Tele-Communications, Inc. and Subsidiaries v. Commissioner of Internal Revenue, 95 T. C. 495 (1990)

Cable television franchises are amortizable under Section 1253 of the Internal Revenue Code as intangible assets when acquired in a transfer where the franchisor retains significant control.

Summary

Tele-Communications, Inc. (TCI) sought to amortize the costs of acquiring cable television franchises under Section 1253 of the Internal Revenue Code, asserting that these franchises qualified as amortizable assets. The Tax Court ruled that cable television franchises fall under the statutory definition of a 'franchise' and are thus eligible for amortization over the franchise term or 10 years, whichever is shorter, because the franchisors retained significant rights over the franchises. The court also determined that no goodwill existed in these monopolistic franchises, and calculated the amortizable basis for the franchises at $2,382,129 after accounting for tangible assets and going concern value.

Facts

In 1978, TCI acquired three cable television systems in Moberly, Jefferson City, and Titusville from Athena Communications Corp. for $10,400,000. The purchase price was allocated among the systems based on their miles of cable. Each system operated under a franchise agreement with local municipalities, which were nonexclusive but functioned as de facto monopolies due to the capital-intensive nature of the cable industry. The franchise agreements granted TCI the right to operate the systems for a specified period, subject to various controls and requirements by the franchisors. TCI sought to amortize $3,994,000 of the purchase price as franchise costs under Section 1253.

Procedural History

TCI filed a petition in the U. S. Tax Court contesting the Commissioner's disallowance of a $662,998 amortization deduction for 1978, claiming an overpayment of $318,239. The Commissioner argued that cable television franchises were not intended to be covered under Section 1253. The Tax Court, after hearing expert testimonies on valuation, ruled in favor of TCI, determining that cable television franchises qualified for amortization and established the basis for amortization at $2,382,129.

Issue(s)

1. Whether a cable television franchise qualifies as a 'franchise' under Section 1253(b)(1) of the Internal Revenue Code.
2. Whether TCI is entitled to amortize the costs of acquiring the cable television franchises under Section 1253(d)(2)(A).

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3. What is the proper valuation of the franchise costs for amortization purposes?

Holding

1. Yes, because a cable television franchise meets the statutory definition of an agreement giving the right to provide services within a specified area.
2. Yes, because the transfer of the franchises was not treated as a sale or exchange of a capital asset due to significant control retained by the franchisors.
3. The proper valuation of the franchise costs for amortization is $2,382,129, after accounting for tangible assets and going concern value.

Court’s Reasoning

The court relied on the plain language of Section 1253, which defines a franchise as an agreement giving the right to distribute or provide services within a specified area. The court rejected the Commissioner’s argument that Congress did not intend to include cable television franchises, noting the absence of specific exclusions other than for professional sports franchises. The court also determined that the franchisors retained significant power, right, or continuing interest over the franchises, disqualifying the transfer as a sale or exchange of a capital asset and allowing for amortization under Section 1253(d)(2)(A). The valuation of the franchise costs was based on the income method, which accounted for current and future subscribers, and excluded goodwill, as the franchises operated in a de facto monopolistic environment.

Practical Implications

This decision clarifies that cable television franchises acquired in a transfer where the franchisor retains significant control can be amortized under Section 1253. It provides a framework for valuing franchise costs by excluding goodwill and accounting for going concern value in monopolistic environments. Taxpayers in similar industries can use this case to support amortization claims for franchise costs. The ruling also affects how cable television operators and other businesses with similar franchise agreements structure their transactions and report their taxes. Subsequent cases and IRS guidance have followed this precedent in determining the amortizability of franchise costs.

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