

**PLR 9703025, 1997 WL 15982 (IRS PLR)**

**Internal Revenue Service (I.R.S.)**

**Private Letter Ruling**

Issue: January 17, 1997  
October 21, 1996

Section 512 -- Unrelated Business Taxable Income (Taxable v. Not Taxable)

512.00-00 Unrelated Business Taxable Income (Taxable v. Not Taxable)

512.01-00 Exception, Additions, and Limitations on Unrelated Income

512.01-01 Rents and Royalties

Dear Sir or Madam:

This is in reference to your letter dated April 15, 1996, requesting a ruling that your sublicense of excess television channel capacity will not produce unrelated trade or business income subject to taxation under sections 511-514 of the Internal Revenue Code.

The information provided indicates that you (the "Consortium") were incorporated for the purpose of providing, through a regional consortium of educational and charitable institutions, noncommercial instructional television fixed service ("ITFS") for the residents of a particular geographic area. The Consortium has six member institutions ("Member Institutions") and has been recognized as exempt from federal income tax as an organization described in section 501(c)(3) of the Code.

Of the 20 channels in the ITFS/Educational Broadcast spectrum for the area, 14 of these are licensed to Member Institutions for educational and instructional broadcasting purposes. In the course of your exempt purpose operations, you use no more than five (5) full time and two (2) part-time channels. The remaining channels represent capacity in excess of the amount necessary to carry educational and instructional programming to the general public ("Excess Channel Capacity"). The Federal Communications Commission permits the sublicense of such Excess Channel Capacity to others for commercial purposes.

The Consortium has executed a sublicense (the "Sublicense Agreement") of its Excess Channel Capacity with X, a for-profit commercial corporation. The Sublicense Agreement contemplates that X will utilize the Excess Channel Capacity to provide wireless cable television in competition with traditional wire-based cable operators.

Under the Sublicense Agreement, the Consortium grants X the right to broadcast over seven (7) full-time and two (2) part-time (weekend and evening) channels. The remaining channel capacity (five full-time and two part-time channels) is retained by the Consortium for broadcast of educational and instructional programming in accordance with its charitable purpose.

A summary of the major rights and obligations of the parties under the Sublicense Agreement is as follows:

1. The Consortium provides X with the use of seven full-time and two part-time channels of its FCC-licensed broadcast spectrum, which are excess to the Consortium's needs for educational and instructional programming.
2. The Consortium reserves the use of certain retained channels for broadcast of educational and instructional programming.
3. **The Consortium permits X access to its earth receiving station so long as such use does not interfere with the needs of the Consortium or the Member Institutions.**
4. X pays fees to the Consortium in the form of an initial lump sum payment and monthly payments equal to the greater of an agreed fee per X subscriber or a monthly minimum amount.
5. X reimburses the Consortium for all costs incurred on behalf of X including certain legal and engineering expenses.
6. X provides, services and operates all equipment necessary for it to broadcast over the Excess Channel Capacity and pays all costs incurred by it in the use of the Excess Channel Capacity.
7. X completes and maintains at its own expense adequate transmission facilities over which its programming may be broadcast.
8. X pays all costs and expenses associated with the use and upkeep of the transmission tower over which its signals are broadcast.
9. **X pays a monthly fee in exchange for utilization of the Consortium's receiving earth station.**

The Consortium's receiving earth station is a large wireless telecommunications satellite dish measuring approximately 27 feet across and 20 feet in width. The dish is permanently mounted into a concrete slab, which is set approximately 8 to 10 feet into the earth. The structure cannot be moved without destruction of its foundation.

Section 511 of the Code provides, in part, for the imposition of tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term unrelated business taxable income as the gross income received by an exempt organization from any unrelated trade or business regularly carried on by it, less deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications in section 512(b).

Section 512(b)(2) of the Code provides that one of the modifications to be taken into account in determining unrelated business taxable income is that “all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income” shall be excluded.

Section 512(b)(3) of the Code, subject to certain exceptions not here relevant, excludes rents from real property in determining unrelated business taxable income and all deductions directly connected with such income.

Section 1.512 (b)-1 of the Income Tax Regulations provides that whether a particular item of income falls within any of the modifications provided in section 512(b) shall be determined by all the facts and circumstances of each case. For example, if a payment termed “rent” by the parties is in fact a return of profits by a person operating the property for the benefit of the exempt organization or is a share of the profits retained by such organization as a partner or joint venturer, such payment is not within the modification for rents.

Section 513(a) of the Code defines the term “unrelated trade or business” as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt purposes.

Section 1.513-1(b) of the regulations provides that for purposes of section 513 of the Code the term “trade or business” has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income); and that it is substantially related, for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is

derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

In Rev. Rul. 81-178, 1981-2 C.B. 135, royalty income is defined as any payment received in consideration for the use of a valuable intangible property right, whether or not payment is based on the use made of such property. However, payments for personal services provided in connection with the granting of such rights are not royalties under section 512(b)(2) of the Code. Such income, and related expenses, must be taken into account in computing the organization's unrelated business taxable income under section 512.

The Sublicense Agreement is not substantially related to your exempt purposes, other than as a source of additional funds. Accordingly, income generated by the agreement is unrelated business taxable income unless otherwise excluded.

A royalty is generally defined as a payment for a licensee's valuable right to use the property of another without requiring any significant action on the part of the party offering the use of the right. Rev. Rul. 81-178, *supra*, supports this view and lists items such as trademarks, trade names, service marks, and members' names, photos, and facsimile signatures the payments for the use of which would constitute royalties. The Rev. Rul. then explains that when more than the use of a valuable right is involved, e.g., when the services are included, it no longer meets the commonly accepted definition of a royalty.

Under the Sublicense Agreement, X provides, services and operates all equipment necessary to exercise its exclusive right to broadcast over the Excess Channel Capacity. The Consortium is not involved in the management of X or in the formulation of X's programming in any way, and performs no services for X. X is exclusively responsible for all recurring and capital costs associated with its operations. Under these circumstances, the payments made by X in exchange for X's right to use the Consortium's Excess Channel Capacity are payments for the use of intangible property, and, thus, are royalties within the meaning of section 512(b)(2) of the Code.

Payments made by X under the Sublicense Agreement for utilization of the Consortium's receiving earth station are rents from real property within the meaning of section 512(b)(3) of the Code.

Accordingly, we rule that the Consortium's receipt of payments pursuant to the Sublicense Agreement of its Excess Channel Capacity does not produce unrelated trade or business income subject to taxation under sections 511-514 of the Code, subject to the caveat set forth in the following paragraph.

In this letter we are rendering no opinion concerning the value of X's use of various items of your transmission equipment. **To the extent of the fair rental value of the use of such equipment under this lease, payments from X would be deemed rental payments rather than royalty payments, and would therefore not be excluded from treatment as unrelated business income by virtue of section 512(b)(2).**

This ruling letter is directed only to the organization that requested it. Section 6110(j)(3) of the Internal Revenue Code provides that this ruling may not be used or cited by others as precedent.

We are informing your key District Director of this ruling. Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Kenneth J. Earnest  
Acting Chief, Exempt Organizations  
Technical Branch 2

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