE OR THE GATT TREATY, IT IS CLEARLY UNDERSTOOD THAT THE "CARROT AND STICK" WORKS. (THE FALLACY IN THE ATTACKS ON INCENTIVE POLICIES IS THAT THEY ATTEMPT TO SUGGEST THAT YOU CAN ACCOMPLISH CHANGE WITHOUT CHANGING ANYTHING. THE CIVIL RIGHTS ACT OF 1968 WAS PASSED LESS THAN 30 YEARS AGO. AS MUCH AS ALL OF US WOULD LIKE TO THINK OF AMERICA AS A FREE AND OPEN SOCIETY, 30 YEARS IS TOO SHORT A TIME IN WHICH TO ERASE THE PROFOUND EFFECTS OF INSTITUTIONAL RACISM. IT WAS ONLY TEN YEARS AFTER THE ACT'S PASSAGE THAT THE COMMISSION ENACTED ITS POLICIES).

SUBSEQUENT TO THE ISSUANCE OF THE 1978 POLICY STATEMENT, THE COMMISSION ENTERED INTO ITS "DEREGULATORY" PHASE. THROUGHOUT THE 80'S, WE EXPERIENCED THE RELAXATION OF THE RULES GOVERNING BROADCAST STATION OWNERSHIP, THE INCREASE IN COMPETITION FROM NEW AND NON-BROADCAST SERVICES, AND CONTINUAL ASSAULTS ON EVERY ASPECTS OF THE MINORITY OWNERSHIP POLICIES. THE EFFECT OF EACH OF THESE ACTIONS UPON

MINORITIES WAS TO ENDANGER THE FEW GAINS THAT MINORITIES HAD MADE, AND MAKE IT THAT MUCH MORE DIFFICULT FOR COMPANIES TO BECOME, OR REMAIN, COMPETITIVE -- EVEN THOSE MINORITY COMPANIES WHO MIGHT HAVE APPEARED TO HAVE "MADE IT." JUST LAST WEEK, SENATOR PRESSLER, CHAIR OF THE SENATE COMMERCE COMMITTEE, INVITED MOST OF THE "MAJOR" TELECOMMUNICATIONS COMPANIES TO WASHINGTON TO DISCUSS THEIR CONCERN OVER HIS PROPOSED "SUPERHIGHWAY" LEGISLATION. NO MINORITY COMPANIES WERE PRESENT. WHAT WOULD THESE MULTIBILLION DOLLARS CORPORATIONS VIEW AS AN ISSUE OF CONCERN? THEIR CONTINUING ABILITY TO REMAIN COMPETITIVE IN A CHANGING REGULATORY ENVIRONMENT. ARE THEY SEEKING "PREFERENTIAL" TREATMENT? OF COURSE THEY ARE! I AM NOT SO NAIVE AS TO THINK THAT IN ATTEMPTING TO PLACATE THE PROBLEMS THAT THE TELCOS HAD WITH THE 1994 LEGISLATION THAT SOME "BENEFITS" WERE NOT PUT ON THE TABLE. I AM JUST AS CERTAIN THAT THE HOUSE'S CURRENT BILL WILL REFLECT A SIMILAR WILLINGNESS TO MEET THE DEMANDS AND THE "NEEDS" OF THE TELCOS AND CABLE COMPANIES WHO HAVE BEEN INVITED TO PARTICIPATE IN THE DRAFTING OF THE LEGISLATION. THERE WILL SURELY BE PROVISIONS INCLUDED TO ENSURE THAT THESE POWERFUL COMPANIES WILL NOT SUFFER WHILE MAKING THE TRANSITION INTO COMPLIANCE WITH THE NEW ACT. ANY SUCH PROVISIONS WILL

AFFECT THE TREASURY. AND YET, THESE EFFORTS ARE LAUDED BY ALL PARTIES AS NECESSARY FOR THE FUTURE GROWTH OF THE TELECOMMUNICATIONS INDUSTRY. WHILE THE VERY CLEAR SIGNAL OF THE TELCO BILL NEGOTIATIONS IS THAT THIS IS SOMETHING THAT IS GOOD FOR BUSINESS, DESPITE THE BENEFITS THAT WILL BE ACCORDED TO CERTAIN OF THE INDUSTRIES, ASSAULTS UPON THE FEW INCENTIVES DIRECTED AT MINORITIES SENDS A VERY DIFFERENT SIGNAL. THE CLEAR MESSAGE IS THAT ENDORSEMENT OF MINORITY PARTICIPATION IS GONE, REPLACED BY AN ATTITUDE THAT ESSENTIALLY STATES: "BE THANKFUL FOR WHAT YOU'VE GOT."

THE PUBLIC, THE INDUSTRY, AND THE PRESS ARE ALL VERY ATTUNED TO GOVERNMENTAL SIGNALS. WILL THERE BE A SIGNAL THAT MINORITY OWNERSHIP REMAINS A POSITIVE FOR THIS COUNTRY?

AS MINORITY BUSINESSES BECOME LARGER AND MORE VIABLE, THERE IS A DIRECT IMPACT UPON THE ECONOMIC HEALTH OF THEIR SURROUNDING COMMUNITIES. EVERY ACQUISITION BY A MINORITY CAN PROVIDE A NEW SOURCE OF EMPLOYMENT, A NEW HEALTH PLAN, A BETTER CHANCE OF BECOMING A TAX-PAYING MEMBER OF SOCIETY. BUT OUR BUSINESSES CANNOT GROW ON WISHES AND PRETENDING. WE CANNOT PRETEND THAT HISTORIC AND INSTITUTIONALIZED RACISM MAGICALLY DISAPPEARED IN 1968. NOR CAN WE IGNORE THEIR LINGERING EFFECTS UPON OUR ACCESS TO CAPITAL, OR OUR

ABILITY TO PARTICIPATE IN THE LARGER OPPORTUNITIES. RACE NOT WITHSTANDING, NO ONE ENTERS AN INDUSTRY WITH THE INTENT TO BECOME ITS PERMANENT UNDERCLASS. IN TODAY'S PARLANCE, EVERY ONE SEEKS TO "GROW" THEIR BUSINESS, AND GROWTH MEANS LARGER OPPORTUNITIES TO EXPAND. AND JUST AS THE TWO TELECOM SUBCOMMITTEES HAVE RECOGNIZED, BUSINESS TRADITION SUGGESTS THAT MOST DEALS REQUIRE SOME INCENTIVE ON THE PART OF EACH PARTY TO GO FORWARD IF AN AGREEMENT IS TO BE REACHED.

I WILL CLOSE WITH WHAT I FEEL IS A CLEAR EXAMPLE OF THE COMMISSION'S APPROACH TO ACHIEVING PARITY. WHEN JUST TEN YEARS AGO THE COMMISSION DECIDED TO BREAK-UP AT&T'S MONOPOLY OVER THE TELEPHONE INDUSTRY, IT DID SO BECAUSE IT DECIDED THAT COMPETITION WAS GOOD AND THAT THE "OTHER COMMON CARRIERS" WERE DISADVANTAGED BY THAT MONOPOLY. THE COMMISSION FURTHER DETERMINED THAT BECAUSE OF THAT HISTORIC DISADVANTAGE, IT COULD ACT ON BEHALF OF THE OTHER CARRIERS AND JUSTIFIABLY ENACT POLICIES THAT WOULD ACCORD THE OTHER COMMON CARRIERS CERTAIN ADVANTAGES OVER AT&T AND ITS LOCAL PHONE SUBSIDIARIES. ONE OF THOSE "POOR" OTHER COMPANIES WAS TODAY'S GIANT MCI. THE TAX CERTIFICATE POLICY, IN BOTH ITS MINORITY AND NON-MINORITY APPLICATIONS, WORKS BECAUSE IT PROVIDES A NECESSARY INCENTIVE FOR BUSINESSES TO MOVE COMMISSION POLICIES FORWARD, WHETHER THOSE POLICIES BE

CROSS-OWNERSHIP, CABLE/BROADCAST BREAKUPS, OR MINORITY OWNERSHIP. THE POLICY, IN ANY OF ITS MANIFESTATIONS, HAS ALWAYS BEEN DIRECTED AT THE FACT OF THE TRANSACTION, NOT THE SIZE. MINORITY ENTREPRENEURS ARE BUSINESSPEOPLE NOT UNLIKE ANY OTHER ENTREPRENEURS. WHAT WE LACK AND NEED IS ACCESS TO THE MAJOR MARKETPLACE. WE SEEK ONLY WHAT MCI AND THE NON-BELL COMMON CARRIERS SOUGHT--SOME INCENTIVE OR MECHANISM TO OVERCOME AN HISTORIC UNEQUAL DISTRIBUTION OF OPPORTUNITY. THANK YOU.

ONCE AGAIN I THANK YOU FOR THE OPPORTUNITY TO MAKE THIS PRESENTATION.

Chairman JOHNSON. Thank you, Mr. Sutton.

I appreciate your testimony and your eloquence as to the importance of access into markets. The importance of role models and the importance of people succeeding so others can see success are absolutely important to me.

I think it is concerning that we have in place a public policy that we know so little about. We do not know to whom it gave money, we don't know how much it gave, we don't know whether it affected diversity, we don't know whether there was real management control. Now, that is not to undermine the importance of the policy, but it is to say we have not been doing our job and we should find out.

To the extent you are interested, we will be happy to share with you the information we get from the agencies as they provide us with better information and look at how we can make this policy more accountable, but at the same time, achieve its goal.

Mr. SUTTON. You did note in the testimony that very few minorities actually benefit. What that does, the policy does, is it gives access to the persons who may be willing to sell, even though we may have to pay market price in buying it.

Chairman JOHNSON. I understand that. Thank you very much.

Mr. Winston.

STATEMENT OF JAMES L. WINSTON, EXECUTIVE DIRECTOR AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF BLACK-OWNED BROADCASTERS, INC.

Mr. WINSTON. Good afternoon, Chairman Johnson, members of the subcommittee. On behalf of the National Association of Black-Owned Broadcasters, thank you for the opportunity to present testimony today on section 1701 of the Internal Revenue Code.

Chairman JOHNSON. Excuse me, could you pull the microphone closer?

Mr. WINSTON. Sure. I have the distinct disadvantage here of having to speak after Mr. Sutton.

Chairman JOHNSON. You also will be more severely controlled by the 5-minute limit. Out of respect, he was given latitude.

Mr. WINSTON. But it is a pleasure to have the opportunity to follow his comments, because he is one of the role models that has guided NABOB since 1976.

It has been suggested that the FCC has not implemented the tax certificate policy in a manner which has promoted the ownership of broadcast facilities by minorities. One of the theories espoused by the opponents of the policy is the policy has been abused in sham transactions in which companies identified to the FCC as minority owned are actually controlled by nonminority individuals, who put forth minority individuals to front for them.

The history of the minority tax certificate policy refutes this claim.

As noted, the minority tax certificate policy has been operated by the FCC since 1978. During that time the FCC has issued approximately 300 tax certificates. During that same period, the FCC has approved approximately 15,900 transactions. Tax certificate transactions, therefore, constituted only 1.9 percent.

Chairman JOHNSON. Those were not all license transactions.

Mr. WINSTON. Beg pardon.

Chairman JOHNSON. Those were not all license transactions, were they?

Mr. WINSTON. What do you mean? I am not sure I understand the question.

Chairman JOHNSON. Licensure transactions.

Mr. WINSTON. Oh, yes. In other words, you have to understand there are approximately 11,000 broadcast facilities in America today. So those are transactions of broadcast stations being bought and sold: 15,900.

Chairman JOHNSON. Thank you.

Mr. WINSTON. OK. Therefore, to suggest that—if this program is such a boondoggle, it would generate a lot more activity than it has.

The fact is the vast majority of these tax certificates were issued to companies which were all almost 100 percent minority owned. The entrepreneurs who controlled these companies put together their transactions and built their companies with little or no attention from or support from the nonminority media. However, it now appears that press speculation of one or two possible abuses of the policy have galvanized a tidal wave of opposition to the policy. Such opposition is unfounded.

The FCC, on occasion, may be presented with a proposed transaction in which individuals may seek to circumvent the intent of the policy. However, this subcommittee and most certainly the full committee, has adopted over the years numerous tax policies which favor one group of individuals or companies with tax benefits.

When the subcommittee and full committee adopt and renew such policies, you are obviously mindful such policies must be implemented by the Internal Revenue Service in a manner such that unscrupulous persons would not be allowed to abuse those policies. Thus, you have given the IRS extensive enforcement authority and resources to detect and prevent such abuses.

The FCC, like the IRS, has the authority and resources to detect and prevent abuses of the tax certificate policy. The FCC uses that authority to effectively preclude such abuses.

This subcommittee does not routinely eliminate important tax benefits for individuals in industries for which it has created tax initiatives merely because the IRS may uncover some attempts to abuse those policies. The subcommittee should similarly take no such action against the minority tax certificate policy.

The FCC's tax certificate policy, in any announced transaction which may be causing this subcommittee concern, has received so much publicity that the FCC will be forced to scrutinize any new tax certificate applications extremely thoroughly to assure that no abuse of the policy is occurring. We are certain that the FCC will reject any transactions which fail to comply with the objectives of the policy. NABOB fully supports such close scrutiny.

The only parties who will suffer by elimination of the policy are the honest, dedicated entrepreneurs who will never get an opportunity to use the policy because of this subcommittee's concern about potential abuses. We are left, then, to determine if there are other concerns which warrant elimination of the policy.

We have heard this is not a minority ownership issue but a deficit reduction issue. But is a potential loss of revenues for the Treasury a reason to single out the minority tax certificate policy for elimination? No. This subcommittee and the full committee routinely approve tax measures which result in lost revenues to the Treasury. Congressman McDermott gave several examples earlier today.

Our objective in pointing out these provisions is not to question any of them, to suggest that any of them constitutes bad policy. Rather, the purpose is to point out there is nothing in the FCC tax certificate that is outside the realm of the kinds of policies this subcommittee approves each year.

The question has been asked today should the policy be abolished because there are ways of encouraging minority ownership other than allowing nonminority companies tax deferrals resulting to minorities. The simple answer is, we in the FCC have been looking for almost 20 years and we have yet to find one.

[The prepared statement follows:]

TESTIMONY
OF
JAMES L. WINSTON
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
OF
THE NATIONAL ASSOCIATION
OF
BLACK OWNED BROADCASTERS, INC.
BEFORE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT

January 27, 1995

Good morning Chairman Johnson, and members of the Subcommittee on Oversight. On behalf of the National Association of Black Owned Broadcasters, Inc. ("NABOB"), I thank you for the opportunity to present testimony today on Section 1071 of the Internal Revenue Code.

NABOB was organized in 1976 as a response to the abysmal underrepresentation of Black Americans in the communications industry. Since its inception, NABOB has grown into a major trade association representing the interests of 178 Black-owned commercial radio stations and 20 commercial television stations around the country. Additionally, NABOB counts among its associate membership: law firms, station brokers, national rep firms, financial institutions and a variety of other organizations involved in broadcasting, cable television and common carrier services.

As the voice of the Black broadcast industry, NABOB has been instrumental in shaping national government and industry policies to improve the opportunities for success for Black and all other minority station owners.

The press coverage in anticipation of this hearing has positioned this as a hostile attack upon Section 1071. I hope that through our testimony today, we can demonstrate to the Subcommittee that there is no reason for this Subcommittee to be hostile toward Section 1071. Indeed, we believe that this Subcommittee should embrace Section 1071 as legislation which both Republican and Democratic members of the House have supported in the past and should strive to improve in the future.

It is apparent that one recent proposed transaction has generated a great deal of press interest in Section 1071, and this, in turn, has focused this Subcommittee's attention. However, a review of the history of Section 1071 clearly demonstrates that Section 1071 has been accomplishing precisely what it should be doing and that it should be preserved and possibly expanded.

Chairman Johnson's press advisory setting forth the focus of this hearing asks a series of questions which the Subcommittee will seek to answer today. Those questions can serve as an efficient tool for understanding and appreciating the importance and value of Section 1071.

The first question asked in the press advisory is: "Whether the FCC's 1978 policy is consistent with the underlying intent of Section 1071?" First it should be pointed out that Section 1071 was enacted in 1943. In 1943, the communications industry was owned and controlled and completely dominated by non-minorities. Indeed, at the time of the adoption of Section 1071, all of American life, including this House and this Subcommittee were similarly controlled and dominated. Moreover, 1943 was eleven years before the Supreme Court's decision in Brown v. Board of Education, 347 U.S. 483 (1954), which means that legal segregation as approved by the U.S. Supreme Court in 1896, in Plessy v. Ferguson, 163 U.S. 537 (1896) was still the law of the land.

Therefore, if the question this Subcommittee seeks to have answered today is: "Did Congress direct the FCC to create the minority ownership policy using Section 1071, when Congress adopted Section 1071 in 1943?" this hearing can be over very quickly. However, we submit that this is not the correct manner for viewing the question raised in the press advisory. The proper method for viewing the question raised in the press advisory is: "In light of Congress's treatment of Section 1071 over the seventeen years since the FCC adopted the minority ownership policy, is the FCC's 1978 policy consistent with the underlying intent of Section 1071?" The answer to this question is a resounding "yes," and it is this history on which this Subcommittee should focus.

As the Subcommittee is well aware, Section 1071 was not a new provision when the FCC included the promotion of minority ownership as a policy which could be used to allow a grant of a tax certificate. Section 1071 was adopted by Congress in 1943 to allow the gain from the sale or exchange of broadcast facilities to be deferred in cases where the sale or exchange is certified by the FCC "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(a) (1988).

After its enactment in 1943, the Commission used Section 1071 to promote its policy of diversification of ownership and control of the broadcast industry. The FCC allowed companies to obtain a tax certificate under section 1071 to defer the gain on the sale of broadcast stations in circumstances in which the FCC determined that a station owner possessed too great a control over the dissemination of news and information in a single market. Thus, when the FCC determined that a single owner held an excessive degree of ownership and control over daily newspaper, radio stations, television stations and/or the cable television systems in a given market, the FCC granted a tax certificate to the owner if the owner sold certain of its broadcast holdings.

In 1978, the FCC turned to Section 1071 to address a related issue of diversification of ownership of the mass media. The nature and magnitude of the problem which confronted the Commission in 1978 was fully considered and analyzed by the United States Supreme Court in 1990, when the Court addressed the constitutionality of the minority ownership policies adopted by the Commission in 1978. In that case, Metro Broadcasting v. FCC, the Supreme Court observed that the

FCC adopted its minority ownership policy after several years of consideration of the problem of the lack of participation by African Americans and other minorities in the ownership and control of broadcast facilities. Metro Broadcasting v. FCC, 497 U.S. 547 (1990).

In Metro, the Court noted that in 1968, the FCC first addressed the lack of involvement of African Americans and other minorities as employees in the broadcast industry. Id. at 554-555. The Court pointed out that the FCC, in 1968, recognized that a diverse work force in the broadcast industry was essential if minorities were to be able to achieve their First Amendment right to freedom of expression. Id. The Court noted that, after several years of developing, implementing and enforcing equal employment opportunity ("EEO") rules, the FCC realized that it had not achieved any significant increase in minority control of broadcast facilities. Id. at 554-556. The Court pointed out that it was only after its inability to increase control of broadcast facilities by minorities through its EEO rules between 1968 and 1978, that the FCC turned its attention to policies designed to further ownership of broadcast facilities by minorities. Id.

The Court then analyzed two aspects of the FCC's minority ownership policy, other than the tax certificate. The Court noted that the petitioner in the Metro case challenged the constitutionality of the minority ownership policy as not having been created and implemented within the FCC's statutory authority from Congress. The Court examined the extensive legislative history surrounding the minority ownership policy and determined that the FCC had developed and implemented the policy with statutory authority from Congress. Specifically, the Court reviewed the numerous legislative determinations, beginning in 1988, by Congress that the minority ownership policy as adopted by the FCC in 1978, and as amended and expanded up to that date, should not be altered by the FCC. Id. at 560. The Court ruled that this series of successive legislative actions established fully that the policy as adopted by the FCC in 1978 reflects the intent of Congress on this issue.

This analysis by the Supreme Court allows this Subcommittee to fully answer all of the questions raised in the press advisory: (1) the tax certificate policy is consistent with the underlying intent of Section 1071, in that it furthers an important public policy objective; (2) the FCC's administration of Section 1071 has been approved by Congress and does not constitute an impermissible exercise of legislative authority; (3) Section 1071 fosters minority ownership of broadcast facilities; and (4) the policy is a necessary and appropriate means of achieving this goal.

Therefore, NABOB submits that those who oppose the continued operation of Section 1071 to foster minority ownership must come forward with justification for reversing the determination of the U.S. Supreme Court that promotion of minority ownership is an appropriate public policy objective for the FCC. We submit there is no basis for reversing that determination.

To support an elimination of Section 1071, the opponents of the policy should demonstrate either that: (1) the objective of the policy has been achieved and the policy is no longer needed, or (2) the FCC's administration of the policy has not actually promoted minority ownership.

The record clearly refutes either such assertion. First, the objective of the policy has not been accomplished. The objective of the minority tax certificate policy is to help facilitate ownership of broadcast facilities by African Americans and other minorities at a level commensurate with their proportion in the American population. The circumstances which led the FCC to adopt the tax certificate policy in 1978 have not changed significantly. In 1978, African Americans constituted approximately 10% of the American population, and yet owned less than 1% of all then licensed radio and television stations.

Today, the National Telecommunications and Information Administration reports that, while now comprising approximately 12% of the American population, African Americans own less than 2% of all television and radio stations. Report of the National Telecommunications and Information Administration, September 1994. These numbers clearly demonstrate that the situation which necessitated the adoption of the minority tax certificate policy has not changed significantly since the adoption of the policy. In fact, just this past September, Vice President Al Gore stated at the NABOB Fall Conference that these current ownership statistics are "a disgrace." Broadcasting & Cable, September 19, 1994, page 6.

The next ground upon which the opponents would seek to over-turn the policy is that the FCC has not implemented the policy in a manner which has promoted the ownership of broadcast facilities by minorities. The theory espoused by such opponents of the policy is that the policy has been abused in "sham" transactions in which companies identified to the FCC as minority owned are actually controlled by non-minority individuals who put forward minority individuals to "front" for them. The history of the minority tax certificate policy refutes this claim.

As noted, the minority tax certificate policy has been operated by the FCC since 1978. During that time, the FCC has issued approximately 300 tax certificates. During that same period, the FCC has approved approximately 15,900 transactions. See Broadcasting & Cable, March 7, 1994, p. 37, and January 2, 1995, page 46. Tax certificate transactions therefore constituted only 1.9% of broadcast transactions since 1978.

Moreover, the vast majority of these tax certificates were issued to companies which were all or almost 100% minority owned. The entrepreneurs who controlled these companies put together their transactions and built their companies with little or no attention from or support from the non-minority media. However, it now appears that press speculation of one or two possible abuses of the policy have galvanized a tidal wave of opposition to the policy. Such opposition is unfounded.

The FCC on occasion may be presented with a proposed transaction in which individuals may seek to circumvent the intent of the policy. However, this Subcommittee, and most certainly the full Committee, has adopted over the years numerous tax policies which favor one group of individuals or companies with tax benefits. When the Subcommittee and full Committee adopt and renew such policies, you are obviously mindful that such policies must be implemented by the Internal Revenue Service in a manner such that unscrupulous persons will not be allowed to abuse those policies. Thus, you have given the IRS extensive enforcement authority and resources to detect and prevent such abuses.

The FCC, like the IRS, has the authority and the resources to detect and prevent abuses of the tax certificate policy. And the FCC uses that authority to effectively preclude such abuses. This Subcommittee does not routinely eliminate important tax benefits for individuals and industries for which it has created tax policy initiatives, merely because the IRS may uncover some attempts to abuse these policies. The Subcommittee should similarly take no such action against the minority tax certificate policy.

The FCC's tax certificate policy, and any announced transaction which may be causing this Subcommittee concern, have received so much publicity that the FCC will be forced to scrutinize any new tax certificate applications extremely thoroughly to assure that no abuses of the policy are occurring. We are certain that the FCC will reject any transactions which fail to comply with the objectives of the policy. NABOB fully supports such close scrutiny.

The only parties who will suffer by an elimination of the policy, are the honest, dedicated entrepreneurs, who will never get an opportunity to use the policy, because of this Subcommittee's concern about potential abuses. The Subcommittee should not punish those who can properly benefit from the policy, when the FCC has been preventing, and can in the future continue to prevent, any potential abuses.

We are then left to determine if there are other concerns which warrant an elimination of the policy. We have heard that this is not a minority ownership issue, but a deficit reduction issue. But, is the potential loss of revenue for the Treasury a reason to single out the minority tax certificate policy for elimination? No.

This Subcommittee and the full Committee routinely approve tax measures which result in lost revenues for the Treasury. In fact, the staff of the Joint Committee on Taxation prepares a report of the Estimates of Federal Tax Expenditures each year, which shows this Committee an estimate of the tax expenditure consequences of its various policies. The November 9, 1994 report shows dozens of tax provisions which result in lost potential income to the Treasury which this Subcommittee has approved. For example:

- Exclusion of income of foreign sales corporations -- $1.4 billion
- Deferral of income of controlled foreign corporations -- $1.1 billion
- Inventory property sales source rule exception -- $3.5 billion
- Expensing of exploration and development costs -- $0.5 billion

- Exclusion of investment income on life insurance and annuity contracts -- $0.8 billion

- Special treatment of life insurance company reserves -- $2.1 billion

- Deduction of unpaid property loss reserves for property and casualty insurance companies -- $1.6 billion

- Depreciation of rental housing in excess of alternative depreciation system -- $1.0 billion

- Depreciation of equipment in excess of alternative depreciation system -- $19.9 billion

- Reduced rates for first $10,000,000 of corporate taxable income -- $43.9 billion

Included in this report is a mere $0.1 billion estimate for the FCC minority tax certificate policy. Therefore, if the objective is to eliminate the budget deficit, there would appear to be many much "fatter" policies to review.

Then perhaps the problem is not the size of the cost to the Treasury, but a "social engineering issue." Well, again this would not seem to justify singling out this policy. The Tax Expenditure Estimate also lists numerous provisions which clearly constitute social engineering:

- Deductibility of mortgage interest on owner-occupied residences -- $53.5 billion

- Deductibility of property tax on owner occupied homes -- $13.7 billion

- Exclusion of capital gains at death -- $12.7 billion

Our objective in pointing out these provisions is not to question any of them or to suggest that any of them constitutes bad policy. Rather, the purpose is to point out that there is nothing in the FCC tax certificate that is outside the realm of the kinds of policies this Subcommittee approves each year.

The next question then is: should the policy be abolished because there are better ways of encouraging minority ownership than allowing non-minority companies tax deferrals for selling to minorities? The simple answer is that we and the FCC have been looking for almost twenty years, and we have yet to find one. As stated above, the FCC adopted the tax certificate policy after ten years of trying to promote meaningful participation by minorities in broadcasting. What the FCC found was that the only time minorities learned that desirable broadcast facilities were for sale was after the deal was signed and the sale was announced in the trade press. The trading in the most desirable broadcast facilities was, and still is, conducted in a closed circle of the largest companies.

No one called minorities to buy the most desirable facilities, because they were the most expensive. It was assumed that a minority buyer would have difficulty obtaining financing for a major acquisition, and the seller would have to wait for the minority to go to several lending sources before he could finance a deal, if he could finance it all. And, unfortunately, that assumption was usually correct.

But, the tax certificate caused the telephones of some minority buyers to start ringing. Non-minority sellers realized that, if they could defer paying capital gains taxes, it would be worthwhile waiting for the minority buyer to arrange financing. The result is that the tax certificate generated some telephone calls to minority buyers. It did not produce a flood of such calls (300 tax certificate deals out of 15,900 broadcast deals since 1978). But it produced some where none had been received before. If the policy is eliminated, many prospective minority buyers can plan to disconnect their telephones, because no one will be calling to sell them broadcast facilities.

Then, we get to the final question which seems to be driving this hearing: At some point should a deal be considered too "big" to justify a tax certificate? To answer this question the Subcommittee must consider the underlying purpose of the tax certificate policy. The policy is intended to enable minorities to have an effective means of asserting their First Amendment rights through the ownership and control of broadcast facilities. To date, the tax certificate policy has fallen far short of producing such a result. The companies which control the dissemination of news, information and opinion in this country are all multibillion dollar businesses. If minorities are to be able to compete with the companies which currently dominate this industry, they must have at least some companies of substantial size.

In its seventeen year history, the tax certificate has never had an impact which could be said to have allowed minorities to gain a substantial ownership position in this industry. Although minorities own approximately 3% of broadcast stations, that ownership represents only approximately 0.5% of the gross revenues of the broadcast industry. One transaction will not significantly change that situation. At such time as the policy produces minority ownership in the broadcast industry which even approaches the proportion of minorities in this society, we would agree that some sort of limit should be placed on the policy. For now, such a result is nowhere in sight.

Therefore, we submit that the Subcommittee should take no action against the FCC's minority tax certificate policy. The policy has been approved by the Congress as consistent with the intent of Section 1071, the FCC has Congressional authority to continue the policy, the policy is a necessary and appropriate means of achieving minority ownership, and it does foster minority ownership. In fact, the policy should be expanded rather than curtailed.

Thank you.

Chairman JOHNSON. Thank you for your testimony.

Close scrutiny does matter, and if you have any thoughts about how we go about that, you are welcome to submit them.

We are going to have to reduce the time to 3 minutes. I am sorry about that, but in order for everybody to be heard, we do have to do that. So if you will proceed promptly.

STATEMENT OF TYRONE BROWN, ESQ., ON BEHALF OF BLACK ENTERTAINMENT TELEVISION, SYNCOM FUNDS, AND RADIO ONE, INC.

Mr. BROWN. Madam Chair, my name is Tyrone Brown. I was a Commissioner at the FCC when the tax certificate policy was established. I worked for it within the Commission. I supported it. I voted for it and I continue to support it now.

We just heard that in the 17 or so years since the policy was established, we have had a total of 300 tax certificate transactions out of 15,000, nearly 16,000 total transfers. If this policy were providing major windfalls, as a general matter, to either side of the transaction, we certainly would see many, many more transactions structured around the tax certificate than have occurred. I will come back to that at the end of my points, if I may.

Chairman JOHNSON. Mr. Hancock will be able to stay so we will be able to resume the 5 minutes.

Mr. BROWN. OK. I will still try to stay——

Chairman JOHNSON. That is all right, your experience is very interesting.

Mr. BROWN. I got into the broadcasting field as a lawyer for the Washington Post broadcast operations. When I got into the field, one of the early transactions that I was involved in on behalf of the Post was the acquisition of a television station. That acquisition took place the way that all transactions, radio and television, took place at that time.

It was a small group of very courtly people, very courtly men, who acted through brokers, who had all the information about which broadcast stations were available and which ones were not. There were not any black people, there were not any Hispanics, there were not any women. That was the way we did business in America in 1974 and 1975.

Now, I should say about the Washington Post, at the same time I was involved in that transaction, they transferred an FM station to Howard University. That station has become one of the most successful, leading minority-controlled stations in this community. So I am not knocking the Washington Post.

But, they did television transactions the way transactions were done at that time. No black, no Hispanic, no Native American, no female-based business was going to get the information to be able to get into this marketplace.

Well, 4 years after that, I went to the FCC as a Commissioner. When one young man named Frank Washington came to me and said, well, what about section 1071 and what about if the Commission did try to do something about the one-half of 1 percent—because that is what it was then—of these licenses passed out by government that are in the hands of minorities?

What if the Commission said we will encourage that; could they then operate under section 1071? I said, "Hey, maybe that will work. You know what it will do? It will mean that minority individuals will get information about available stations. When they indicate an interest in getting into the business, and in order to do that, they will have to have the wherewithal, they will have to have some kind of access to capital, they will have to have experience. But somebody will talk to them because they are carrying a piece of paper. Someone will talk to them. These brokers will let them know that the opportunities are out there. When they knock on the door of a banker, maybe somebody will open the door because they have a piece of paper in their hand."

Now, Madam Chair, this program has not been a windfall. It has not been a rip-off. There have been 300 transactions in nearly 20 years. The overwhelming majority of those 300 transactions have been radio transactions, small radio transactions.

The overwhelming majority of the individuals involved in those transactions are still in the business today. Now, we have——

Chairman JOHNSON. When you say the overwhelming majority of transactions, do you mean of the 15,000 or the 317?

Mr. BROWN. Of the 317 transactions. They are still in business today. Some of them have traded up in terms of the number of stations, but they are still in the business today.

Then, Madam Chair, we look at the big transaction that gets all of the press coverage. Well, that transaction is an aberration in terms of the pattern that we have seen under this policy. But beyond that, I would bet the family jewels that this transaction would never have resulted in a $280 to $400 million tax. The transaction would have been done with somebody else, it would have been done as a merger, it would have been done as a tax-free reorganization, it might not have been done, it might have been done as a swap. But the fact of the matter is that the transaction would not have occurred with tax consequences on the order of $300 to $400 million.

Madam Chair, the Treasury was never going to get that money. This is not a loss to the Treasury. What happened here is what happens in any transaction. You consider all of the factors that go into deciding whether you are going to dispose of property, when you are going to dispose of it, what kind of liabilities you are going to pick up, what kind of liabilities you are going to pass to other people; if you are a public company, you consider what impact the transaction will have on your stock and your shareholders, what you are going to do with the cash. You look at all those factors and you decide this is the way I am going to do the deal.

You change one of the major factors, like the tax consequences, you do it a different way or you do not do it. Four hundred million dollars? Nobody dislikes money. Nobody is going to give it to the Treasury if they can find a way not to do it.

Madam Chair, I will stop at this point and submit my written testimony for the record.

[The prepared statement follows:]

STATEMENT OF TYRONE BROWN, ESQ., ON BEHALF OF BLACK ENTERTAINMENT TELEVISION, RADIO ONE, INC., AND THE SYNCOM FUNDS

1. Statement of Interest, Summary of Position.

Madam Chairperson, Members of the Subcommittee:

My name is Tyrone Brown. I am submitting this Statement for myself and on behalf of Black Entertainment Television, Radio One, Inc., and The Syncom Funds.

I am an attorney engaged in telecommunications practice with the Washington, D.C. law firm of Wiley, Rein & Fielding. From 1977 to 1981, I served as a Commissioner of the Federal Communications Commission.

Prior to my tenure at the FCC, I was Vice President, Legal Affairs of Post-Newsweek Stations, Inc., the broadcast subsidiary of the Washington Post Company which operates television broadcast stations in a number of cities. After leaving the FCC, I helped to organize and manage District Cablevision, Inc., the cable television service provider in the District of Columbia. I have never had an interest in any transaction involving the issuance of a tax certificate under section 1071 of the Internal Revenue Code.

Since 1978, and beginning during my tenure as a Commissioner, the FCC, acting under section 1071, has issued a "tax certificate" (entitling the recipient to a deferral of taxable gain) to any taxpayer desiring such a certificate who sells a radio or television station, or a cable television system, to a minority individual or a minority-controlled firm. The purpose of this hearing is to assess the FCC's legislative authority to issue tax certificates in these circumstances, and to assess the effectiveness and appropriateness of the FCC's approach in fostering the goal of increased minority ownership of broadcast and cable television outlets.

Madam Chairperson, I respectfully submit that both the FCC's interpretation of section 1071 and its authority to issue minority ownership tax certificates are well established under current law. The FCC's interpretation and its authority have been repeatedly confirmed in appropriations legislation enacted by the Congress annually since 1988.

Of course, Madam Chairperson, this Subcommittee may initiate changes in the law. I respectfully urge the Subcommittee not to recommend dismantlement of the minority ownership tax certificate program. The FCC, through two Republican and two Democratic Administrations, has painstakingly developed this program, and it works. I would request that, based upon input from the FCC and interested parties, the Subcommittee report only such prospective changes, if any, as it concludes will make more effective the FCC's administration of minority ownership tax certificates under section 1071.

The FCC's program has led directly to a five-fold increase in minority ownership of radio and television broadcast stations, and to an increase in minority ownership of cable television systems as well. Elimination of this initiative would signal that increased minority ownership of electronic media of mass communications no longer is a priority with the Congress. This would be a wholly inappropriate message. Even with the tax certificate, minorities today control no more than three percent of the nation's broadcast outlets, and fewer still of its cable television systems.

2. **The FCC's Tax Certificate Policy Effectively and Appropriately Furthers the Goal of Minority Ownership.**

Madam Chairperson, I stated that minorities today own approximately three percent of the nation's broadcast stations. In 1978 when the FCC adopted its initial Statement of Policy on Minority Ownership, minority ownership was not much more than one-half of one percent.

In the light of the impact that the broadcast and cable technologies have on all the diverse, smaller communities that make up our national community, in my capacity as an FCC Commissioner I considered the minority ownership situation that existed in 1978 to be unacceptable. Frankly, Madam Chairperson, I consider the minority ownership situation that exists today to be not much better. However, it is better. And, I am convinced that the little improvement that has occurred is in large part attributable to the availability of the minority ownership tax certificate.

In making the tax certificate the centerpiece of its initial effort to achieve greater minority ownership in broadcasting and, later, in cable television, the FCC adopted a device that is precisely tailored to overcome, to some to a degree, the two missing ingredients that typically frustrate the minority entprepreneur's attempt to become involved as an owner of a broadcasting or cable television outlet. These two missing ingredients are, first, lack of information and, secondly, lack of access to capital.

Madam Chairperson, quite simply, the tax certificate converts the minority entrepreneur into someone whom a prospective seller may want to talk with, and into someone who will not necessarily confront only closed doors when he or she ventures into the capital markets.

The certificate does not confer wealth upon the minority entrepreneurs through a reduction in selling price. Nor does it deny the Treasury a tax, since taxes are merely deferred and not reduced or eliminated. On the other hand, economic activity is stimulated through the retention of funds in gainful private sector activity.

This is what the tax certificate secures for the minority entrepreneur, and it is all that it secures for him or her. But the open door, and that access to the prospective supplier of capital, may be (after his or her own dogged determination) the minority entrepreneurs's most important asset.

Madam Chairperson, it is for this reason that I strongly urge the Subcommittee to support continued availability of the minority ownership tax certificate under section 1071.

3. The FCC Possesses Explicit Authority To Issue Minority Ownership Tax Certificates.

Madam Chairperson, because the Subcommittee has raised a number of questions about the FCC's current authority to issue minority ownership tax certificates, I also feel the need to address this issue of legislative authorization.

There have been suggestions that the FCC, in the 1978 Statement of Policy, abruptly and impermissibly altered its prior interpretation of section 1071 of the Internal Revenue Code. The implication is that prior to 1978 the FCC issued a tax certificate only when the taxpayer was compelled to dispose of broadcast property due to new agency policy, but in announcing the minority ownership policy the Commission for the first time extended section 1071 treatment to voluntary dispositions.

Madam Chairperson, I want to assure the Subcommittee that adoption of the tax certificate policy in 1978 did not involve any expansion of the Commission's interpretation of section 1071. As we specifically stated in the 1978 Policy Statement, under preexisting agency practice the FCC had routinely issued tax certificates in connection with certain voluntary dispositions of broadcast properties that furthered agency policy.

In any event, Madam Chairperson, if doubts once existed about the FCC's authority to issue tax certificates in connection with transfers of broadcast and cable outlets to minorities under current law, those doubts now have been resolved in favor of such authority.

In each fiscal year since 1988, the FCC appropriations legislation has not only expressly acknowledged the existence of the Commission's minority ownership tax certificate policy, but it has also expressly forbidden use of appropriated funds to repeal or retroactively change that policy. The fiscal 1995 legislation, for example, states that appropriated funds may not be used to repeal or retroactively change the FCC's minority ownership initiatives, "including those established in the Statement of Policy on Minority Ownership of Broadcasting Facilities . . . ."

Under the circumstances, Congressional endorsement of the FCC's interpretation of its authority under section 1071 could hardly be more clear.

4. The FCC's Minority Ownership Policies Have Evolved in a Spirit of Bipartisanship and Cooperation.

Madam Chairperson, the FCC has never treated its minority ownership policies as static rules that are good for all circumstances or for all time.

The original tax certificate policy was an initial response that grew out of a first conference on minority ownership sponsored by the FCC in 1977 under the leadership of Richard Wiley who chaired the Commission during the Nixon and Ford Administrations.

Extension of the tax certificate policy to sales of cable television systems occurred in 1982 under President Reagan's Chairman Mark Fowler, as a result of recommendations from an Advisory Committee headed by then-Commissioner Henry Rivera.

Most recently, Congress' enactment of spectrum auction legislation, and its mandate to the FCC to assure opportunities for minority ownership participation in the auctioned spectrum (as well as ownership participation by female-controlled firms and small businesses) has required the Commission to undertake what is perhaps its most comprehensive reexamination of its minority ownership policies to date.

Hopefully, this process of re-examination and refinement will continue. In that process this Subcommittee has an appropriate oversight role to assure that section 1071 is not abused.

5. Conclusion.

Madam Chairperson, members of the Subcommittee, in closing I wish to reemphasize that I, as well as Black Entertainment Television, Radio One, Inc., and The Syncom Funds, strongly urge the Subcommittee to support the continued availability of the minority ownership tax certificate under section 1071.

Thank you for this opportunity to share my views in this very important area.

Chairman JOHNSON. I appreciate your comments. It does appear we still need a record. We still need to know what in fact——

Mr. BROWN. I would agree with that.

Chairman JOHNSON. Who has had ownership. The fact we have none of that, does matter. But I hope it is as you say.

Mr. BROWN. I would be glad to include in the record a list of all of the companies that have received tax certificates.

Chairman JOHNSON. That would be interesting.

Mr. BROWN. Since the inception of the program, because I have it available and will be glad to do that.

Chairman JOHNSON. If you know all the principals in those companies, that would be useful, too.

Mr. BROWN. I am not sure I do, but to the extent I can.

Chairman JOHNSON. Because the government has a hard time coming up with that information. Any information you can give us along that line is helpful.

[The following was subsequently received:]

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

Before 1978, minorities owned approximately one half of one percent (40) of the approximately 8,500 total broadcast licenses issued by the FCC. In fact, the National Association of Black Owned Broadcasters (NABOB) reports that approximately 2 to 3 minority broadcast transactions were consummated each year prior to the implementation of the FCC minority tax certificate policy in 1978. 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 the application of section 1071 to minority owned broadcast and cable properties (15 years).

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%)**

Of the total number of licenses currently held by minorities the data available indicates that up to 30% of the radio stations were acquired with the use of a tax certificate and up to 90% of the television stations were acquired with the use of a tax certificate. Data is unavailable for cable. Also, NABOB reports that the vast majority of existing minority broadcast owners have utilized tax certificates 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.

During the past 15 years, the issuance of minority tax certificates has resulted in the sale or transfer of over 260 radio licenses, 40 television licenses and 30 cable licenses, totalling approximately 330 tax certificates issued for minority deals. In contrast, approximately 117 non-minority tax certificates have been issued during the life of Section 1071.

Type of License	Certificates Issued	of Total
Minority Radio	260	58%
Minority TV	40	9%
Minority Cable	30	7%
Non-minority	117	26%
Total	447	100%

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
1978	4	1%
1979	12	4%
1980	10	3%
1981	15	5%
1982	15	5%
1983	10	3%
1984	11	3%
1985	17	5%
1986	18	5%
1987	33	10%
1988	33	10%
1989	45	14%
1990	46	14%
1991	18	5%
1992	14	4%
1993	21	6%
1994	8	2%
Total	330	100%

Diversity of Ownership:

Ownership data is available for approximately 55% (142) of the tax certificates issued in minority radio transactions. From this sample, there are approximately 77 separate owners (54%) 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 well 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.

Size of Transactions:

After reviewing a sample consisting of 55% 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 $3.5 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 to FCC 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."

[Tax Certificate chart retained in Committee files.]

Chairman JOHNSON. Mr. Alarcon.

STATEMENT OF RAUL ALARCON, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, SPANISH BROADCASTING SYSTEM, INC.

Mr. ALARCON. Good afternoon, Madam Chairwoman, members of the Oversight Subcommittee. My name is Raul Alarcon, Jr., president and chief executive officer of the Spanish Broadcasting System. I thank you for the opportunity of addressing you here today.

In your hearing announcement you stated that these hearings would examine, among other things, whether the tax incentive provided in section 1071 of the Internal Revenue Code, in fact, fosters minority ownership of broadcast facilities. It is precisely this question that I wish to address today. Let me state at the outset that the tax certificate program, in my opinion, is a tremendously valid and beneficial policy and a tribute to the Congress that mandated it and to the FCC that implements it.

Let me tell you a little about the Spanish Broadcasting System. SBS is a family-owned and operated radio company founded in 1983. My father, one of the founders, was born in Cuba, as I was, where he owned a chain of radio stations that were seized by the Castro government in 1960. We emigrated to the United States with very few possessions and became U.S. citizens. For 20 years my father worked his way up in the Spanish language radio and, for him, the purchase of our first station in 1983 represented the fulfillment of his dream to return to the business of owning and operating broadcast stations.

Our first station was a small AM station licensed in Newark, N.J. The owners of SBS, who are all Hispanic, mortgaged everything they had to start this station. However, we would never have emerged from the starting gate if not for the government's tax certificate program. The tax certificate policy encourages sellers to take the risk of selling to small, less well-known companies and allows minority-controlled entities to gain a foothold in an industry that is dominated by historically established major media corporations.

Today, 12 years after we purchased our first station, we are the largest Hispanic-owned media company in the United States. We operate 7 radio stations in the major markets—New York City, Los Angeles, and Miami. Each of these stations provides Spanish language programming and public service that is targeted to the community it serves. WSKQ FM, our New York FM, is in fact the only Spanish language FM station in New York City.

I am proud to say that our stations are public service oriented and financially successful. We own the No. 1-rated radio station in Los Angeles, Calif., surpassing all other English and Spanish language competitors. We are the fifth-rated radio station in the highly competitive New York market, making us the first foreign language station to break into the top 10 in the history of New York City audience ratings.

The FCC's tax certificate policy made all this possible. Without the tax certificate, it is highly questionable whether any of the sellers would have sold their stations to SBS. Each of the SBS stations was purchased under the issuance of a tax certificate. We believe that the company itself, SBS, is proof of the success of the tax certificate policy.

The fact of the matter is that it is hard for anyone to break into the broadcast industry. Many of the barriers to entry are created by the simple fact that the radio spectrum is limited and broadcast licenses are a scarce and highly valued commodity, especially in the major markets where Hispanic listeners are concentrated. Available stations are getting harder to find, particularly for the minority buyer. The FCC's decision to relax the duopoly ownership rules has created a new group of in-market buyers, in effect, foreclosing many opportunities for minorities in the future.

The tax certificate policy is the least intrusive way for the government to accomplish the goal of increasing minority ownership of broadcast stations. It involves no government loans, no government loan guarantees, no set-asides, and no government mandates, nor is it a giveaway. It is, as many commentators have observed, a deferral—a deferral—not a waiver of tax. It works. The advantages offered by the tax certificate make it possible for minority buyers to compete for and purchase broadcast stations.

Let me dispel a common myth. There is an assumption that the tax certificate allows minority buyers to purchase stations at a discount. This has not been my experience. Spanish broadcasting has paid market prices for its stations. But without the ability to defer the gain on a sale, many station owners would not sell their stations at all, let alone to a minority buyer with limited resources.

What difference does Hispanic ownership make? As broadcasters, we believe it makes a big difference. I have heard people say Hispanic ownership is of no real consequence. If this is true, why was there no Spanish language FM station in New York before we inaugurated WSKQ FM 5 years ago? Similarly, why were Asians the first to establish Asian language stations? Why were African-American broadcasters pioneers in introducing the urban format in major cities?

The fact is we care about the communities we serve. I have heard complaints about minorities buyers making quick sales following tax certificate transactions. In 12 years of operations, we have never sold a station. We are invested in this business, committed to the business, and committed to the communities we serve.

During the gulf war, during Hurricane Andrew, the California earthquake, and the civil disturbances in Los Angeles, we provided news and information in Spanish to our communities in New York, Florida, and California. These broadcasts included information regarding emergency relief services and fundraising efforts on behalf of thousands of victims in need of assistance. No mainstream broadcasters speak to this community in the way we do, nor, in my view, are they capable of doing so.

Also, we provide jobs, new jobs, both for on-air as well as administrative personnel. We provide market opportunities and revenues for the businesses that advertise on SBS radio stations, and we showcase talent that would not otherwise receive air play or recognition.

I have one more paragraph, Madam Chair.

Chairman JOHNSON. OK.

Mr. ALARCON. As I have said, the tax certificate program made all of this possible. In our opinion, an opinion that is shared by millions of Spanish radio listeners, the tax certificate program works and works well. It should be retained.

Indeed, if we are to measure the effectiveness of government programs by the many social benefits they engender, then the tax certificate program should not only be retained, but other even more far-reaching and innovative measures to encourage minority ownership in the media should be investigated and implemented.

Thank you, Madam Chair.

[The prepared statement follows:]

STATEMENT OF RAUL ALARCON, JR.
PRESIDENT AND CHIEF EXECUTIVE OFFICER
SPANISH BROADCASTING SYSTEM, INC.
before the
Subcommittee on Oversight
Committee on Ways & Means
United States House of Representatives
Washington, D.C.
January 27, 1995

Madame Chairman and Members of the Oversight Subcommittee. My name is Raul Alarcon, Jr. I am the President and Chief Executive Officer of Spanish Broadcasting System, Inc. I am pleased to have this opportunity to testify before the Subcommittee concerning the government's policy of issuing tax certificates on the sale of certain telecommunications facilities. This program has several purposes, one of which is to encourage the sale of telecommunications properties to minority owned or controlled companies.

In your hearing announcement, you stated that these hearings would examine, among other things, "whether the tax incentive provided in section 1071 [of the Internal Revenue Code] in fact fosters minority ownership of broadcast facilities." It is this question that I wish to address today.

Let me begin by telling you something about Spanish Broadcasting System. SBS is a family-owned and operated radio company, founded in 1983. My father, one of the founders, was born in Cuba, as I was. In Cuba, he owned a chain of radio stations that were seized by the Castro government. We emigrated to the United States with very few possessions. We became United States citizens, and for twenty years my father worked his way up in Spanish language radio, working jobs in programming, sales, and advertising. For him, the purchase of our first station in 1983 represented the fulfillment of his dream to return to the business of owning and operating broadcast stations.

Our first station was a small, AM station licensed to Newark, New Jersey. This station was the first Spanish-language station introduced into the New York/New Jersey radio market in more than a quarter century. The owners of SBS, who are all Hispanic, mortgaged everything they had to start this station. However, we would never have emerged from the starting gate if not for the government's tax certificate program. The tax certificate policy encourages sellers to take the risk of selling to small, less well-known companies, and allows minority controlled companies to gain a foothold in an industry that is dominated by successful, established, and well-financed companies.

Twelve years after we purchased our first station, we are the largest Hispanic-owned media company in the United States. We operate seven radio stations in major markets: WSKQ-AM and FM serving New York, KXED-AM and KLAX-FM in Los Angeles, WCMQ-AM and FM serving Miami, and WZMQ in Key Largo. Each of these stations provides Spanish language programming and public service that is targeted to the community it serves. WSKQ-FM is, in fact, the only Spanish-language FM station in New York City.

I am proud to say that our stations are public service oriented and financially successful. We own the number-one rated radio station in Los Angeles, California, beating out all other English and Spanish-language competitors. We are the fifth-rated radio station in the highly competitive New York market, making us the first foreign language station to break into the Top Ten in the history of New York City audience ratings.

The FCC's tax certificate policy made this possible. Without the tax certificate policy, it is highly questionable whether any of the sellers would have sold their stations to SBS. Each of the SBS stations was purchased under a tax certificate -- and we believe that SBS is proof of the success of that policy.

In 1978, when the FCC announced that it would use its authority to grant tax certificates as a means of encouraging minority ownership of broadcast facilities, the Commission observed that "diversification in the areas of programming and ownership ... can be more fully developed through ... encouragement of minority ownership of broadcast properties."[1]

We recognize that this policy has been controversial. Yet even its most vociferous critics have cited Spanish Broadcasting as one of the program's success stories. It is important to keep in mind, therefore, that this success is a direct result of the tax certificate policy. The tax certificate made it possible for us to buy each station we own -- and made it possible for us to offer Spanish language programming that serves America's large and growing Hispanic community. In the case of each purchase, the seller has made the issuance of a tax certificate a condition of the sale.

The fact of the matter is that it is hard for anyone to break into the broadcast industry. Many of the barriers to entry are created by the simple fact that the radio spectrum is limited -- and broadcast licenses are a scarce and highly valued commodity. Barriers to entry are especially high in the major markets where Hispanic listeners are concentrated. Competition is keen. Stations in the Top Ten radio markets range in price from $40 million to $150 million.

Available stations are getting harder to find, particularly for the minority buyer. The FCC's decision to relax the duopoly ownership rules has made it possible for broadcasters to buy second, third, and fourth stations in markets that were previously closed to them -- thereby creating a new group of buyers -- and foreclosing many opportunities for minorities. In this environment, Blacks, Hispanics, and other minorities that have historically lacked access to capital markets are now faced with even more limited opportunities to acquire and operate radio stations, and -- in many cases -- are forced to bid against media giants with vast resources.

The tax certificate policy is the least intrusive way for the government to accomplish the goal of increasing minority ownership of broadcast stations. It involves no government loans, no government loan guarantees, no setasides, and no government mandates. Nor is it a giveaway. It is, as many commentators have observed, a deferral -- not a waiver -- of tax. And it works. The advantages offered by the tax certificate make it possible for minority buyers to compete for and buy broadcast stations.

The tax benefit goes to the seller -- not to the minority buyer. And let me dispel one common myth. There is an assumption that the tax certificate allows minority buyers to buy stations at a discount. This has not been my experience. Spanish Broadcasting has paid market price for its stations -- but it was the tax certificate that made the deal possible. Without the ability to defer the gain on a sale, I know from experience that many station owners would not sell their stations at all -- let alone to a minority buyer with limited resources.

What difference does Hispanic ownership make? As broadcasters, we believe it makes a big difference. I have heard people say that Hispanic ownership is of no real consequence -- that any smart broadcaster will program to the Hispanic market. If this is true, why was there no Spanish-language FM station in New York before we started WSKQ-FM five years ago? Similarly, why did it take Asians to establish the first Asian language stations? Why are some of the highest-rated urban formatted stations owned by Black broadcasters?

The fact is -- we care about the communities we serve. I have heard complaints about minority buyers making quick sales following tax certificate deals. In 12 years of operation, we have never sold a station. We are invested in this business, committed to it and to the communities we serve. The tax certificates have made it possible for SBS -- a 100% Hispanic-owned company -- to address the needs, interests, and problems of the Hispanic community.

During the Gulf War, during Hurricane Andrew, during the California earthquake and the civil disturbances in Los Angeles, we provided news and information -- news of special interest to the Hispanic communities -- in New York, Florida, and

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[1] Statement of Policy on Minority Ownership of Broadcasting Facilities, May 25, 1978, FCC 78-322, at 4.

California. Our AM stations have morning news blocks dedicated to news and local affairs. We sponsor community events. We are involved in the fabric of the community and its neighborhoods, and our numerous public service awards attest to our standing in the community. No mainstream broadcasters speak to this community in the way that we do, nor -- in our view -- are they capable of doing so.

We provide jobs -- new jobs -- both for "on-air" as well as administrative personnel. We provide market opportunities and revenues for the businesses that advertise on SBS radio stations. We provide a showcase for talent that would not otherwise receive airplay or recognition. If other, mainstream stations are now discovering Hispanic markets and Hispanic programming, it is because we pointed the way -- and continue to lead. In 1983, when we purchased our first station, there were fewer than 100 Spanish-language radio stations in the United States. Today, there are more than 300 Spanish-language formatted stations.

The tax certificate program, like all programs, has its failures and its successes. SBS is a success story. There are others. We can only speak from our experience, but -- in our view -- doing away with the tax certificate program, as some have suggested, would be short-sighted -- and offers no real guarantees of new tax revenues.

First, as noted, the tax certificate program only permits a deferral of tax -- not a waiver. Second, it cannot be assumed that, but for the tax certificate program, each and every sale to a minority owner would have generated tax revenues in the year of the sale. Many sales would never happen in the first place. Many owners would not sell their properties at all if they couldn't defer the taxes -- or they would search for other tax-favored ways to sell their properties.

Finally, to the extent minority owners have turned stagnant properties into money-making ventures, created jobs, and opened new markets, the tax certificate program has generated taxes -- and keeps doing so, year in and year out. The tax certificates facilitate such new investment, and bring new ideas and new voices to the broadcast community, a community that must be -- by definition -- a reflection of America's pluralistic society.

The tax certificate program made it possible for us to buy our first radio station. It enabled us to grow from one small station to become the largest Hispanic media company in the nation -- and a market leader in the largest radio markets in the United States. We are proud of our accomplishments -- and we are proud of our record of service to the community.

In our opinion, an opinion that is shared by millions of Spanish radio listeners, the tax certificate program works and works well. It should be retained. Indeed, if we are to measure the effectiveness of government programs by the many social benefits they engender, then the tax certificate program should not only be retained, but other, even more far-reaching and innovative measures to encourage minority ownership of the media should be investigated and implemented.

We thank you for this opportunity to present our views.

Chairman JOHNSON. Thank you very much.
Ms. Sutter.

STATEMENT OF DIANE SUTTER, PRESIDENT, SHAMROCK TELEVISION, BURBANK, CALIF., ON BEHALF OF AMERICAN WOMEN IN RADIO AND TELEVISION, INC.

Ms. SUTTER. Thank you. Good afternoon Chairperson Johnson and members of the subcommittee. I am Diane Sutter, president of Shamrock Television and past national president of American Women in Radio and Television. Shamrock Television and Shamrock Broadcasting operate radio and televisions stations in the United States and are seeking to acquire additional stations.

I appear before this subcommittee today on behalf of AWRT, and to express AWRT's strong support for the use of tax certificates by the FCC to increase minority ownership of broadcast and other mass media properties. Since our testimony has been filed with this subcommittee, I will summarize it.

AWRT is a nonprofit national organization of professional men and women working in the electronic media.

Chairman JOHNSON. You don't have to feel rushed. You do have your 5 minutes.

Ms. SUTTER. Thank you. The mission of AWRT is to enhance the impact of women in the electronic media. AWRT strongly supports the policies to promote the ownership of broadcast and other communications properties by women and minorities, including the FCC's award of tax certificates pursuant to section 1071 to increase minority ownership.

Consistent with the underlying intent of section 1071, tax certificates have proven to be a valuable incentive that furthers the FCC's policy of increasing ownership of broadcast stations and cable properties by qualified minorities. AWRT also supports the extension of the FCC's tax certificate policy to include the availability of section 1071 certificates to investors and qualified women-owned companies to advance diversity which does not now exist.

Based on my experience in the broadcast industry, I can tell you firsthand that the availability of tax certificates can be a pivotal factor in evaluating a broadcast sale or an investment.

AWRT supports rigorous review by the FCC of the eligibility of companies for tax certificates. The potential for abuse should not be used as a basis to eliminate an appropriate and effective market-based incentive for increasing minority ownership of broadcast stations and an incentive that could appropriately be used to increase ownership of broadcast stations and other mass media facilities by women.

As you have heard, and will hear today, the use of tax certificates has directly buttressed the FCC's important goal of increasing minority ownership and diversity of broadcast and cable facilities. Tax certificates have added the value of stimulating investment in mass media properties by minority-owned companies.

By requiring the recipient of a tax certificate to reinvest the sale proceeds in a qualified property, the awarding of 1071 stimulates economic growth, specifically 1071's requirement of investing the proceeds in a qualified replacement properties to defer tax investments not to eliminate them.

Tax certificates also provide a direct market-based incentive for investment in minority-owned companies. Market-based incentives that increase access to capital are essential to redressing the underrepresentation of minorities and women in the broadcast industry.

Statistics on women-owned businesses demonstrate the continued barriers that women face in raising capital required to acquire broadcast and cable properties. The discrimination that exists against women entrepreneurs has been recognized by Congress. Congress' recognition of the barriers faced by women in obtaining financing for business ventures, as well as in statistics included in our testimony on the low level of representation of women ownership in broadcast stations, fully supports the extension of the FCC's policy of awarding 1071 tax certificates to qualified women-owned companies seeking to acquire broadcast and cable facilities to provide incentives for women ownership of broadcast and cable properties.

The statistics demonstrate what Congress clearly recognized when it enacted the Omnibus Budget Reconciliation Act of 1993, and in the order to the FCC to use spectrum auctions to award licenses for the commercial mobile radio services; that the dissemination of spectrum licenses among a wide variety of applicants, including businesses owned by women, is an important and legitimate government interest.

The same congressional concern about underrepresentation by women, and the provision of spectrum-based services that resulted in that congressional mandate, warrants the use of section 1071 tax certificates as an incentive to increase female ownership of broadcast and cable facilities.

AWRT has encouraged the FCC to conduct a survey and study the current level of women ownership of broadcast facilities. The FCC has not conducted such a survey since 1982. Such a study would enable the FCC and Congress to identify the trends in broadcast ownership and provide an important foundation for future policy decisions.

We would like to work with this subcommittee and to supplement our testimony by providing additional written comments in relation to things we have heard today, and we encourage the subcommittee to look for ways in which we can increase the diversity which we believe minority certificates have brought to the picture by including women.

[The prepared statement follows:]

**TESTIMONY OF DIANE SUTTER
ON BEHALF OF
AMERICAN WOMEN IN RADIO AND TELEVISION, INC.
BEFORE THE
HOUSE WAY AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT**

JANUARY 27, 1995

Good morning, Chairwoman Johnson and members of the Subcommittee. I am Diane Sutter, President of Shamrock Television and past national president of American Women in Radio and Television, Inc. ("AWRT"). Shamrock Television is the owner of a small market network television station. Shamrock also is actively engaged in seeking to acquire additional small and medium market television stations. Shamrock Broadcasting, Inc., our affiliate, owns 18 major market radio stations. It is an honor for me to appear before this Subcommittee today on behalf of AWRT and to express AWRT's strong support for the use of tax certificates by the FCC to increase minority ownership of broadcast and other mass media properties.

AWRT is a non-profit, national organization of professional women and men who work in radio, television, cable, advertising -- essentially the electronic media -- and closely allied fields. The mission of AWRT is to enhance the impact of women in the electronic media and allied fields by educating, advocating, and acting as a resource to its members and the industry. AWRT strongly supports appropriate policies to promote the ownership of broadcast and other communications properties by women and minorities. AWRT believes that the FCC's award of tax certificates pursuant to Section 1071 to increase minority ownership of broadcast and cable properties is an example of just such an appropriate market-based policy. Consistent with the underlying intent of Section 1071, tax certificates have proven to be a valuable incentive that furthers the FCC's policy of increasing ownership of broadcast stations and cable properties by qualified minorities. AWRT also supports the extension of the FCC's tax certificate policy to include the availability of Section 1071 certificates to investors in qualified women-owned companies seeking to acquire broadcast and cable properties and to companies that sell their existing broadcast and cable properties to qualified women-owned companies.

Since adoption of the FCC's policy to award tax certificates to increase minority ownership of broadcast properties in 1978, tax certificates have proven to be one of the most valuable financial incentives in broadcast acquisitions. As of October 1994, 283 tax certificates have been awarded by the FCC for broadcast stations while 25 have been issued for cable sales. Based on my experience in the broadcast industry, I can tell you first hand that the availability of tax certificates can be a pivotal factor in evaluating a broadcast sale or investment.

To ensure the appropriate use of Section 1071 certificates, AWRT supports rigorous review by the FCC of the eligibility of companies for tax certificates. Stringent case-by-case review of the ownership and qualifications of a company on which an application for a tax certificate is based can be conducted by the FCC to weed out any potential abuses of the FCC's tax certificate policy. The general, unsubstantiated fear of such abuses should not be used as a basis to eliminate an appropriate and effective market-based incentive for increasing minority ownership of broadcast stations and an incentive that could be appropriately used to increase ownership of broadcast stations and other mass media facilities by women.

Past studies have shown that the use of tax certificates has directly buttressed the FCC's important goal of increasing minority ownership of broadcast and cable facilities. Tax certificates have the added value of stimulating investment in mass media properties and minority-owned companies. By requiring the recipient of a tax certificate to reinvest the sale proceeds in "qualified replacement property," the awarding of Section 1071 tax certificates stimulates economic growth. Specifically, Section 1071's requirement of reinvesting the proceeds of the tax certificate in "qualified replacement property" to defer taxation fuels additional investment by the seller. This investment, rather than the mere pocketing of the sale proceeds, stimulates additional economic growth in the form of economic expansion, additional job growth and the creation of new and greater market opportunities. Tax revenues also are derived even if the investor who receives a tax certificate elects to reinvest the proceeds of the tax certificates in other existing media properties rather than new properties because the investment in the existing property will trigger a taxable sale of that existing property.

The tax revenues gained from the multiplier effect of this additional investment and the continued operation of the broadcast and cable properties by minority-owned companies may well offset the revenue losses from deferral of taxation permitted by the award of a Section 1071 tax certificate. In addition, award of a Section 1071 certificate merely permits deferral of the tax. The tax ultimately will be realized upon the sale of the replacement property.

Tax certificates also provide a direct market-based incentive for investment in minority-owned companies. Initial investors in minority-owned companies are eligible for a Section 1071 certificate on the sale of their interests. Market-based incentives that increase access to capital are essential to redressing the under-representation of minorities and women in the broadcast industry. Statistics on women-owned businesses demonstrate the continued barriers that women face in raising the capital required to acquire broadcast and cable properties. The discrimination that exists against women entrepreneurs has been recognized by Congress. Seven years ago, due in large part to the leadership of women in Congress, Congress enacted the Women's Business Ownership Act of 1988. In 1992, Congress again sought to redress the hurdles that women and minorities face in raising capital by enacting the Small Business Credit and Business Opportunity Enhancement Act of 1992. Congress' recognition of the barriers faced by women in obtaining financing for business ventures as well as statistics on the low level of representation of women in ownership of broadcast stations fully support extension of the FCC's policy of awarding Section 1071 tax certificates to qualified women-owned companies seeking to acquire broadcast and cable facilities and to provide incentives for women-ownership of broadcast and cable properties.

Thirty-two percent (32%) of all small businesses were owned by women in 1991 according to the U.S. Small Business Administration.[1] Despite these encouraging general statistics, this business growth has not been mirrored or even suggested in the broadcast industry. In 1987, the latest year for which relevant statistics currently are available, only 26 television stations were owned and controlled by women out of 1,342 television stations operating in the United States.[2] In other words, in 1987 only 1.9% of all television stations were owned and controlled by women. Out of the 10,244 radio stations operating in the United States at that time, only 394, or 3.8% of all radio stations, were owned 50% or more by women.[3] Thus, in 1987, only 420 out of a total of 11,586 broadcast stations were owned and controlled by women.

Other studies confirm the low level of representation of women in the ownership ranks of broadcast facilities. A Congressional Research Service Study entitled "Minority Broadcast Station Ownership and Broadcast Programming: Is There a Nexus?," released in 1988, found that women held a 51% or greater ownership interest in 7.1% of the broadcast stations surveyed. A study commissioned by the FCC in 1982 found that women held 50% or more of the stock of the licensees of 8.5% of the AM stations, 9% of the FM stations and 2.8% of the television stations across the country. Although the 1982 study and the 1988

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[1] *See Women Business Owners*, Congressional Caucus on Women's Issues (1992).

[2] *See Women Owned Business*, U.S. Department of Commerce (1990) (based on 1987 economic census); *see also* 1988 *Broadcasting/Cablecasting Yearbook*, p. A-2. More recent statistics on women-owned businesses are expected to be released by the Bureau of the Census in June 1995.

[3] *Id.*

Congressional Research Service study are not directly comparable because they use different definitions of control (50% and 51%), the comparison is still useful. The rough comparison reveals that women controlled 7.9% of stations in 1982 and only 7.1% in 1988 -- if not a decline, then certainly a stagnation, in the number of women-owned broadcast stations.

These numbers obviously are at odds with the number of women in the United States and in the U.S. workforce. According to the 1990 U.S. Census, women represented 46% of the civilian labor force in the United States. The FCC's latest employment statistics also indicate that women and minorities continue to be employed in the broadcasting industry at levels significantly below their representation in the overall workforce. In 1993, women constituted only 39.6% of the broadcast workforce, with 32.8% at the professional managerial level. In the cable industry, total employment of women decreased from 41.7% to 41.6, 30.9% of the professional/managerial jobs in the cable industry are held by women.[4]

These statistics demonstrate what Congress clearly recognized when it enacted the Omnibus Budget Reconciliation Act of 1993 and authorized the FCC to use spectrum auctions to award licenses for commercial mobile radio services -- that the dissemination of spectrum licenses among a wide variety of applicants, including businesses owned by women, is an important and legitimate government interest. The same Congressional concern about under-representation by women in the provision of spectrum-based services that resulted in that Congressional mandate warrants the use of Section 1071 tax certificates as an incentive to increase female ownership of broadcast and cable facilities.

Finally, AWRT has encouraged the FCC to conduct a survey and study on the current level of women ownership of broadcast facilities. A study on female ownership of broadcast licenses has not been undertaken since the FCC's study in 1982. Such a study would enable the FCC and Congress to identify trends in broadcast ownership and provide an important foundation for future policy decisions.

AWRT looks forward to continuing to work with the Congress and this Subcommittee on issues of importance to women in the communications industry. I appreciate the opportunity to testify and would be pleased to respond to any questions.

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[4] *FCC Equal Employment Opportunity Trend Report* (June 22, 1994).

Chairman JOHNSON. Thank you very much. Thank you for your input.

My colleague, Mr. Hancock, does have a question for the panel, so he has gone to vote. He will come back. If you would be so kind as to wait, he has a question, and then we will invite the other panel.

Unfortunately, I cannot return after this vote, so I will review the other testimony in writing.

I do, though, invite you all to submit, having heard the substance of the hearing, your thoughts about how this law can be improved. It clearly has some strengths, it clearly has some weaknesses. We have very little record to go on. The role of congressional oversight in this area has not been an honorable one in the last few years, and so we will be making some changes in this law, and I invite your input into those changes so that we may preserve its strengths and correct its weaknesses.

Thank you for your participation.

[The following was subsequently received:]

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Spanish Broadcasting System

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Raúl Alarcón
President

<u>By Hand</u>

February 6, 1995

Hon. Nancy Johnson
Chairman
Subcommittee on Oversight
Committee on Ways & Means
1102 Longworth House Office Building
United States House of Representatives
Washington, D.C. 20515

Re: Section 1071
Supplement to Hearing Testimony

Dear Chairman Johnson:

As you will recall, I was privileged to testify at the Subcommittee's January 27th hearing on the Federal Communications Commission's use of Section 1071 tax certificates to increase minority ownership of broadcast facilities. This letter supplements that testimony, and I ask that a copy be included in the record to the Subcommittee's hearing.

First, during the hearing, the observation was made that tax certificate sales increased substantially in the 1980's, and some questioned the reason for this uptick. I submit that the reason for this increase was the overall health of the economy in the 1980's. During the 1980's, money was available for entrepreneurs looking for investment properties -- including minority buyers with tax certificates -- and a substantial number of television and radio stations were bought and sold. Some were tax certificate sales, but I suspect that the number of tax certificate sales is directly related to the number of sales generally, and ebbs and flows with the market for broadcast stations.

Second, during the hearing it was noted that the Section 1071 tax certificate is not the only means by which the FCC seeks to increase minority ownership. In particular, mention was made of the FCC's distress sales policy, which allows broadcasters at risk of losing their license to sell their stations to qualified minority buyers at a price equal to 75% or less of the station's fair market value.

It is true that the FCC has used its distress sales policy to encourage sales to minority buyers -- but the distress sales policy could never substitute for the tax certificate. First, few stations are threatened with license revocation in any given year, let alone designated for a revocation hearing.* Second, of the small number, even fewer stations are available in markets with sizable minority audiences. I speak from experience.

Several years ago, on procedural grounds, I lost the chance to purchase a New York area station under the distress sale policy when the Commission, after a prolonged proceeding, decided to revoke the broadcaster's license, thereby foreclosing any distress sale. After that sale fell through, it was ten years before I again had an opportunity to buy a New York station -- at a cost of $55 Million, one of the highest prices ever paid for a New York City station. Even then, I was only able to purchase the station because I could offer the buyer the tax certificate.

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* *In his testimony before the Subcommittee, FCC General Counsel William Kennard stated that "approximately 330" tax certificate sales between 1978 and 1994 involved sales to minority-owned entities. During that same time period, according to the FCC, only 42 distress sales have been approved. In the Matter of Policies and Female Ownership of Mass Media Facilities, FCC 94-323 (Released January 12, 1995), at 4.*

Honorable Nancy Johnson
February 6, 1995

The tax certificate program has come under serious criticism in recent weeks -- and, as you suggested in statements during the hearing -- it may be appropriate for the Subcommittee to consider ways in which the policy can be made more accountable. Speaking, however, as an Hispanic-American broadcaster who has purchased every one of his stations with a tax certificate, who has never sold a station, and who has programmed every one of his stations to reach the Hispanic audience, I urge you to resist efforts to undertake wholesale repeal of Section 1071.

I am available to discuss this and other issues with you at your convenience.

Sincerely,

Raul Alarcon, Jr.

cc: Honorable Charles Rangel
Honorable Robert Masui

[Recess.]

Mr. HANCOCK [presiding]. Thank you very much for sticking around for a few minutes. I apologize, but there were a couple of questions that I had on my mind that I would like to ask, even though I was not here for all of your testimony.

Mr. Sutton, you indicated in your testimony that you had been involved in various situations involving the tax benefit of the minority enterprise. How many have you been involved in?

Mr. SUTTON. In both instances I sold to minorities to encourage others to get into the business; two instances.

Mr. HANCOCK. OK. You say in two instances.

Mr. SUTTON. Yes.

Mr. HANCOCK. Have you been involved in more than one?

Mr. WINSTON. I am the executive director of the trade association. I am not a station owner, sir.

Mr. HANCOCK. OK. Have you been involved in one?

Mr. BROWN. I have never been involved in it.

Mr. HANCOCK. OK.

Mr. ALARCON. Yes, Congressman, I have been involved in five transactions where tax certificates have been issued.

Mr. HANCOCK. OK. Here again, I apologize for asking you to wait for 10 or 15 minutes, but Mrs. Sutter, there is one question. Are you making a real good case here for capital gains for everybody?

Ms. SUTTER. Well, interestingly enough, one of the arguments for the minority tax certificate is that it can, in the same way capital gains is designed to, encourage reinvestment and the stimulation of the economy, that this serves that same purpose. So I would see the likeness to it, in that it can also be a spur to getting investment in the economy, and doing that while at the same time creating diversity, which of course capital gains does not.

Mr. HANCOCK. Well, I want to get this in as part of the record. There are people that say that capital gains only benefits the rich, and yet the situation and the case we are making here is that capital gains treatment, through tax deferment, benefits minorities pretty strongly.

This is similar to capital gains. In effect, it would apply in basically the same way, except it is earmarked as a tax benefit rather than just an across-the-board capital gains.

Ms. SUTTER. Well, it is a tax deferment subject to reinvestment in the economy.

Mr. HANCOCK. Which, in effect, is what the principle of capital gains is. It defers the taxes and that way it creates more investment and creates more economic stimulation.

Ms. SUTTER. Right. The difference with this is that it is mandated as a prerequisite to getting the tax certificate.

Mr. HANCOCK. Right. In other hearings we will be talking about capital gains and the capital gains treatment, so I just wanted to get it into the record.

Thank you very much. I appreciate it. I apologize again for keeping you here so long.

Yes, sir.

Mr. WINSTON. Mr. Hancock, may I speak to the last point you raised about the general capital gains tax reduction and how it would compare with respect to the tax certificate?

The critical point that needs to be understood about the tax certificate is that the tax certificate causes the transaction to occur to a minority. What happens is, if I am looking to sell a desirable broadcast facility, there are potential buyers lined up. Many of those potential buyers can just call their bank and have the funds wired the next day, if I strike a deal with you.

The problem is that, for minorities, it means going out, raising funds, dealing with bankers you have never dealt with before, and it takes time. If I have a desirable property to sell, I do not want to waste time waiting for a minority to get the money. But if a minority is going to give me a tax certificate, then there is a time value that comes with that tax certificate, and I am willing to wait for him or her to get their money together to make that transaction occur.

So if it is not uniquely geared toward minorities, minorities will not get those transactions. Someone will get a tax capital gains benefit but it will not be the minorities.

Mr. HANCOCK. I appreciate the point that you are making, and there is no question that it works that way. But one of the things that is happening right now in our economy is there are a lot of transactions that are just on the verge of being closed, that are waiting now to see what the U.S. Congress does on capital gains. So the whole thing fits together.

Like I say, I just wanted to make sure that we understand that capital gains, if we get it through up here, benefits everybody, including minorities. That is the only point, and I wanted it in the record.

Thank you very much for your testimony.

I guess this is the final panel for the day. I am assuming most of you have been here since the hearing started this morning and know there has been a lot of testimony. As you have been here, you know we are going to stick fairly close to the 5-minute time limit. Your written statements will become part of the record, and we would appreciate it if you would keep your verbal testimony as concise as possible so we can abide by the 5-minute testimony rule.

We are not going to cut you off. You have taken your time to be here, and we want to make sure that you have the opportunity to make your full statement.

So with that, Mr. Oxendine.

STATEMENT OF JOHN E. OXENDINE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BROADCAST CAPITAL FUND, INC., AND PRESIDENT AND CHIEF EXECUTIVE OFFICER, BLACKSTAR COMMUNICATIONS, INC.

Mr. OXENDINE. That is correct, thank you. Thank you Congressman Hancock, and I really appreciate the opportunity to be here today. I have my comments for the record and I am just going to make a few points.

Right now I am president of the Broadcast Capital Fund. We have funded, made 50 commitments to minorities over the last 14 years I have been running the company; two-thirds black station owners and one-third Hispanic small deals. We have used tax certificates.

I am also president of a company called Black Star Communications. I own three little television stations. I also spent the last 2 years on the Small Business Advisory Committee at the FCC, working on what we could do for small businesses, women, and rural telephone companies.

I would just like to say for the record that I certainly support the minority tax certificate, even though it has its challenges, for two major reasons.

The first is that it is important for diversity. In the 50-some-odd deals that we have done, we have found that it is important to have ownership. When you look at the 300-plus television markets around the country, if we, as minorities, do not have the No. 1, 2, 3, or 4 stations in terms of ratings and market share, it is important that we be able to find financing so we can own some of the smaller stations in the market. We usually own or can purchase most of the smaller stations in the market.

Most of our deals have been in the small to medium markets and the tax certificates have been very, very important there. Where the owners are there and live in the city of license, we have seen a real change. Because if the ownership is there and there is a diversity of ownership, there is a diversity of message to the community. I have seen that in the 14 years I have been in broadcasting.

Importantly, the tax certificate has facilitated small business development because these are some small radio stations that otherwise would not have been bought.

With regard to the tax certificate, we have seen the tax certificate used primarily to help us (minorities) access capital. It has allowed us to have a "buy-in" to the game. Like Mr. Winston said, in most instances it is the chicken or the egg scenario. If you have a deal, you have to have money. When we go for the deal, if we don't have money, the sellers won't close the deal. So tax certificates have made us attractive.

In the instances where we have used the tax certificate, if a property costs $10 and the majority of the population can pay $10, we come along and offer $7 because there is minimally a 30-percent tax to pay. Usually the seller doesn't give it to us for $7. We get it for $8.5. So the loss, or the deferral of taxes, is really not as much as it could be. It is only $1.50 instead of $3.

In the instances where there are tax deferrals, it is usually in the interest of the seller to reinvest, whether it is the small deals I deal with or the major deal that people are alluding to down the road. If you are an entrepreneur and you have an opportunity to take a tax deferral, if you do not reinvest that money, you are going to have to amend your tax returns for that year and pay interest. Smart entrepreneurs, rather than having their money sitting around idly for 2 years, will invest it in something that will make some money and provide a good return.

So from our experience, the tax certificate has not only been good in generating business in providing access to capital and motivating people to invest in minority-owned companies, but the seller is also motivated to do something entrepreneurial with his tax services. Hopefully, that seller would do so in the community.

Most of our tax certificates have been small. When I came into the business 14 years ago, there were less than 50 minority-owned broadcast properties, and now there are close to 300-plus. That is still less than 3 percent. Of the 11,000 properties in the United States, anywhere between 500 to 1,000 get bought and sold every year. The couple hundred that represent the tax certificate deals over the past 15 years have not been bad or very costly.

But when you look at radio, TV, cable—radio, financing radio transactions has worked very effectively because when you own radio you have to be part of the community or you will not make it. With television station ownership, you do not have as much control in programming, but if you are the owner, your feelings and concerns are reflected in the community for the things that are important to us (minorities). For cable, it is a little more difficult because it is larger and less local. But our experience overall has been pretty good, and I will defer to my colleagues.

[The prepared statement follows:]

Testimony of

JOHN E. OXENDINE
President and Chief Executive Officer,
Broadcast Capital Fund, Inc.
&
President and Chief Executive Officer,
Blackstar Communications, Inc.

before the

Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
January 27, 1995

Madam Chairman and members of the Subcommittee, thank you for the opportunity to testify today as you begin to examine tax certificates in communications ventures under Section 1071 of the Internal Revenue Code.

As the President of Broadcast Capital Fund, Inc. ("**Broadcap**"), a venture capital company which has financed nearly forty minority broadcasters, and as the President of Blackstar Communications, Inc. ("**Blackstar**"), a minority owned and controlled company which has three television stations, let me express my strong support for the use of tax certificates to increase diversity among the trustees of the public's airwaves.

Let there be no doubt that the FCC's tax certificate policy has directly led to a significant increase in diversity of broadcast ownership in the United States. For more than seventeen years, the Federal Communications Commission has used tax certificates to promote broadcast ownership by new entrants previously precluded from ownership through historical patterns of discrimination. Both the Congress and the Supreme Court have approved this goal of diversity in broadcast ownership. When the FCC began its minority tax certificate policy, minority-owned stations numbered fewer than fifty -- less than one percent of all broadcast stations. We now have over 320 minority-owned commercial broadcast stations. The FCC has issued approximately 280 tax certificates with respect to broadcast stations. While I don't know precisely how many of those acquiring broadcast stations through tax certificates currently own and operate the same broadcast stations today, the FCC's tax certificate policy contributed significantly to a broader, more diverse, and more competitive broadcast marketplace.

Let there also be no doubt that much remains to be done to tear down the barriers to wider participation in broadcast ownership and to foster a level, competitive playing field in which opportunities are available for broad participation in this industry. Tax certificates are vital to this important effort. For example, even with the nearly eight-fold increase in broadcast ownership by African-Americans, Asian-Americans, Hispanic Americans, and Native Americans, these Americans combined own and control less than three percent of the more than eleven thousand commercial broadcast stations in the United States. Yet, since 1978 their representation in our population increased from 20 percent to 23 percent, three percentage points. During the same period, however, their representation in broadcast ownership only increased about two percentage points, from less than one percent to just under three percent.

Why have we not achieved greater diversity in broadcast ownership? Study after study lays the blame on lack of access to capital. Minority business borrowers have less equity to invest, receive fewer loan dollars per dollar of equity investment, and are less likely to have alternative loan sources. Broadcap came into being as a private initiative formed within the broadcasting industry to help tear down that single greatest barrier to broader and more diverse participation in industry ownership. As the President of Broadcap, I can assure you that the FCC's tax certificate policy has contributed to our successes in fostering diversity in broadcast ownership by funding new entrants. The tax certificate policy does what it is designed to do: it encourages existing owners seeking a buyer to look beyond the usual prospects, and it attracts investors.

What is the tax certificate, and why does it work? Section 1071 of the Code empowers the FCC to certify that a sale or exchange of property is necessary or appropriate to effectuate a change in its broadcast ownership policies. A tax certificate enables the seller of a broadcast station to defer recognizing the gain realized upon a sale, either by: (1) treating the sale as an involuntary conversion with the recognition of gain deferred by the reinvestment of the proceeds in qualified replacement property, or (2) electing to reduce the basis of certain depreciable property, or both. The FCC issues tax certificates to those who sell broadcast stations to minority-controlled buyers. Those providing start-up capital that permits a new minority broadcast venture also can receive tax certificates when they sell their non-controlling interests.

The availability of tax certificates promotes diversity in broadcast ownership in two ways. First, it encourages licensees to consider selling their stations to new entrants. These licensees might otherwise continue to hold their properties or sell to others without considering qualified buyers outside their customary circle of business acquaintances. Second, the availability of the certificate helps these new entrants attract much needed financing so that they can acquire their stations and compete in the marketplace.

Quite simply, no measure that Congress or the FCC has ever taken to foster ownership diversity in the broadcast industry comes anywhere close to the tax certificate program in its effectiveness. Take away the minority-controlled broadcast stations that came into being through the help of tax certificates and you take away a significant portion of the gains that minorities have made in station ownership since 1978. This history of success does not mean that the tax certificate program cannot be improved. I strongly urge, however, that you not allow unsupported allegations of isolated abuse to blind you to the unquestioned good that this program is accomplishing.

The costs of the program are often overstated. A tax certificate does not give the seller a tax credit, but merely permits deferral of the tax on the gain from the sale. If the seller only decided to sell his property because of the availability of a tax certificate, then diversity of ownership has been encouraged without any loss of tax revenue because without the tax certificate, the sale would not have occurred. In any event, the tax certificate holder has a limited period to reinvest in qualified replacement property or to reduce the tax basis in depreciable property already held. The reinvestment itself is often a taxable transaction in which a third party will recognize gain. The cost of the program through postponement of taxation thus may be far less than many have assumed.

Newspapers report only on big tax certificate transactions. The list of the station sales for which the FCC has issued tax certificates, however, includes relatively few major market stations. Most tax certificate transactions have involved medium and small market stations, many licensed to communities not familiar to those outside the state. The huge tax certificate transaction does not typify the usual type of transaction aided by tax certificates. We should not hamstring the entire tax certificate program based upon false assumptions that tax certificates just support megadeals.

I also have heard the concern that the FCC requires only a one-year holding period before a station acquired under the minority tax certificate policy can be sold. In the first place, that concern does not do justice to the FCC. To be sure, the FCC has a one-year bar against the sale of such a station. That rule, however, does not mean that the FCC accepts tax certificate transactions that provide for the controlling parties to withdraw after one year. Rather, the FCC looks for meaningful, long-term gains in diversity of ownership and looks askance at proposals that include mechanisms by which long-established broadcasters can buy out the new enterprise at an early stage.

Some transactions may well have slipped through the FCC's review. The answer to these abuses, however, is not to terminate the program, but to strengthen enforcement and review by the FCC. In December 1994, the FCC began a rulemaking proceeding to consider how to improve the effectiveness of its current programs to promote ownership diversity, including the tax certificate program. In that proceeding, the FCC is well able to consider whether it needs to limit devices that might permit well-established broadcasters to buy out the new entrants fostered by the tax certificate policy, and to obtain the benefits of tax certificates without contributing to the important objective of increasing ownership diversity. If the FCC should find that stations acquired with tax certificates are lapsing back into the control of long-established broadcasters, it could impose a longer required holding period, with appropriate exceptions.

In short, I urge you not to dismiss an entire program because of isolated abuses or perceptions of abuse. Instead, allow the FCC -- the expert agency that Congress established -- to complete the proceeding that it began in December. If the FCC's action does not address this Subcommittee's concerns, it is of course your prerogative to revisit the program. Then, however, you will have the factual record of the FCC's proceeding to guide you in any necessary action to ensure that the merits of the tax certificate program are preserved.

Mr. HANCOCK. Thank you.

STATEMENT OF DOROTHY E. BRUNSON, PRESIDENT, BRUNSON COMMUNICATIONS, INC., PHILADELPHIA, PA., AND PRESIDENT, ASSOCIATION OF BLACK-OWNED TELEVISION STATIONS

Ms. BRUNSON. Mr. Chairman, my name is Dorothy Brunson. I am the president of Brunson Communications, Inc., which owns and operates a station, channel 48, in Philadelphia, Pa. I am also the President of the Association of Black Television Station Owners.

I have worked for 32 years in the communications industry, and during that time I have vigorously worked to bring new business ventures into the marketplace, created new jobs, and promoted economic growth.

To deviate from my remarks one bit, it is very important that we view this tax certificate policy as an economic stimulus and not as a social issue. It is no different from any other policy which stimulates growth, whether it be at the Federal level for various and sundry departments of our government, or whether it be at the State level.

When I started my company, I had to divest everything that I owned and put at risk my entire 20-some-odd years of business. I had a very difficult time borrowing, simply because the complexities of dealing with the broadcast industry by traditional lenders makes the process for minorities, especially those with little experience or who have never owned before, a very difficult one. In spite of that, and the fact that I could not borrow the kinds of funds that were necessary, I succeeded and now employ 20-plus people.

Section 1071 is an important mechanism for helping minorities to gain access to capital. Now, that statement presents a very different kind of view than what you might have heard earlier, but minorities have always been allowed to own properties. Mostly very low grade properties, very unacceptable, and the properties themselves have not really gotten us into mainstream. What it has done is gotten us in trouble and created a mechanism by which we have failed because the properties themselves were inferior.

Section 1071 gives us access to capital, because for once we are able to get quality properties, and those properties can give us the kind of cash-flow and the kind of benefits where we can pay back huge debts. Therefore, lending institutions look at us and look at our deals in a more traditional sense as opposed to looking at it as a broadcast deal where it is one that "I don't understand the complexities of," or one that doesn't make economic sense. It has cash-flow and it has the other components that make a significant difference in terms of access to capital that we would never be able to have without section 1071.

The situation created by selling to a minority is that it allows this minority to provide growth to a division of a company. Historically, when a division is sold off, that smaller division has grown and expanded into a larger division. If you were to allow me to read from my paper, some years ago the FCC required CBS to spin off a small business it operated in the cable television and program syndication field. Those spun-off businesses became the basis of

Viacom. From that modest beginning, Viacom has today grown to a size at least as large as its beginning. Now Viacom has focused its energy on businesses other than cable television. It wants to sell to a minority individual who wants to do and is doing the same kind of thing.

It is my experience, after having worked in this industry for over 32 years and worked in the economic development arena for over 40 years, that any time one uses tax to stimulate small business growth, it is good for America. Further, it provides the kind of economic benefit and the kind of jobs and growth opportunity and tax base for the community it is in by stimulating growth for that community. That is what section 1071 does.

Section 1071 stimulates economic growth in other ways. It allows communications firms to defer recognition of capital gains. It encourages those firms to invest in businesses and facilities that will yield long-term growth, which is one way to stabilize America's tax base. This is much like the capital gains tax and other measures that are being favored by Congress. But under section 1071 the tax will, will eventually be paid. It is not something that is deferred and then goes away forever, as many of the government programs which exist to help other agencies within the government.

This effect is also similar to that of many other provisions in the Tax Code. Those provisions also stimulate investment through targeted treatment of capital gains, and that is what we are talking about, targeted treatment of capital gains.

Unlike section 1071, many of those targeted treatment of capital gains provisions do not require eventually full payment of the capital gains tax. In each case, Congress has determined that in the long term, tax revenues will be increased, not reduced by policies that promote economic growth. Section 1071 accomplished this precisely with the exact same results as any other division.

I appreciate the opportunity to talk with you today and hope these remarks will be considered.

[The prepared statement follows:]

January 27, 1995

TESTIMONY OF DOROTHY E. BRUNSON
President, Brunson Communications Inc.
(WGTW TV, Philadelphia, PA)
President, Association of Black Owned Television Stations

Before: Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
Hon. Nancy L. Johnson, Presiding

Good morning Madame Chairperson and members of the committee. I am Dorothy Brunson, President of Brunson Communications Inc., which owns and operates a television station on channel 48 in Philadelphia, Pennsylvania. I am also President of the Association of Black Owned Broadcasters. I have worked for 32 years in the communications industry. In that time, I have worked vigorously to bring new business ventures into the marketplace, creating new jobs and promoting economic growth. But, Madame Chairperson, no one can create new business enterprises without access to capital.

Let me tell you about my recent experience in starting up TV channel 48. Two and one half years ago, I struggled to construct TV 48. Even with a construction permit in the fourth largest market, I could not borrow from any lending institution. Banks and other lenders would not do loans for a specialized business like broadcasting--certainly not for a start-up company like ours. To get on the air, I had to sell everything I owned, including my life insurance policy. We also set up a private placement funding instrument to repay our investors, which netted out to a very high rate of return. All those steps allowed us to put our station on the air. We now employ 20 people.

Even with the great sacrifices I have had to make, I was lucky. TV 48 is a reality today because of my 30 years of experience in the broadcast industry. But the sad fact is that for many minorities, access to capital remains a major hurdle. It is a hurdle that keeps many minority entrepreneurs from ever starting up their enterprises. When those enterprises are not started, everyone is robbed of the jobs and economic growth they would have provided.

Section 1071 is an important mechanism for helping minorities gain access to capital. Large communications firms receive the right to defer recognition of their own capital gains. In exchange, they help minorities acquire smaller parts of their communications businesses. Those minorities, given a chance to build something of their own, focus all their energy and entrepreneurial spirit on those businesses. They grow the businesses. The prior owners, who have focused their attention elsewhere, would never have expanded these businesses in anything like the same proportions.

Here is a case in point. Some years ago, the FCC required CBS to spin off small businesses it operated in the cable television and program syndication fields. Those spun-off businesses became the basis of Viacom. From that modest beginning, Viacom has today grown to a size at least as large as CBS itself. Now Viacom has focused its energies on businesses other than cable television. It wants to sell that business to a minority individual with a proven record of operating successful cable television systems. If that individual is permitted to acquire Viacom's cable systems, he will, I believe, build upon them in the same way Viacom built upon CBS's spun-off businesses twenty years ago.

The result will be a bigger and better company--providing more jobs--than would otherwise exist. And that will not occur without the tax certificate policy.

Section 1071 stimulates economic growth in another way. By allowing communications firms to defer recognition of capital gains, it encourages those firms to invest in businesses and facilities that will yield long term growth. This effect is very much the same as the effect of reducing the capital gains tax, a measure favored by many in Congress. But under Section 1071 the full tax must eventually be paid.

This effect is also similar to that of many other provisions in the tax code. Those provisions also stimulate investment through targeted treatment of capital gains. Unlike Section 1071, many of those provisions do not require eventual full payment of the capital gains tax. In each case, Congress has determined that in the long term, tax revenues will be increased--not reduced--by policies that promote economic growth. Section 1071 accomplishes precisely the same result.

Madame Chairperson, I appreciate the opportunity to talk to the committee today. I know the committee will deliberate carefully on this important issue, and I hope I have contributed to those deliberations.

Mr. HANCOCK. Thank you, Ms. Brunson.
Mr. Cornwell.

STATEMENT OF W. DON CORNWELL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GRANITE BROADCASTING CORP., NEW YORK, N.Y.

Mr. CORNWELL. Thank you, Mr. Chairman, for allowing me to testify today. I am Don Cornwell, chairman of the Board of Directors and chief executive officer of Granite Broadcasting Corp. In addition to my duties at Granite, I am also active in the broadcasting industry as a member of the television board of the National Association of Broadcasters, and I appreciate the opportunity to appear today before you in support of section 1071 of the Tax Code.

The development and growth of Granite into the largest African-American controlled company in the television station ownership business in this country is a testament to the success of the tax certificate and section 1071. To date we own and operate six network affiliated television stations across the country, in California, Illinois, Minnesota, Wisconsin, Indiana, and New York. We are closing on a seventh station in Texas next week and expect to complete the acquisition of a station in Michigan in June.

Let me explain how we got started. In 1988, Granite bought its first and smallest stations in Duluth, Minn., and Peoria, Ill. We started small because my own equity capital combined with that of family, friends, and former employers was used to purchase these stations. My investment, which represented then and today virtually all of my family's net worth, bought the majority of the voting stock in Granite. No one has the right to buy my equity position or to exercise any of my rights as the controlling shareholder.

Over time, our reputation has grown, and, as a result, we have been able to attract the large amounts of capital necessary to acquire larger stations. I want to emphasize to the subcommittee that our objective since 1988 has been to build a strong company, a company which can compete in the 21st century. Thus, we continue to own each station we have acquired to date, despite receiving many attractive offers to sell.

My own experience tells me that the minority tax certificate program accomplishes the FCC and Congress' goal of encouraging program diversity. There is no doubt in my mind that editorial policy does follow ownership. While I am careful, I might add, not to inject myself into station manager's programming decisions, since we really do believe in localism, in several instances there is no question but that our ownership has resulted in programming that was more diverse than that provided by previous owners.

Now, I might add, we give some examples that will be in the written comments submitted into the record.

The tax certificate program has been extremely important in the development and growth of our enterprise. While valuation and certainty of financing ultimately, frankly, determines the willingness of a seller to choose our proposal, clearly the tax certificate has been very helpful in persuading owners to pay close attention to a proposal from us.

For example, we were able to persuade companies such as Pulitzer, Landmark Communications, and Meredith to sell us television stations which they, frankly, had not intended to sell. I might just add as an aside that I disagree with the gentleman on the previous panel, because we have gotten benefits in the pricing. Some would say I am a pretty tough negotiator despite the smile on my face.

The certificate's value depends solely on the seller. At the outset of our negotiations we cannot be sure that a seller will find our proposal the most attractive. The seller must consider whether they expect to realize any taxable gain and whether they intend to reinvest the proceeds of a sale in acceptable like-kind property. The certificate's actual value can be uncertain, and sometimes not large in dollar terms. However, I must assure you that in each of our six acquisitions to date, and the two currently under discussion or under way, there would be no deal without the certificate.

We share the concerns of the Congress and the FCC about potential abuses of this program, and we welcome an opportunity to work with you to develop ways to ensure that the spirit of this program is satisfied. We believe that satisfaction of that spirit requires at least three standards:

First, a significant at-risk investment by minority investors at the inception of the enterprise. Second, executive management control. Third, the absence of any mandatory rights by nonminority investors to buy out the controlling minority investor.

Further, we believe that the Congress, the FCC, and the IRS should require a written representation and warranty from the recipient of the tax certificate, i.e. the seller, that these or other appropriate standards have been met to the best of their knowledge.

Granite has set an additional standard for itself for participation in this program. Our standard is inappropriate as an act of legislation, but we would like to go on record as to what our practice has been.

We believe that our company has realized and our shareholders have realized benefits from the program and, therefore, one should expect more from us than one might expect from an average company in our industry. Thus, we have gone out of our way, despite the fact that we are not a rich company, to stretch to create paid station employee opportunities as a means of providing young people, mostly minorities, I might add, an opportunity to gain entry level employment in our company and this industry.

In addition, we have contributed significantly to industry-supported foundations which are designed to encourage minority students to enter the broadcasting field.

We also have made available our station and management to assist in training minorities who participate in a Commerce Department program for prospective owners. It is a training program.

This concludes my remarks. Thank you for allowing me an opportunity to testify.

[The prepared statement follows:]

STATEMENT OF

W. DON CORNWELL

CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
GRANITE BROADCASTING CORPORATION

Chairwoman Johnson, Congressman Matsui, and Members of the Subcommittee on Oversight, my name is Don Cornwell. I am Chairman of the Board of Directors and Chief Executive Officer of Granite Broadcasting Corporation ("Granite"). In addition to my duties at Granite, I am also active in the broadcasting industry as a member of the television board of the National Association of Broadcasters. My company is also a member of the National Association of Black Owned Broadcasters. I appreciate the opportunity to submit testimony on section 1071 of the tax code, which the Federal Communications Commission ("FCC") has used to issue tax certificates which encourage greater ownership by minorities of radio, television and other properties.

Background on Granite's Operations

The background information on our operations highlights the benefits of the FCC tax certificate program. Granite owns and operates six network affiliated television stations across the country, all of which were acquired under this program. We have stations in California, Illinois, Minnesota, Wisconsin, Indiana and New York. We are also in the process of acquiring stations in Texas and Michigan.

We bought our first and smallest stations in 1988. These stations, which are located in Duluth, Minnesota and Peoria, Illinois, are necessarily small because my own equity capital, combined with that of family, friends and a former employer, was used to purchase them. Over time, Granite was able to develop a strong reputation enabling it to attract the amounts of capital required to acquire larger stations.

Over the next four years, we acquired four additional network affiliated television stations and a large interest in a fifth station. In 1989, we acquired stations in Fort Wayne, Indiana and San Jose, California. In 1993, we acquired stations serving Fresno, California and Syracuse, New York, and the largest equity stake in the leading television station serving Buffalo, New York.

By the end of 1995, Granite will consist of eight stations (plus our equity interest in the Buffalo station) competing in television markets ranging in size from Grand Rapids-Kalamazoo-Battle Creek, Michigan to Duluth, Minnesota-Superior, Wisconsin. These markets range in size from the 36th to the 128th market. We will employ approximately 750 individuals; and, after six years, we will have become the largest African-American controlled company in the television station ownership business.

Our objective is to ensure that Granite is strong enough to compete in the electronic media market in the 21st century. We will remain builders; and, thus, we have not and will not engage in the trading of stations. We continue to own each station we have acquired to date. We have done this despite receiving attractive offers to sell.

We believe that our ownership of each of these stations has made a difference. Each station, while affiliated with one of the three traditional networks, is directed to become the leading provider of local news, weather, and sports information in our communities of service. In addition, we pride ourselves on the strength of our involvement in our local communities.

Development of Section 1071

In the press release announcing this hearing, you indicated that the Subcommittee will examine the FCC's 1978 policy and the implementation of section 1071. Following is a brief background description of the history behind enactment of Code section 1071 and the current tax certificate program. We believe that the history shows that the minority tax certificate program does fit within and further the original goals of section 1071.

The predecessor to section 1071 was enacted in 1943.1/ This provision emanated from the adoption of FCC ownership regulations prohibiting common control of certain directly competing radio stations.2/ These ownership rules were directed toward ensuring diversity in the content of broadcasts.3/ As a result of the new policy prohibition, a number of licensees that held interests in two stations were required to dispose of one of these interests.4/ Lawmakers enacted the predecessor to section 1071 (old section 112(m)) to afford relief, through issuance of tax certificates, to taxpayers who were required to dispose of certain broadcast holdings. Since 1943, the FCC has expanded its multiple ownership rules to prohibit a number of cross-ownerships.5/ Ironically, in more recent years, the FCC has again reversed itself and liberalized the multiple ownership and cross-ownership rules in markets where sufficient diversity of viewpoints is available.

In 1978, the FCC expanded its program to promote diversity of viewpoints. Under this new program, the FCC announced it would issue tax certificates for sales of broadcast facilities to "parties with a significant minority interest" in cases where "there is a substantial likelihood that diversity of programming will be increased."6/ Congress did not change the language in section 1071 when the FCC's new policy was put into effect. Much like its 1943 action in breaking up cross-ownership arrangements because they limited diversity of viewpoints in the marketplace, extending the tax certificate program to minorities was an acknowledgement that its prior actions in granting licenses had failed to take into account the importance of minority ownership and control of licensees in achieving the desired diversity of viewpoints in the marketplace.

1/ Former section 112(m) was enacted as part of the Revenue Act of 1943, Pub. L. No. 78-235, § 123, 58 Stat. 21 (1944).

2/ See S. Rep. No. 627, 78th Cong., 1st Sess. 53-54 (1943), reprinted in J. Seidman, Legislative History of Federal Income and Excess Profits Tax Laws, 1953-1939, at 1602-03 (1954); Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 FCC2d 979, 983 n. 19 (1978) ["1978 Policy Statement"] (tax certificates originally used to remove hardship of involuntary transfer resulting from divestiture imposed by FCC's multiple ownership rules); 47 C.F.R. § 3.35, 8 F.R. 16065 (1943). Before that time, some radio station licensees owned more than one station in the same city. See G.C.M. 37430 (1978).

3/ See, e.g., In re Radio Corp of America, 10 F.C.C. Reports 212, 213 (1943).

4/ See F.C.C. 56-919, 21 Fed. Reg. 7831 (1956).

5/ See Blake & McKenna, Section 1071: Deferral of Tax on FCC Sanctioned Dispositions of Communications Properties, 36 Tax Law Review 101, 104-06 (1980) (citing examples such as elimination of cross-ownership of AM radio stations, FM radio stations, and television stations in same market).

6/ See 1978 Policy Statement, 68 FCC2d 979, 982-93.

<u>Description of Current Minority Tax Certificate Program</u>

Current section 1071 is restrictive and is helpful only in those cases where the seller is in a tax position to use the certificates. If qualified, the tax certificate program can provide effective incentives for a station owner to sell to a minority or for an investor to provide financing for the minority owner.

As currently drafted and implemented, the FCC is allowed to issue a tax certificate only to two classes of taxpayers: (1) a seller of a broadcast station upon the sale or exchange of the broadcast property to a minority-controlled company, or (2) an initial investor who provides the necessary "start-up" financing to a minority-controlled purchaser of a broadcast station.7/ The tax certificate enables the qualified taxpayer (i) to defer payment of capital gains tax on the sale of the broadcast property or interest, provided that the taxpayer reinvests the proceeds in qualified replacement property,8/ or (ii) to reduce the basis of certain depreciable property remaining in the taxpayer's hands immediately after the sale of broadcast property or interest, or acquired in the same taxable year.9/

To qualify under the FCC's minority tax certificate policy, the minority company must demonstrate that it is minority controlled. Traditionally, the test with respect to corporate applicants has been whether minorities10/ own more than 50% of the voting stock.11/ More recently, the FCC has expanded the eligibility requirements to permit limited partnerships with minority general partners to qualify, provided that the minority partner owns at least 20% of the partnership's total equity.12/

Additionally, the issuance of a tax certificate is dependent upon the timing of certain events. A seller of a broadcast property can be issued a tax certificate only after the sale or exchange has actually occurred. Initial investors in a minority-

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7/ For an initial investor to qualify for a tax certificate, the investment must meet the following criteria: (1) the investor must have provided "start-up capital" to the minority enterprise, defined as funds provided within one year of the company's acquisition of a broadcast property; (2) the investor must have sold its interest in the company; and (3) the company must qualify as a minority-controlled company both before the investor purchases the interest and after the investor sells the interest in the company.

8/ Qualified replacement property must be "similar or related in service or use" to the converted property. Thus, such property may consist of hard assets (<u>e.g.</u>, broadcast or cable assets) or stock in a corporation whose income is primarily derived from broadcasting or cable operations.

9/ Gain may still be recognized under other Code sections (<u>e.g.</u>, depreciation recapture under sections 1045 or 1050. <u>See</u> Glazer & Fisher, <u>Section 1071: FCC-Certified Transactions Involving Minority-Controlled Entities</u>, 47 Tax Lawyer 91, 110-11 (1994).

10/ For the purpose of the FCC's tax certificate policy, the term "minority" includes Blacks, Hispanics, American Indians, Alaskan Natives, Asians, and Pacific Islanders. <u>Minority Ownership in Broadcasting</u>, 92 FCC2d 849, 849 n. 1 (1982) ["1982 Policy Statement"].

11/ <u>1978 Policy Statement</u>, 68 FCC2d at 983 n.20.

12/ <u>1982 Policy Statement</u>, 92 FCC2d at 853-55.

controlled purchaser of a broadcast station can be issued a tax certificate only after the sale of their interests in the minority-controlled buyer.13/ A minority company that obtains a broadcast station involving a tax certificate must retain the station for at least one year. This restriction does not apply if a minority company proposes to sell the station to another minority company within the one-year period.

Tax Certificate Program's Significant Impact on Development and Growth of Company

Although we recognize that a number of factors have helped our business succeed, the minority tax certificate program has been extremely important in the development and growth of our enterprise. The program has allowed Granite to acquire each of its existing stations, so that now we are large enough to offer minorities real employment and business opportunities.

Valuation and certainty of financing ultimately determine the willingness of a seller to accept any of our acquisition proposals; however, Granite's experiences indicate that the tax certificate program clearly has been helpful in persuading owners to consider and accept our proposals. For example, we were able to persuade companies such as Pulitzer, Landmark Communications, and Meredith to sell us television stations which they originally had not intended to sell at all.

However, there is no guarantee that the tax certificate will make our proposal the most attractive to a particular seller. In some cases, the seller does not expect to realize any significant taxable gain. In other cases, the seller is going out of business and has no interest in reinvesting the proceeds of the sale in "like kind" property acceptable to the IRS in order to realize the tax certificate's benefits.

Potential Abuses of Program Raises Concern

Granite shares the concerns of the Congress and the FCC about potential abuses of the minority tax certificate program. In that regard, we were extremely careful in the creation of Granite to satisfy what we perceived as not only the letter, but also the spirit, of the FCC's policy.

When I founded Granite in 1988 with a partner, the investment I made represented then and today virtually all of my family's net worth. My investment bought the majority of the voting stock in Granite, and no one has the right to purchase my equity position or exercise any of my rights as the control shareholder. Further, not only do I operate as the Chairman and CEO of the Company, we also have significant minority representation on our Board of Directors.

When we have acquired stations, in many instances the seller has spent a considerable amount of time conducting their own due diligence regarding the structure of Granite. I specifically recall the transaction where Granite acquired our Fort Wayne, Indiana station, WPTA-TV, where the seller's counsel insisted that Granite prove its strict compliance with the law. Such due diligence should be a requirement in every transaction.

My own experience tells me that the minority tax certificate program accomplishes the FCC's goal of encouraging program diversity. While I am careful not to inject myself into my station managers' programming decisions, since we believe in localism, I know of cases where my ownership has resulted in programming that was more diverse than that provided by previous non-minority

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13/ 1982 Policy Statement, 92 FCC2d at 858.

owners. For example, one of our stations, which had never commemorated Black History Month, produced and aired profiles of prominent, local African-Americans during Black History Month, featuring unsung heroes in the community, after the station had been purchased by Granite Broadcasting. Although there is no overt link in this case, I believe that a station's editorial policies in general reflect its ownership's views. The Supreme Court believes so as well.14/

Granite has set an additional standard for itself when it participates in this program. While this standard would be inappropriate as an act of legislation, we would like to go on record as to our practice. We believe that the benefits realized by our Company from the tax certificate policy require us to exceed expectations, that otherwise might exist from the average company in our industry, with regard to helping increase minority representation and thus promoting diversity of viewpoints in the broadcast medium. We are not a rich company, despite our rapid growth. However, we have stretched financially to create paid station employee opportunities as a means of providing young people -- mostly minorities -- an opportunity to gain entry level employment. In addition, we have contributed significantly to industry-supported foundations which are designed to encourage minority students to enter the broadcasting field. We also make available our stations and management to assist in training minorities who participate in a Commerce Department program for prospective owners of new stations.

We welcome an opportunity to work with the Subcommittee and the Administration to develop ways to ensure that the spirit of this program is satisfied. We believe that satisfaction of that spirit requires a significant at-risk investment by minority investors at the inception of the enterprise, executive management control, and the absence of mandatory rights by non-minority investors to buy out the controlling minority investor. Further, we believe that the Congress and the FCC should require a written representation and warranty from the recipient of the tax certificate that these or other appropriate standards have been met to the best of their knowledge.

Another Suggestion to Improve Section 1071

As long as you are examining section 1071, we would like to offer a suggestion to improve the tax administration of this provision. An important requirement of the provision is that the holder of a certificate must reinvest the proceeds in "property similar or related in service or use to the property converted." For this purpose, "stock of a corporation operating a ... broadcast station, whether or not representing control of such corporation," is considered property eligible for reinvestment and tax deferral. In Rev. Rul. 66-33, 1966-1 C.B. 183, the Internal Revenue Service interpreted section 1071 to require that stock in a corporation which holds its licenses and conducts operations through wholly-owned subsidiaries rather than directly, is not "property similar or related in service or use", even when the sole assets of the parent are stock in subsidiaries which hold licenses and operate broadcast stations.

This interpretation is too restrictive. At present, Granite holds one of its licenses directly; the others are owned in subsidiaries. Our lenders are constantly demanding that we hold all of our licenses in separate subsidiaries in order to protect their interests as creditor. Since the Supreme Court has held that

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14/ See, e.g., Metro Broadcasting, Inc. v. F.C.C., 497 U.S. 547, 570-71 (1990) (citing TV 9, Inc. v FCC, 495 F2d 929, 938 (D.C. Cir. 1973), cert. denied, 419 U.S. 986 (1974)).

they cannot acquire a security interest in the licenses itself, they can best protect their interests if they have a pledge of the stock of the subsidiary holding the license, along with negative pledges. It is important that a company like Granite be considered property similar or related in service or use in order to attract additional capital from sellers seeking to reinvest. Yet, lending restrictions make that difficult to maintain and, in many cases, impossible.

No harm would be done to the intent of section 1071 if Rev. Rul. 66-33 were overruled by amending the statute explicitly to permit stock in a corporation primarily engaged in operating radio broadcast stations, directly or through subsidiaries, to be investments eligible for deferral of gain. We would welcome discussions with you or your staff to determine if a resolution of this problem is possible.

Conclusion

Granite's experience with the minority tax certificate program shows that the program serves the intended goals of encouraging minority ownership in the broadcast industry and thus promoting diversity of content in broadcasts. The program has been very important to the growth and development of our Company, and has also encouraged the re-circulation of capital in our economy.

Granite shares Congress' and the Administration's concerns about potential program abuses. The Company has taken great pains to comply with both the letter and spirit of the program. We welcome this opportunity to work with the Congress and the Administration to develop ways to ensure that the program continues to serve its intended purposes, both from a communications policy and tax policy perspective.

Thank you for allowing me an opportunity to testify. I would be pleased to answer any questions.

Mr. HANCOCK. Thank you, Mr. Cornwell.
Mr. Bustos.

STATEMENT OF AMADOR S. BUSTOS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, Z-SPANISH RADIO NETWORK, INC., CAMERON PARK, CALIF.

Mr. BUSTOS. Yes, that is correct.

Mr. Chairman, Mr. Hancock, the tax certificate was intended for people, entrepreneurs, like us. In your rush or eagerness to not reward Viacom with a lot of money, please do not sacrifice us. I can see your concern and the subcommittee's concern, but do not sacrifice the people that otherwise would be benefiting from this kind of program.

My name is Amador Bustos, as you mentioned, and I am the president and chief executive officer of Z-Spanish Radio Network. Z-Spanish was formed only 2 years ago, 2 years and a couple of months. So even though some of the companies here have a lot longer trajectory, we are a smaller company and a newer company, which is part of the reason why the tax certificate was so important and crucial to us.

Currently, we operate and own a radio network of eight stations in the western United States. They are all Spanish and we produce a network that is delivered via satellite to all of our stations. Now we currently employ approximately 80 people and 90 percent of those employees are Hispanic.

On behalf of Z-Spanish and all other minority broadcasters in the United States, I urge the Congress to allow the survival of the tax certificate even if they may be modified to be improved, because it has the most effective role in prying open the door for access to ownership to broadcasting radio licenses to bona fide minority entrepreneurs. The prying, the opening of the door, is really the issue of access, because if you do not have at least that window of opportunity, then you do not have access.

For 20 years I have worked to become an owner of radio broadcast properties. As is evidenced by the attachment in my statement, you have a plan for the development and acquisition of broadcast stations for the Latino community, which Mr. Joseph Aguayo and myself presented to the FCC when they had their conference on minority ownership on April 26, 1977, that is 1 full year before the minority tax certificate was implemented, while I was already before the FCC as a graduate student trying to get the minority access to the broadcast industry.

A lot of that came also from reading and being a student during the days of the Civil Rights Commission and reading the documents on window dressing on the set, and all of the other things that went along with the Commission reports. So 20 years later, here I am again.

Our statements in 1977 urged the Small Business Administration to repeal its Opinion Molder Rule which effectively banned the SBA participation in loans in the broadcast industry. Our advice was not heeded then. It took almost 18 years, until last year, when they finally repealed that rule.

Our 1977 statement also urged the FCC to take steps to provide minority businessmen and women access to the growing television and cable industry. Our advice was not heeded very well either, because the minority representation in that industry is very small.

For us, the issue in 1977 was access and opportunity, fairness and justice. In 1995, the issue remains exactly the same, Mr. Hancock. In 1977, minorities owned approximately, as you heard, 1 percent. Now it is about 3 percent.

There has been some minor improvement, and that improvement, I think, has to do mainly with the effectiveness of the tax certificate. The effectiveness of the tax certificate resides in the fact that it stimulates the existing owners of broadcast and cable properties to actually talk to us, to seek minorities, to assist us in qualifying to actually purchase their properties.

This policy is truly driven by the market economy and the private negotiations of a buyer and seller. It is also one of the policies that, from a regulatory standpoint, the FCC can afford to offer to minorities—a very short turnaround period from where they can become nonowners to owners. People have talked ability, some of the other benefits or other preferences that the FCC has. Those are not as effective.

The broadcast properties are extremely limited commodities. Even if I had the money, I could not simply start my radio station in a community of my choice. The top 100 markets are virtually all taken. A minority entrepreneur has now only two choices: he can either seek a license from the FCC or buy an existing one. The seeking of the license is a very long process and it is also very costly. Litigation is very expensive and time consuming.

I have, for 10 years, applied for construction permits through the FCC and I have not gotten a single one. The fact is that people always litigate you to death and for one reason or another.

On the other hand, the view of a tax certificate policy, the seller will provide in the owner—or the potential brokers will call you from all parts of the country to try to offer you properties because they know they have that tax certificate.

So the basic principle; do not sacrifice the many, many entrepreneurs that are new to the industry, that are coming in, because there is one big mega deal. There may be something you can do about the mega deals, but the greatest majority of people that are benefiting from the certificate is ourselves. I have a track record of 20 years of trying to get properties and not being able to succeed until 2 years ago and that is because of the access of capital.

Typically, in those circumstances back before the tax certificate, white men sought to sell their properties to other white businessmen. They did not even offer the properties to us, and it was only the tax certificate that made the difference in terms of being able to bring those to the table.

To conclude, I know the battle of the minority issues of the sixties and seventies are out of fashion with many policymakers today. However, when we juxtapose the study I presented to the FCC two decades ago with the situation today, it can be seen that only very little has changed, and that minorities control very few stations. However, if you want to modify the certificate, do not repeal it and only improve it.

Because if you repeal it, Congress would be tantamount to saying that minorities have now gained equal status, have equal opportunity, have equal access, and that racism has been eradicated from the United States, which is clearly not the case.

My appeal to this subcommittee, and I am going to conclude, and this Congress, as it attempts to reshape this country with its Contract With America, that it be sure it includes all Americans: Black Americans, Hispanic Americans, Asian Americans, and Native Americans. The Speaker, I heard him last night at the dinner on television, he spoke to that effect; that the Contract With America was going to include all Americans. Because if it does not, it will become a contract on America, and a death warrant to the ideals of equality and justice that this country was built on.

Thank you, sir.

[The prepared statement and attachments follow:]

TESTIMONY OF AMADOR S. BUSTOS TO THE WAYS AND MEANS COMMITTEE, UNITED STATES HOUSE OF REPRESENTATIVES CONCERNING THE FCC'S MINORITY TAX CERTIFICATE PROGRAM

My name is Amador S. Bustos. I am President and Chief Executive Officer of Z-Spanish Radio Network, Inc. (Z-Spanish). Z-Spanish was formed just over two years ago. It is headquartered in the Sacramento, California metropolitan area. Z-Spanish currently owns and operates eight radio stations in the western United States. Z-Spanish established and operates "La Zeta", the first United States-based Hispanic-owned radio network, offering Spanish-language music and entertainment nationwide via satellite. Z-Spanish currently employs approximately 80 people, of whom 90 percent are of Hispanic origin (See Exhibit A).

On behalf of Z-Spanish and all other minority broadcasters in the United States, I urge Congress to permit the survival of the Minority Tax Certificate Program[1] because it has been one of the most effective tools to "pry" open the door for access to ownership of broadcast radio licenses by *bona fide* minority entrepreneurs.

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[1]See 26 U.S.C. §1071; ***Statement of Policy on Minority Ownership of Broadcast Facilities,*** 68 FCC 2d 979 (May 25, 1978).

For twenty years I have worked to become an owner of radio broadcast properties. As evidence of this please see Exhibit B, "A Plan for the Development and Acquisition of Broadcast Stations for the Latino Community", which Mr. Joseph Aguayo and I presented on behalf of National Latino Media Coalition to the FCC Conference on Minority Broadcast Ownership on April 26, 1977, one full year before the Minority Tax Certificate Program was adopted.

Our 1977 statement urged the Small Business Administration to repeal its "Opinion Molder Rule", which effectively banned SBA participation in loans for the acquisition and operation of broadcast station. Our advice was not heeded until last year when the SBA finally repealed the rule. Our 1977 statement also urged FCC to take steps to provide minority businessmen access to the then-growing cable television industry.

For us, the issues in 1977 were access and opportunity, fairness and justice; in 1995, the issues remain the same[2].

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[2]The Supreme Court of the United States in ***Metro Broadcasting, Inc. v. FCC***, 497 U.S. 547, 610-11, wrote: "Our history reveals that the most blatant forms of discrimination have been visited upon some members of the racial and ethnic groups identified in [FCC minority preference] programs. Many have lacked the opportunity to share in the Nation's wealth and to participate in its commercial enterprises. It is undisputed that minority participation in the broadcasting industry falls markedly below the demographic representation of those groups . .

In 1977, minorities owned approximately 1 percent of the then-existing broadcast stations. Eighteen years later, minority individuals and/or companies today own less than 3 percent of the commercial radio and television stations in America.[3]

In my view, the single most effective instrument in achieving the modest gains which have occurred over the past two decades, of all the minority incentives given by the FCC, has been the tax certificate.

Its effectiveness resides in the fact that it stimulates existing owners of broadcast and cable properties who desire to sell their stations or systems to actively and aggressively seek out and assist qualified minority entrepreneurs. This is a policy that is truly driven by a free market economy and the private negotiations between

. . and this shortfall may be traced in part to the discrimination and the patterns of exclusion that have widely affected our society. As a Nation we aspire to create a society untouched by that history of exclusion and to ensure that equality defines all citizens' daily experience and opportunities as well as the protection afforded to them under law."

[3]In its January 12, 1995 "Notice of Proposed Rulemaking" in MM Docket Nos. 94-149 and 91-140, ***Policies and Rules Regarding Minority and Female Ownership of Mass Media Facilities***, FCC 94-323, 10 FCC Rcd --, at paragraph 5, the FCC reports that, as of June 30, 1994, "minorities represented almost 23 percent of the national workforce but control only 2.9 percent (323) of the 11,128 commercial radio and television stations on the air. Similarly, of the approximately 7,500 cable operators, 0.2 percent (15) are minority-controlled." [footnotes omitted].

seller and buyer. It is also one of the only policies that, from a regulatory standpoint, the FCC can offer which are truly effective and help to place minority entrepreneurs into broadcast ownership in relatively small period of time.

As you know broadcast licenses are an extremely limited commodity. Even if I have the money, I cannot simply start my own radio station in a community of my choice. In virtually all of the "top 100" media markets, all existing and available space in the broadcast spectrum is occupied by operating stations. A minority entrepreneur such as myself has only two options: (1)to seek a license from the FCC[4]; (2) or to buy an existing one. Despite all the minority preferences provided by the FCC in the comparative hearing it is extremely difficult to get a license through this method. In my case I have filed numerous applications for construction permits for new FM stations for almost 10 years and have not gotten a single one through a decision of the

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[4]The only way this can be done in most markets is to file an application in competition with the renewal of license application of an existing station (radio licenses are renewed every seven years; television licenses are renewed every five years); in most cases, unless the existing licensee has a demonstrated record of violations of the Commission's Rules or has been convicted under narcotics trafficking statutes, such a challenge generally is futile, as the FCC has a "renewal expectancy" policy which generally favors the granting of the renewal application and the denial of the challenger's application.

FCC. Rather, because of the length of time the process takes and its high expenses, I have been "beaten by money". In other words, in most cases I have been forced to settle because our competitors have had more money and resources.[5]

On the other hand, in view of the tax certificate policy, sellers of broadcast and cable properties are incentivized to make their properties available to minority entrepreneurs. In my own experience, I receive calls from both owners of stations and business chance brokers specializing in the mass media industry at least once a week, informing me of properties for sale throughout the country and soliciting me to purchase them. These calls do not just come from the state of California, but from brokers all over the nation. For example, we recently purchased an AM/FM combination in the Fresno, California market after being solicited by a broker from Tampa, Florida. Twenty years ago, this type of business climate did not exist in

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[5] I am a non-voting stockholder in an application for a new station which has been pending at the FCC since 1987 and has still not been resolved; I am also an individual applicant in a challenge against an existing station's renewal application which has been pending since February, 1990. Despite the FCC's rhetoric in which it publicly claims to be interested in helping minorities, its staff's performance in the processing of hearing cases would not lead one to believe that the FCC is truly interested in increasing minority ownership.

our country. Typically, white businessmen sought out and sold their properties to other white businessmen. They did not even think to offer their properties for sale to members of the minority communities in this country. The tax certificate policy ensures, for economic reasons, that a competent businessman will always give a fair shake to a minority businessman to purchase his property.[6] The FCC then processes applications for its consent to the assignment of licenses of radio and television station typically in a 60-90 day period.

The issue of the Minority Tax Certificate is not an economic issue of quantifying how much the treasury is losing because the issuance of a certificate does not provide a tax credit. The issuance of a tax certificate only involves a tax deferral, generally for no more than 3 years, and only if the gain from the sale of the broadcast station to a minority-controlled company is reinvested in the communications industry. This program does not deprive the federal Treasury of revenues by forgiving a tax that might otherwise be due on the gain after a sale of a

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[6]Unlike renewal applications, applications for the sale of broadcast properties cannot be challenged by competing applications (although they are subject to petitions). *See* 47 U.S.C. §310(d).

broadcast property. Rather, taxes are deferred. The minority tax certificate program is both good public policy and good tax policy, because (1) it brings qualified minorities into the broadcasting industry, thereby diversifying control of the mass media and continuing to keep the door open for minorities to have a voice and access to the vital means of communication, and (2) it keeps money flowing through the mass media industry and sustains it as a dynamic and growing industry which is the best of its kind in the world and provides great service to the public. The same theoretical argument that is use to justify the reduction in the capital gains tax applies to the protection of the tax deferral given by the Tax Certificate; provides capital for expansion, employment, productivity, consumption and eventual revenues for the treasury through sales and income taxes.

To conclude, I know that a lot of the minority issues of the 1960s and 1970s are "out of fashion" with many policy makers today. However, when one juxtaposes the study that I presented to the FCC some two decades ago with the situation today, it can be seen that only very little progress has been made. Minorities own a controlling interest in just 323 of the 11,128 commercial broadcasting stations and just 15 of the 7,500 cable television systems in the nation. This extremely low percentage fails to come close to the 23 percent of the workforce which minority individuals comprise. The tax certificate policy has been a singularly successful means of bringing new minority entrepreneurs into the mass media industry. It has been said that non-minority investors have been abusing the system by using "minority" front persons. The Commission has means available to detect "shams" and to prevent abuses; for example, it could designate tax certificate applications for hearings before administrative law judges to determine whether the minority in question is *bona fide.*[7] Clearly, it is in the public interest for Congress and the FCC to develop means to curb abuses of otherwise beneficial programs.

However, a repeal of the tax certificate would be tantamount to Congress saying that minorities have now

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[7]The Supreme Court of the United States noted in ***Metro Broadcasting, Inc. v. FCC***, 497 U.S. 547, 595, n. 48, that FCC minority preferences are subject to administrative scrutiny to identify and eliminate from participation those applicants who are not bona fide. The FCC's adjudicatory staff has well over 10 years experience in ferreting out those applicants who seek minority preferences by "sham" ownership devices but who are in fact undeserving of those preferences. See e.g. ***KIST Corp.***, 99 FCC 2d 173, 186-90 (FCC Rev. Bd. 1984), *affirmed as modified* 102 FCC 2d 288, 292-93 and n. 11 (1985).

gained equal status, have equal opportunity, and equal access, and that racism has been eradicated from the United States, which is clearly not the case at this time. The tax certificate policy works, enhances minority ownership of and participation in the mass media, and in the long run does not result in a government forgiveness of tax liabilities. It is good tax policy and good social policy, and Congress ought to let it stand.

My appeal to this committee and the Congress as it attempts to reshape this country with its "Contract with America" that it be sure to include all Americans, Black Americans, Hispanic Americans, Asian Americans and Native Americans. Without fair access for all citizens will become a "contract on America;" a death warrant on the ideals of equality and justice that this country was built upon. Those are the precious principles that the founding fathers embodied in the Constitution that you have sworn to uphold. So, when you deliberate the fate of the tax certificate policy, be sure that tomorrow's America continues to be the land of opportunity for all, not just for the rich and famous; that America continues to be the land that rewards the entrepreneurial spirit, not only the concentration of capital into "mega"-companies; and that tomorrow's America continues to be the land of equality and justice, not tyranny and discrimination.

Respectfully submitted,

Amador S. Bustos, President
Z-Spanish Radio Network, Inc.

DATED: January 27, 1995

EXHIBIT 3

Z-Spanish Radio Network!

What's Driving Hispanic Market Growth?

- More Hispanics were added to the population during the 1980s than all other minorities combined.
- Hispanics increased *seven times faster* than the rest of the population during the past decade.
- In two decades Hispanics will outnumber African Americans and become the nations largest minority group.
- Hispanic purchasing power swells to over $200 Billion.

Why Spanish Language Media?

- Hispanics make up one-quarter of the California population and represent 46% of the population growth in California.
- Over 75% prefer to speak Spanish.
- Strong desires to maintain cultural roots.

Contact your Z-Spanish Radio Representative.

Z-Spanish Radio Network, Inc.
340 Brannan Street, Suite 101
San Francisco, CA 94107
Tel: (415) 284-9200
Fax: (415) 284-9205

How do you reach over 2 million Hispanics with one phone call?

TM

Z-Spanish Radio Network, Inc.

"La Z's" Program Director hand picked his "Dream Team."

The combination of a distinctive format and nationally renowned talent, coupled with state-of-the-art technology to deliver a flawless, CD quality sound, give "La Z" a sophisticated, modern sound.

Raul Brindis
6am - 10am
Raul has a team of supporting characters that make the morning at La Z "wackier" than any "morning zoo." Their high energy, jokes, character impressions, gossip on entertainers, and laughter wake up the audience and gets them in a good mood for the day ahead.

Elias Conde
10am - 3pm
Elias' smooth voice and infectious good humor keep the audience moving through the day and glued to La Z. On a regular basis Elias has live interviews with established and up-and-coming recording artists.

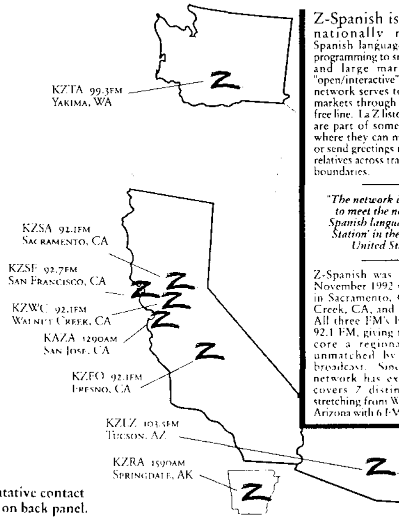
Salvador Homero Campos
3pm - 7pm
Sal's powerful air presence and magic touch for mixing music has commuters dancing in their seats during the drive home. He has three distinctive programs: "La Hora del Trabajador" (Workers Hour), "Los Grandes Anos del Rock" (Spanish Rock greatest hits), and "La Hora de Los Novios" (Love Lines).

Gonzalo Siles
7pm - 12midnight
Gonzalo is the creator of "La Hora Romantica" (Romantic Hours) where listeners read original poems during an hour of pure love tunes.

Rafael Vasquez
12midnight - 6am
"Late Night with Chico Suave" brings high energy to keep the late night audience awake and dancing.

Talent and format are Z advantage.

Z Spanish Hit Radio is a music intensive format developed by R&M award winning Program Director Salvador Homero Campos. This format can best be described as a blend of three established radio formats: Contemporary Hit Radio (CHR), Contemporary Country (Banda/Ranchera), and Top 40/Dance. "La Z's" unique sound comes from the lively danceable tunes mixed with the quick and witty style of our radio personalities. The tight DJ interventions, and heavy rotation of new releases appeals to everyone from 12+, but the bulk of our audience is in the primary demographics of 18-49.



Z-Spanish is bringing nationally renowned

Spanish language talent and programming to small, medium, and large markets. The "open/interactive" nature of the network serves to unify these markets through our 800-Toll free line. La Z listeners feel they are part of something bigger where they can make requests or send greetings to friends and relatives across traditional radio boundaries.

"The network is designed to meet the need for a Spanish language 'Super Station' in the Western United States."

Z-Spanish was launched in November 1992 with stations in Sacramento, CA, Walnut Creek, CA, and Fresno, CA. All three FM's broadcast on 92.1 FM, giving this network core a regional presence unmatched by any other broadcast. Since 1992, the network has expanded and covers 7 distinct markets stretching from Washington to Arizona with 6 FMs and 4 AMs.

See representative contact information on back panel.

EXHIBIT B

A PLAN FOR THE DEVELOPMENT AND ACQUISITION OF

BROADCAST STATIONS FOR THE LATINO COMMUNITY

Presented to the F.C.C. Conference on
Minority Broadcast Ownership
Washington, D.C.

April 26, 1977

By the National Task Force On
Latino Broadcast Ownership Of The
National Latino Media Coalition

Amador Bustos Joseph M. Aguayo

STATEMENT:

The Latino population of the U.S. now stands at 23 million strong. The same group of 23 million now earns $30 billion per year and spends $27 billion on consumer goods primarily advertised through the media of TV, radio and newspapers -- as does most of the American public.

It is also noteworthy that the distribution of the Latino population corresponds with the top 50 TV, radio and newspaper markets of the nation -- thus, the Latino community is often a dominant market segment in leading market areas.

Of the 954 television stations in the U.S. as of mid-June of 1975, more than 100 provide some amount of Spanish-language programming. The Spanish International Network (Channel 41 in New Jersey) and its almost eleven affiliate stations provide mostly Spanish language programming produced in Mexico for syndication through Central and South American including Puerto Rico.

In terms of the radio market, more than 200 stations broadcast in Spanish with programming for at least 30 hours per week. The number one radio and TV market of New York City has at least two stations with 24 hours and 18 hours of only Spanish-language programming.

Given this scope of population and buying power, the extent of Latino ownership and management of broadcast stations poses a national scandal. Presently, only six television stations are owned and operated by Spanish-speaking interests, with two new additional licensees pending.

The National Latino Media Coalition has, at its Fifth Annual Conference in New York City, constituted a National Task Force on Latino Broadcast Ownership, and proposes to the Federal Communications Commission, the following recommendations which, if accepted by the FCC, should be sent to President Carter and also the various federal agencies indicated:

I. FINANCING OF LATINO BROADCAST VENTURES

A. That the Small Business Administration's present policy of disallowing loans and loan guarantees for broadcasting be changed by either administrative correction or legislative amendment. The SBA should be empowered to provide specific set-asides for minority broadcast ownership.

B. That the Corporation for Public Broadcasting provide radio start-up monies for Latino ownership as well as sufficient monies from its community service grants and minority training grants for the training of Latino broadcast personnel and the hiring of professional staff.

C. That the Educational Broadcast Facilities Division of the Office of Education specifically set a priority of funds for the purchase of broadcast facilities for potential Latino and other minority entrepreneurs.

II. FEDERAL COMMUNCIATIONS COMMISSION

A. That the FCC commit itself to both VHF and UHF drop-in frequencies and channels for specific use and ownership by Latino owners in key Latino markets.

B. That the FCC allow for public access to its computer data on frequency allocations as to selected Latino markets, as well as existing financial, and other station market data as contained. It is likewise recommended that the FCC's Office of Consumer Affairs be assigned to handle this responsibility.

C. That the FCC give public priority to both pending and future licensing applications by Latino and other minority owners.

D. That the FCC streamline and give priority status to the processing of licensing application from Latino owners and other minority groups.

E. That the FCC should immediately undertake to hire Latino professionals in its various divisions who will be able to respond and handle licensing and other applications with adequate care and sensitivity.

The National Task Force on Latino Broadcast Ownership of the NLMC recognizes the leadership commitment of the Federal Communications Commission in the broadcasting field and recommends that a similar conference on Minority Ownership of Cable Broadcast Media be convened in the immediate future.

The National Latino Media Coalition commends the FCC on its unprecedented conference on Minority Ownership in the Broadcasting Field and urges the FCC to exercise its commitment on those federal agencies (SBA, Corporation for Public Broadcasting, Office of Education, etc.) to ensure that the above-mentioned areas are issues and resources realized.

Mr. HANCOCK. Thank you, Mr. Bustos.
Mr. Montero.

STATEMENT OF FRANCISCO R. MONTERO, COUNSEL, AMERICAN HISPANIC-OWNED RADIO ASSOCIATION AND RADIO BROADCASTERS ASSOCIATION OF PUERTO RICO

Mr. MONTERO. Yes, that is correct. Thank you, Congressman Hancock. I know I am the caboose on this train, so I will try to keep it short.

My name is Francisco R. Montero and I am a communications attorney and a partner with the law firm of Fisher, Wayland, Cooper, Leader & Zaragoza, and I represent, among others, the American Hispanic-Owned Radio Association, which is a nonprofit trade association made up of Hispanic-owned commercial radio stations. I also represent the Radio Broadcaster's Association of Puerto Rico and also counsel members of the Hispanic National Religious Broadcasters.

My comments will focus on the difficulty minority-owned broadcasters face in gaining entrance to the broadcasting industry. I will save a rehash of what section 1071 says. I think we are all pretty familiar with it now. However, in applying that section to the FCC's policies of diversity, localism and minority participation in broadcasting, I think the FCC reasonably exercised discretion. As a means of promoting the FCC's policies, minority tax certificates are both cost effective and inexpensive to administer.

It is a bitter irony, I think, that one of the fastest growing segments of the population, that is Hispanic Americans, is one of the most underrepresented in the broadcasting industry. Yet because of the language barrier that they face, Hispanics are frequently most in need of effective media outlets.

The Hispanic population comprises approximately 9.9 percent of the U.S. population, and is expected to be the largest ethnic minority in the country by the turn of the century. Hispanics are culturally and politically diverse on both ends of the aisle; however, they stand united in their desire to participate in American society and commerce.

Also, they are united in that their countries of origin share a common tongue, and that is Spanish. It is estimated that 97 percent of Hispanic Americans speak at least some Spanish, and 51 percent speak it exclusively. This is a demographic which has not been lost on nonminority broadcasters. Two of the three national Spanish language radio chains are non-Hispanic owned; and the two major Spanish language television networks in the United States are not owned by Hispanics. MTV, CNN, HBO, NBC, and CBS have all formed Spanish language-programmed networks or channels, but Hispanics do not own these.

While Hispanic broadcasters admire and applaud the efforts of these non-Hispanic companies to serve the Hispanic community, there needs to be equal growth in the numbers of Hispanic broadcasters who understand and respond to the subtle issues affecting the Hispanic American community.

As the Hispanic population of the United States has grown, so has the spread of Spanish-speaking communities in cities and States which have not previously seen Hispanic populations. The

Hispanic populations of most American cities goes without printed news and information in Spanish, and must consequently rely on radio and television broadcasts for local news and information. It is the Hispanic broadcasters that usually serve this need. They are the ones that tell the Hispanic community in Spanish about which schools are closed during snow storms and where to go during national disasters.

Also, it should be noted that virtually all of the noncommercial Hispanic-owned radio and TV stations are programmed in Spanish, and they serve the educational and religious needs of the communities.

The minority tax certificate policy assists minorities to gain an ownership stake in the broadcasting industry and carries out the FCC's policy of promoting localism and diversity on the airwaves and, ultimately, benefits the tax base. Through ownership, these broadcasters have grown and provided employment to the Hispanic community. Thus, the benefits of the certificate trickle down throughout the community and the marketplace.

I was going to cite a graphic example, an anecdotal example of the benefits of the tax certificate, but I think Amador Bustos and Raul Alarcon and several of the others on the panels this morning are shining testaments of the success stories created by the FCC's tax certificate policy.

Often Hispanics, like other minority groups, do not have the track record to obtain the financial backing to outbid nonminority broadcasters in the open market. Capital and financing are extremely difficult to come by. The large nonminority-owned broadcasters have the credit and collateral to outbid the minority broadcasters. Without the existence of the minority tax certificate program, many successful Hispanic broadcasters would not have had the opportunity to compete with the larger, better financed, nonminority-owned broadcasters to acquire their first station.

As a final matter, there is another interesting point here with Hispanic broadcasters. It should be noted that Hispanic American broadcasters face some of their fiercest competition from Latin America. Mexican stations reach Texas, New Mexico, and California. Dominican stations reach Florida, Puerto Rico, and the U.S. Virgin Islands. These stations are not subject to the stringent Federal regulations that Hispanic American broadcasters face. Also, they usually undercut Hispanic American broadcasters in their advertising rates because of reduced overhead costs.

It is tragic that several State governments actually advertise with Mexican stations because they are cheaper to reach the Hispanic population in the United States than buying time on stations owned by Hispanic Americans. Programs like the tax certificate help stem that tide. The program helps Hispanic Americans enter the market so that they can compete and serve as a growing and productive segment of the American society, and this in turn helps keep American advertising dollars in the United States where they belong.

For these reasons, the FCC's tax certificate policy should be preserved and endorsed. I am available to answer any questions if you have any. Thank you.

[The prepared statement follows:]

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January 27, 1995

Testimony of Francisco R. Montero
Counsel to the American Hispanic Owned Radio Association
and the Radio Broadcasters Association of Puerto Rico
before The Subcommittee on Oversight
of the Committee on Ways and Means
Presiding Congresswoman Nancy L. Johnson (R-CT)

Good morning Ladies and Gentlemen. My name is Francisco R. Montero. I am a communications attorney and partner with the Washington law firm of Fisher Wayland Cooper Leader & Zaragoza L.L.P. My primary practice area involves the representation of Hispanic broadcasters before the Federal Communications Commission. I represent the American Hispanic Owned Radio Association ("AHORA"), a non-profit trade association made up of Hispanic owned commercial radio stations, as well as the Radio Broadcasters Association of Puerto Rico. Also, I have counseled members of the Hispanic National Religious Broadcasters.

My comments will focus on the difficulty minority owned broadcasters face in gaining entrance to the broadcasting industry. Congress gave the FCC wide discretion in the implementation of Section 1071 of the Internal Revenue Code. The Section provides that the FCC may issue a tax certificate that permits sellers of broadcast properties to defer capital gains taxation on a sale or exchange of property whenever it determines that such a sale or exchange is "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..." The minority tax certificate policy is consistent with the original intent of Section 1071. In applying Section 1071 to promoting the FCC's policies of diversity, localism, and minority participation in broadcasting, the Commission reasonably exercised its discretion with Congressional endorsement. As a means of promoting the Commission's policies, minority tax certificates are both cost effective and inexpensive to administer. The policy should, therefore, remain intact. Moreover, it should be noted that the FCC has initiated a rulemaking proceeding regarding its minority tax certificate policy. Comments and reply comments on the Commission's rulemaking proceeding are due on April 17 and May 7, respectively. As such, the Congress should consider the comments that are filed in that proceeding.

It is a bitter irony that one of the fastest growing segments of the population, Hispanic Americans, is one of the most under-represented in the broadcasting industry. Yet, because of the language barrier they face, Hispanics are frequently most in need of effective media outlets. The Hispanic population comprises approximately 9.9% of the U.S. population, and is expected to be the largest ethnic minority in the country by the turn of the century. Hispanics are culturally and politically diverse. However, they stand united in their desire to participate in American society and commerce. Also, they are united in that their countries of origin share a common tongue, Spanish. It is estimated that 97% of Hispanic Americans speak at least some Spanish and approximately 51% speak it exclusively.

This is a demographic which has not been lost on non-minority broadcasters. Two of the three national Spanish language radio chains are non-Hispanic owned. The two major Spanish language television networks in the United States are not owned by Hispanics. MTV, CNN, HBO, NBC, CBS have all formed Spanish language programmed networks or channels. None are Hispanic owned. While Hispanic broadcasters admire and applaud the efforts of these non-Hispanic companies to serve the Hispanic community, there needs to be equal growth in the numbers of Hispanic broadcasters who understand and respond to the subtle issues effecting the Hispanic American community. The greatest obstacle Hispanics face in entering the broadcasting industry is a lack of capital which makes it nearly impossible to enter into and grow in the market. This reality has been recognized by various Federal, state, and local efforts to help Hispanics and other minority groups gain access to vital news and public service information in Spanish.

As the Hispanic population of the U.S. has grown, so has the spread of Hispanic communities in cities and states which were not previously known for their Hispanic populations. Cities like New York, Los Angeles, Miami, Chicago and Washington are known to have very large Hispanic populations. However, we are seeing the growth of Hispanic communities in cities such as Portland, New Haven, Nashville, Oklahoma City, and Salt Lake City to name a few. Unlike many other minority populations in the country, however, the Hispanic community faces a real obstacle in gaining access to local news and information in the Spanish language. The existence of local Spanish language media outlets to provide local news, weather and information in Spanish is essential.

The only cities in the country with regular Spanish language newspapers are the largest metropolitan areas with major Hispanic populations. As such, the growing Hispanic population of most American cities go without printed news and information and must, consequently, rely on radio and television broadcasts for local news and information. It is the small Hispanic broadcasters that usually serve this need. In fact, most Hispanic broadcasters program their stations in Spanish. They usually own their station in their home town and frequently serve as their own general manager. It is the small Hispanic broadcaster who will tell the Hispanic community in Spanish about which schools are closed during a snow storm or where to go during a natural disaster. While there are national Spanish language broadcasting chains, very few provide local news and information and only one is Hispanic owned.

The minority tax certificate policy assists minorities to gain an ownership stake in the broadcasting industry and carries out the FCC's policy of promoting localism and diversity on the airwaves, and ultimately benefits the tax base. Over the past five years, there have been over a dozen instances in which Hispanic Americans have used the tax certificate policy to help them acquire a station. Through ownership, these broadcasters have grown and provided employment to the Hispanic community. Likewise, they have provided an advertising outlet for other local businesses which serve the Hispanic community. These businesses have, in turn, grown. Finally, because of the limitations placed on minority tax certificates, the purchase price paid for the station is usually reinvested into the country's communications infrastructure. In short, the policy helps minority businesses succeed, serves the community and generates tax revenues. Thus, the benefits of the certificate trickle down throughout the community and the marketplace.

A graphic example of the benefits of the tax certificate policy involves a client of mine who acquired his first AM station in Laredo in 1990. He is from Laredo and still lives in Laredo. Because he could offer the previous owner a tax certificate, he was able to lower his bid and, thus, afford to buy the station. He is an Hispanic American and he programs the station in Spanish. He is the general manager of the station and his mother answers the telephone. His station was such a success that in 1993 he bought an FM station in Laredo which he also programs in Spanish. Most recently he has acquired an interest in an AM station near San Antonio which is also programmed in Spanish. Without the assistance he received from the tax certificate program, he would never have been able to afford the first station, and the industry would have lost a successful, tax paying participant.

The FCC has long recognized the need and value of encouraging diversity and localism as strong public policy objectives. In furtherance of this policy, the FCC has long recognized the need and value of encouraging Hispanic and other minority ownership in broadcast facilities. However, minority broadcasters have continually faced obstacles in obtaining the necessary financial assistance to compete. The fact that non-Hispanic broadcasters are entering the Spanish language broadcasting market to the virtual exclusion of Hispanics is testimony to the problem. Often, Hispanics, like other minority groups, do not have the track record to obtain the financial backing to out-bid non-minority purchasers in the open market. Capital and financing are extremely difficult to come by. The large non-minority owned broadcasters have the credit and collateral to out-bid minority broadcasters. While the FCC is to be commended in its efforts to encourage minority ownership, without the existence of the minority tax certificate program, many successful Hispanic broadcasters would not have had the opportunity to compete with larger, better financed non-minority owned broadcasters to acquire their first station.

As a final matter, it should be noted that Hispanic American broadcasters face some of their fiercest competition from Latin America. Mexican stations reach Texas, New Mexico and California. Dominican stations reach Florida and Puerto Rico. These stations are not subject to the stringent Federal regulations that Hispanic American broadcasters face. Also, they usually undercut Hispanic broadcasters in their advertising rates because of reduced overhead costs. It is a sad example that the State of California purchases Spanish language advertising time from stations in Mexico to reach the Hispanic American communities in San Diego and other cities, frequently to the exclusion of Hispanic American broadcasters in those American cities. Thus, Hispanic American broadcasters, who serve this vital role of providing the Hispanic American community with local Spanish language news and information, are being beat out by Latin American competitors. Programs like the tax certificate policy help stem the tide. The policy helps Hispanic Americans enter the market so they can compete and serve this growing and productive segment of the American society. This, in turn, helps keep American advertising dollars in the United States where they belong. For these reasons, the FCC's tax certificate policy should be preserved and endorsed. I am, of course, available to provide any additional information that the Committee may request.

Mr. HANCOCK. Well, thank you very much for your testimony. That will become part of the record.

I would just like to make the statement that this hearing was not called for the express purpose of eliminating something that is beneficial to the economy and beneficial to minorities. And, it is not only to determine the justification for a specific situation that maybe should or maybe should not occur.

The testimony I have heard today, in my own opinion, has been very informative. I think this panel and the previous panels understand that we do have a problem which we are going to try to address. I think that is what the public expects of us under the Contract With America.

Your particular company, Mr. Oxendine, you are a venture capital company and you evidently also own three television stations. Are you into radio also or just television?

Mr. OXENDINE. I finance radio and I own TV.

Mr. HANCOCK. Is your Capital Fund incorporated? Is this a minority enterprise, also?

Mr. OXENDINE. Yes, it is. It was started by the broadcast industry. ABC, NBC, CBS, and 73 other broadcasters invested in the company. So it is called Broadcast Capital Fund. We went to the SBA and asked for a license. We have a MESBIC and we use that. So we took that, and in the last 14 years we have been lending to minorities.

Mr. HANCOCK. Broadcast Capital Fund is primarily funded by major——

Mr. OXENDINE. By the broadcasters.

Mr. HANCOCK.—broadcasters. Fine.

Mr. OXENDINE. It is a not-for-profit private initiative.

Mr. HANCOCK. Private venture capital?

Mr. OXENDINE. Yes.

Mr. HANCOCK. Do any of the witnesses have anything that you would like to add, briefly?

Mr. BUSTOS. Congressman Hancock, you keyed on a particular aspect that I also had cut out of my dissertation because it was a little bit longer, and that is the similarity to the capital gains tax.

The deferral is very closely—has the same effect of allowing that company to save to reinvest in another portion of the economy, or generally the communications industry as well, which will then produce jobs in that industry, which increases productivity and so forth. The whole cycle goes to productivity, to employment, and then to eventual taxation through tax or employment income taxes. So it does have a close parallel and since it is also a deferral and not a credit, I think it has even a healthier benefit.

Mr. OXENDINE. Congressman Hancock.

Mr. HANCOCK. Yes, sir.

Mr. OXENDINE. I just wanted to say something with regard to the FCC and we, as minorities. I think that it is important to understand that when we go before the FCC to ask about whether or not we qualify for a tax certificate, I think, Don Cornwell, you alluded to what his company does, but I think the FCC in making its comments to the subcommittee was kind of remiss in saying what they do, because they really are good electronic policemen policing the airwaves.

When you talk about the minority control issue before the FCC, you have to make the distinction between equity control and voting control. A limited partnership is one thing, and a regular corporation is another in terms of equity participation and voting control requirements.

The limited partnership mirrors a regular business. Regular business people come to an investor and say, "Look, I have an idea; I want to finance something. You put up 90 cents, I will put up 10 cents; let me have voting control and together we will make some money."

When we go before the FCC we are asked two things: Are you a minority-controlled organization? To be minority controlled, you have to have 51 percent of the voting stock of your company. That is not difficult to determine. The problem comes with regard to the amount of equity the minority provides. When you look at a limited partnership, you may have 10 limited partners who each put up $10 million. That is not what is important. You have a general partner corporation, which usually includes the minority interest, that is really important.

I think that what you have to look at and ask is: Does the minority really have 20 percent equity in the company? You can have a general partnership corporation of the limited partnership that has only $10,000 as the total equity. So any minority can find $2,000 or $2,100, which could qualify as 21 percent of the equity in the company, and then the majority would put up the balance of $8,000. The problem is that in that general partner corporation assignment, you could also have a preferred stock portion where someone could put up $5 million for an interest in the company.

So I think the question you might want to ask in the future when you examine minority-controlled organizations, is not only do you have voting control, but how does the equity that the minority contributes compare to the entire amount being funded.

I hope you do not pass a law that requires us to put up 51 percent of the equity in a deal. No one does that. The FCC, they have a notice of proposed rulemaking asking for comments from the public regarding minority initiatives. I think one requirement is that we as minorities should put up substantial equity, whatever that number is. I think, Don Cornwell, that is what you were talking about. There should also be some real management control for the minority group, as well as voting control.

The FCC should review the approval rights of the other investors. Too often, when you look at the underlying documents to a particular financing, you find out that the other partners have so much control you, as a minority, are not really in charge. The above are the issues that lots of folks have not looked at, and I think those are easy things to do. Ask some simple basic questions of minorities and their partners and you will find out what is a sham and what is real. The mechanism is there.

Ms. BRUNSON. I would like to bring to your attention the concept that we are costing the government, costing the consumer, costing the public money by using this deferral process. I would like to reemphasize that we are never costing the government if the leveraging of the funds and sale exponentially extends the growth to where you bring in five or six or seven times the impact of jobs and revenue in terms of the economic base. In this way you are really using the mechanism to create for the consumer a much healthier economic environment.

So that when we start using terms where we are saying we are taking this money out of the pocket of America, we must also weigh the concurrent benefit that is being brought to the table by the expansion of these businesses by those of us who are given the opportunity to own a small property, and then put our 150 percent energy into growing those properties to a greater degree than the person who is spinning it off, who may not have the same intensity to do the kinds of things that we will do.

Not only do we bring an economic benefit to the whole process, but we bring an underlining benefit where we provide the training and the development for the next generation of broadcasters coming in so that they will have the wherewithal to be able to understand how to penetrate this medium so that we will have continuous voices of African-American owners and operators.

So I would like for us to look at the process of weighing that which we say we are taking away with that which is also being put on the table by the combined effort of those of us who grow these into much, much larger businesses than they were when we got the tax certificate in the first place.

Mr. HANCOCK. Well, Ms. Brunson as a small businessman before I came to the Congress, you may rest assured that I am familiar with what is called sweat equity. Very familiar with it.

Well, thanks again for your testimony, and this hearing is adjourned. Thank you.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

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February 7, 1995

Hand Delivery

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Re: Hearing to Examine the Operation and Administration of Code Section 1071, FCC Tax Certificate Policy

Dear Mr. Moseley:

We respectfully submit this written statement for the printed record of the January 27, 1995 hearing by the Subcommittee on Oversight of the Committee on Ways and Means ("Subcommittee") to examine the operation and administration of Section 1071 of the Internal Revenue Code of 1986, as amended ("Code"). In accordance with your instructions, six (6) copies are enclosed.

In view of the numerous comments received by the Subcommittee in connection with the hearing, we have not provided an overview of Code Section 1071.[1] Instead, we have assumed familiarity with the Code Section and will respond directly to the inquiries raised.

[1] For an excellent discussion of the mechanics of Code Section 1071, please see, Edward L. Glazer and Stephen D. Fisher, *Section 1071: FCC-Certified Transactions Involving Minority-Controlled Entities*, 47 Tax Law. 91 (1993).

THE FCC'S 1978 POLICY IS CONSISTENT WITH THE UNDERLYING INTENT OF CODE SECTION 1071

The 1978 Policy

On May 25, 1978, the Federal Communications Commission ("FCC") issued its *Statement of Policy on Minority Ownership of Broadcasting Facilities*. 68 F.C.C.2d 979 (1978) (hereinafter cited as the "*1978 Policy Statement*"). The expressed policy was "to increase significantly minority ownership of broadcast facilities." The ultimate goal of this policy was to increase programming diversity so that it more accurately reflected the viewpoints of all Americans. Ownership was preferred as a means of furthering program diversity because it does not require direct governmental intrusion into programming. This policy was consistent with several court decisions,[2] and its ideals are part of the 1934 Communications Act and inherent in the First Amendment.[3]

One of several steps the FCC selected to implement this policy was the use of its authority to grant tax certificates under Code Section 1071 in circumstances the FCC determined appropriate. *1978 Policy Statement*. Appropriate circumstances include those where a sale of media is proposed to parties with a significant minority ownership interest and where there is a substantial likelihood that diversity of programming will be increased.

The policy of using Code Section 1071 to enhance opportunities in the broadcasting industry was expanded to cable television systems in recognition of the technological revolution occurring in the communications and broadcast industries. In December 1982, in a *Policy Statement on Minority Ownership of Cable Television Facilities*, the FCC stated a new policy:

> "Believing that minority ownership of cable television systems is a significant additional means of fostering the inclusion of minority views in programming, and noting the relative scarcity of minority owned cable systems presently operating, the [Federal Communications] Commission adopts a policy of encouraging

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[2] *See*, *Citizens Communications Center v. F.C.C.*, 447 F.2d 1201 (D.C. Cir. 1971); *TV 9 Inc. v. F.C.C.*, 495 F.2d 929 (D.C. Cir. 1973).

[3] In the Communications Act of 1934, Congress assigned to the FCC exclusive authority to grant licenses, based on "public convenience, interest, or necessity," to persons wishing to construct and operate radio and television broadcast stations. 47 U.S.C. §§ 151, 301, 303, 307, 309 (1982 ed.).

> minority ownership of cable systems, utilizing the Commission's tax certificate authority as a form of subsidization of minority entrepreneurs seeking to enter the cable television market." 52 Rad. Reg. 2d (P & F) 1469 (1982).

The FCC acknowledged that "[T]he functions that cable television system operators perform for their subscribers are, to a large degree, similar to those performed by broadcast licensees for their respective audiences." Id. at 1470. The FCC also recognized that greater efforts were necessary to achieve the goal of diversified programming contemplated by the Communications Act of 1934, and stated, "despite our previous efforts to ensure program diversity, it appears that additional measures in the area of cable television are appropriate." Id. at 1471.

In September 1985, the FCC expanded the application of Code Section 1071 to include non-wireline cellular transfers. The FCC explained:

> "although cellular systems do not constitute "radio broadcasting stations" within the meaning of the [Communications] Act [of 1934], a broad reading of the language of the tax statute (Section 1071 of the Internal Revenue Code) is appropriate in light of the general congressional intent underlying the statute's passage and radical transformation of the telecommunication marketplace since the statute's adoption." *In re Telocator Network of America*, 58 Rad. Reg. 2d (P & F) 1443, 1448 (1986).

In responding to the technological innovations occurring in communications and broadcasting industries, the FCC held:

> "In light of the legislative intent of Section 1071, the dramatic changes in telecommunication marketplace since its original enactment and Commission precedent, we conclude that the phrase "radio broadcasting station" is illustrative of the more general congressional intent to facilitate the effectuation of the Commission's policies rather than restrictive, and the scope of the phrase is properly construed as expanding with the extension of the Commission's pro-competitive policies. Accordingly, we hold that the phrase does not bar the issuance of tax certificates in connection with transfers of non-wire cellular partnership interests in cellular markets 31 through 90." Id. at 1450.

Thus, in fulfilling its role in a rapidly evolving industry, the FCC would have been remiss if it had failed to allow its application of Code Section 1071 to evolve in a commensurate manner into the new telecommunications technologies.

Intent of Code Section 1071

Code Section 1071 was originally enacted in 1944 as Section 112(m) of the Internal Revenue Code of 1939 ("1939 Code"). Act of February 25, 1944, Ch. 63, Section 123(a), 58 Stat 40-43, 46. In Code Section 112(m), as originally enacted, Congress delegated to the FCC the authority to grant tax certificates as:

> " . . . necessary or appropriate to effectuate the policies of the Commission with respect to the ownership and control of radio broadcasting stations . . ." 1939 Code Section 112(m).

This section was passed to help the FCC implement a "new policy" that prohibited ownership of more than one radio station in a single market. Senate Finance Committee Report, 78th Cong., 1st Sess., S. Rept. 627 (1943). Congress intended it to provide relief for licensees who had to sell or exchange such stations as a condition of obtaining license renewal. Id. Congress did not specify any limits to this delegation of authority. Thereafter, the FCC exercised its broad regulatory authority to make and change policies concerning the ownership and control of broadcasting stations with the aid of tax certification.

Section 112(m) was recodified without material change as Section 1071 in the Internal Revenue Code of 1954. H. Rep. No. 1337, 83rd Cong., 2nd Sess., reprinted at 1954 U.S. Code Cong. & Ad. News 4621, 59072. However, the Senate Report accompanying the bill did specifically comment on the definition of "radio broadcasting":

> "The form of 'radio broadcasting' as used in the Bill and in the 1939 Code has an established meaning in the industry and in the administration of the Federal Communications Act which is sufficiently comprehensive to include telecasting." S. Rep. No. 1622, 83rd Cong., 2nd Sess., reprinted at 1954 U.S. Code Cong. & Ad. News 4261, 5072.

Clarifying language, in the form of a technical amendment, was substituted into Section 1071 in 1958. This amendment provided that tax certificates would be granted as "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy, by the Commission." Technical Amendments Act of 1958, Pub. L. No. 85-866, § 48, 72 Stat. 1606, 1642 (1958); H.R. Rep. No. 775, 85th Cong., 1st Sess. 29 (1957). This change facilitated the FCC's usage of Section 1071 to implement evolving policies, such as that to increase the diversity of broadcast licensees.

Consistency between 1978 Policy Statement and Code Section 1071

The intent underlying Code Section 1071, namely, to provide the FCC with a tool to effectuate its policies, is entirely consistent with the 1978 Policy Statement. Indeed, Code Section 1071 remains an essential tool at the disposal of the FCC in its attempts to increase minority ownership of broadcast facilities. It is difficult to conceive of many industries that have changed as significantly as the communications industry has over the last fifty years. The FCC would have been remiss if it had not expanded the scope of the tax certificate program to keep pace with the rapid developments in the communications industry.

Recently, attention has been focused on the size of the tax benefits expected to be granted under the tax certificate program. Certainly, it is quite difficult to quantify the social benefit derived from the tax certificate program in any meaningful way. To attempt to assess this benefit against a hypothetical tax cost is pointless. The magnitude of the transactions now being undertaken in the deployment of the National Information Infrastructure, however, are indicative of the importance of the communications industry in our society today. Now, more than ever, it is essential that the tax certificate program be endorsed to ensure universal access to telecom facilities. Code Section 1071 indisputably remains an essential tool in diversifying the ownership of broadcast licenses.

**THE FCC'S ADMINISTRATION OF CODE SECTION 1071
DOES NOT CONSTITUTE AN IMPERMISSIBLE
EXERCISE OF LEGISLATIVE AUTHORITY**

The FCC's administration of Code Section 1071 constitutes a permissible exercise of legislative authority. This has been examined by academics, the courts and by Congress on more than one occasion. In each case, the conclusion reached is that it is a legitimate exercise of legislative authority.

Court Decisions

Prior to the 1978 policy, the Review Board, in an opinion accepted by the FCC, had taken the view that the "Communications Act, like the Constitution, is color blind." *Mid-Florida Television Corp.*, 33 F.C.C 2d 1, 17 (Rev. Bd.), *aff'd*, 37 F.C.C.2d 559. The issue of what the FCC should consider in awarding broadcasting licenses arose in *TV 9, Inc. v. FCC*, 495 F.2d 929

(D.C. Cir. 1973), *cert. denied*, 419 U.S. 986 (1974). In *TV 9*, the FCC, in awarding a license, gave little weight to the fact that the losing applicant was minority-owned. In considering the reasoning of the FCC, the appeals court stated:

> "To say that the Communications Act, like the Constitution, is color blind, does not fully describe the breadth of the public interest criterion embodied in the [Communications] Act. Color blindness in the protection of the rights of individuals under the law does not foreclose consideration of stock ownership by members of a Black minority where the [Federal Communications] Commission is comparing qualifications of applicants for broadcasting rights . . ." *Id.* at 936.

Similarly, the same court, in *West Michigan Broadcasting Co. v. FCC*, 735 F.2d 601 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1027 (1985), considered a situation in which two companies filed mutually exclusive applications to build a new FM radio station in Michigan. One of the companies was owned by a minority who would fully participate in the station's management. In that case, the appeals court held that the FCC could give merit to a minority applicant regardless of whether there was a substantial minority-group population in the city where the license was located. *Id.* at 609. Further, increased media ownership by minorities, the court decided, should conclusively be presumed to advance the public interest. *Id.*

More recently, the Supreme Court upheld the constitutionality of two policies that enhance the opportunities for minorities to acquire FCC licenses. *Metro Broadcasting, Inc. v. F.C.C.*, 110 S. Ct. 2997 (1990). In evaluating two related FCC policies to increase minority ownership, the Supreme Court consolidated *Metro* with *Astroline Communications Company Limited Partnerships et al. v. Shurberg Broadcasting of Hartford, Inc. et al.* The policies in question were 1) the FCC program of awarding enhancement for minority ownership in comparative proceedings for new licenses; and 2) the distress sale program permitting a limited category of existing radio and television stations to be transferred only to minority-controlled firms.

In finding both FCC policies constitutional, the Supreme Court held that minority ownership programs had been specifically approved and mandated by the Congress, and as such required judicial deference. *Id.* at 3008. Additionally, FCC minority ownership policies promote programming diversity. *Id.* at 3009, 3010. Further, programming diversity serves important First Amendment values, and remains consistent with the 1934 Communications Act. *Id.* at 3010, 3012.

Congressional Action

As part of Section 115 of the Communications Amendments Act of 1982, Congress authorized the FCC to choose by lottery among competing qualified applicants for certain licenses as an alternative to lengthy comparative proceedings. Pub. L. No. 97-259, § 115, 96 Stat. 1087, 1094-95 (codified at 47 U.S.C. § 309(i) (1982). Nevertheless, Congress required that:

> "significant preferences will be granted to applicants or groups of applicants, the grant to which of the license or permit would increase the diversification of ownership of the media of mass communications. To further diversify the ownership of the media of mass communications, an additional significant preference shall be granted to any applicant controlled by a member or members of a minority group." *Id.*

The legislative history of this provision acknowledges the FCC's continuing minority ownership policy and diversity of viewpoint rationale, and clearly shows that Congress intended to ensure that a similar minority preference was applied in any random selection licensing system. H. Conf. Rep. No. 765, 97th Cong., 2d Sess., 40, reprinted in 1982 U.S. Code Cong. & Admin. News 2261, 2284.

Since 1987, using appropriations legislation, Congress has prohibited the FCC from using any of its appropriated funds to repeal, retroactively apply changes in, or to reexamine any of its race or gender preference programs. Act of Dec. 22, 1987, Pub. L. No. 100-202, 101 Stat. 1329. This prohibition applies to the tax certificate, distress sale, and comparative licensing programs, respectively. *Id.* The limitation did not prevent an expansion of the programs. Thus, Congress has answered the statutory authority question by effectively ratifying the Commission's interpretation of the public interest standard and adopting a legal presumption that minority ownership produces more diverse programming that better serves the public interest.[4]

There can be no question that the FCC's administration of Code Section 1071 is a permissible exercise of legislative authority. Notwithstanding the judicial decisions and Congressional action, it is disturbing that questions are now being raised by the Subcommittee about the legislative authority to administer a Code section that has been in force and effect for more than fifty years.

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[4] In Comment, *FCC Tax Certificates For Minority Ownership of Broadcast Facilities: A Critical Re-examination of Policy*, 138 U. Pa. L. Rev. 979 (1990), the author correctly concludes that the FCC's administration of the program is within its statutory authority. *Id.* at 999.

Phillip D. Moseley, Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
February 7, 1995

THE TAX INCENTIVE PROVIDED IN CODE SECTION 1071 IN FACT FOSTERS MINORITY OWNERSHIP OF BROADCAST FACILITIES

In our experience as counsel to clients engaged in the broadcasting and communications industry, we emphatically affirm that the tax certificate program has provided opportunities for minority individuals to participate in the broadcasting and communications industries. Moreover, it has served to spark investment in the entire telecommunications industry. In examining the effectiveness of the program, it is noteworthy that the National Telecommunications and Information Administration reported that minorities held .5% of broadcast licenses in 1978, and as of 1994 held 2.9% of them. See, National Telecommunications and Information Administration, United States Department of Commerce, *Analysis and Compilation Minority-Owned Commercial Broadcast Stations*, 1994. Also, the FCC has reported that 378 tax certificates were issued for broadcast stations and cable television facilities from 1978 to 1994.

THE FCC POLICY IS A NECESSARY OR APPROPRIATE MEANS OF ACHIEVING THIS GOAL

The 1978 Policy remains as important today as it was in 1978, if not more so. While there have been significant improvements in minority ownership of broadcasting facilities and greater diversity in programming over the past sixteen years, there is still a long way to go. *See, Metro, supra at 3003-05.* The tax certificate program is one of several effective measures in achieving the FCC's policy objectives and as such should not be repealed or replaced.

The tax certificate policy permits more broadcast and cable properties to reach their highest valued use, thereby creating jobs and generating investment and tax revenues. The policy's reinvestment feature retains capital in the media industries, where it helps build the nationa's growing communications infrastructure. Furthermore, the policy helps small businesses enter the competitive marketplace and ultimately become large taxpayers themselves.

The FCC, working closely with the IRS, possesses the expertise to review and improve upon the tax certificate policy. The FCC is obtaining public comment on the policy, with comments due on April 17, 1995. Among the matters the FCC might consider are the need for additional data on the policy's long and short range tax consequences, the optimal holding period for facilities obtained under the policy, and procedures for additional scrutiny of the bonafides of tax certificate applicants. Congress should defer additional action on this matter until it receives the FCC's report and order.