MEMORANDUM

To: All State Broadcasters Associations

From: Richard R. Zaragoza, Esq., NASBA General Counsel, and Scott R. Flick, Esq., Pillsbury Winthrop Shaw Pittman LLP, Counsel to NASBA

Date: September 18, 2018

Re: NCSA/PEP Programs

This Memorandum is intended to provide State Broadcasters Associations ("SBAs") with background on NCSA/PEP programs from three perspectives: the FCC, the IRS, and practical operating experience. Scott will be in Orlando to discuss/enlarge upon these points. If you have any questions or comments and would like to raise them before the meeting, please email Dick and Scott at your convenience.

None of the following should be regarded as tax advice. Each SBA should rely upon its own tax advisor for guidance in these matters.

<u>The FCC's Perspective</u>

1. The term "NCSA" stands for "Noncommercial Sustaining Announcement," and is the regulatory term long used by the FCC to refer to such announcements. The FCC has not traditionally used the acronym "PEP." "PEP" was adopted by many of the SBAs to respond to a concern that potential sponsors had no idea what a "Noncommercial Sustaining Announcement" was and that the term is admittedly difficult to explain. There is a split among the SBA websites as to whether PEP stands for "Public Information Partnership" or Public Information Program." While the FCC has not adopted either term, that should be of no FCC consequence.

2. NCSA programs were introduced to the FCC in the early 1960's by the Southern California Broadcasters Association, which wanted to help governmental entities and nonprofit organizations promote their programs and services on a statewide basis by encouraging stations to voluntarily air the spots. In return for distributing the spots and providing these entities and organizations with performance reports, these NCSA sponsors paid the SBA. At that time, if someone paid a station to air a spot, (a) the station would have to designate the spot on its program logs as a "commercial," and (b) each commercial spot would count against a cap on the amount of commercial time that a station could air each hour, thereby creating a disincentive for stations to air NCSA announcements. Those two regulatory restrictions, in particular the commercial time "cap," were dropped many years ago thereby unleashing the benefits of NCSA Programs nationwide.

3. Over the years, the FCC issued various rulings on NCSA programs, concluding that the announcements aired under NCSA programs are to be treated as "commercials" because the money received by each SBA from NCSA sponsors in effect benefits the stations participating in the NCSA program, e.g., by reducing SBA dues and by helping the SBA to offer more services). This is why all NCSA spots must contain the FCC-required sponsorship ID tag, including that the announcement is "paid for by…" or "sponsored by…" and the name of the sponsor.

4. The last FCC ruling on NCSA programs registered this FCC concern—NCSA announcements should not be allowed to drown out free PSAs. The FCC stated that because of this concern, it reserved the right to revisit the question of whether NCSA announcements were having an adverse effect on the obligation of stations to air free PSAs. Because of this, we have encouraged all SBAs to implement programs for organizations that want to get in touch with stations about obtaining coverage of their missions or the airing of their PSAs, e.g., providing station contact information to such organizations and/or providing a "primer" on how to create air-worthy PSAs and how to persuade stations to air them.

5. Based on a 1988 decision of the Chief of the FCC's Political Programming Branch, the airing of NCSA/PEP announcements do not have an effect on a station's "lowest unit rate" or "comparable rate." However, if an NCSA announcement were to include the identifiable image or voice of a legally qualified candidate for public office, the airing of such a spot would generally trigger "equal opportunities" for opposing candidates on stations airing the spot.

<u>The Internal Revenue Service's Perspective</u>

1. In two separate Private Letter Rulings, one issued in 1990 and one in 1992, the IRS ruled that the two SBAs' NCSA programs were substantially related to the tax-exempt purposes of each SBA and that as a result, (a) the income generated by their NCSA programs was not "unrelated business income" subject to taxation, and (b) operation of the NCSA program would not jeopardize their status as tax-exempt organizations.

2. The IRS later conducted an audit of the Maryland/DC/Delaware Broadcasters Association focusing on the tax status of its NCSA program. The audit was, we believe, in response to a complaint from a Baltimore-area ad agency that felt the Association's NCSA program unfairly competed with it. The complaint-driven audit was not only costly, but effectively put all SBAs' NCSA programs under an IRS microscope. The IRS argued that stations were required to air unpaid announcements in order to meet their public interest obligations, and that the Association's NCSA program therefore fell outside the SBA's tax-exempt purposes. Consistent with this position, the IRS contended that the Association's NCSA revenue should have been reported as unrelated business income and taxed as such. In representing the SBA, we demonstrated that the airing of NCSA announcements was not required by the FCC, and that the NCSA program was therefore substantially related to the tax-exempt purposes of the Association. The IRS backed off, closing the tax audit without any change in the tax-exempt status of the SBA or the NCSA program, and with no additional taxes imposed on the Association.

3. The Pennsylvania Association of Broadcasters was later subjected to a routine IRS audit, including its NCSA/PEP program. The IRS did not raise any issues with respect to the program. In fact, the IRS agent told Dick Zaragoza that, in her view, the program was so beneficial (cost savings and wide coverage) to governmental agencies and nonprofit organizations as NCSA sponsors that she did not want to do anything that could jeopardize the program.

<u>An "Operational" Perspective – Some Cautionary Thoughts</u>

1. Always double check to make sure that the required sponsorship ID tag is contained on all radio and television NCSA/PEP announcements, and be prepared to stop a campaign if you discover that the sponsorship tag has not been included or is not otherwise legally sufficient. A station airing a spot without the required sponsorship ID tag risks being fined the base amount of $4,000 per airing, which the FCC has increased in circumstances where it feels the facts are particularly egregious. No SBA wants to be responsible for its member stations being fined large amounts for NCSA spots that have been airing repeatedly for weeks or months without proper sponsorship ID.

2. The true identify of the NCSA/PEP sponsor must be disclosed in the spot. Where a third party is funding or helping to fund a sponsor's campaign, the payment to the SBA must come directly from the NCSA/PEP sponsor. If the NCSA/PEP sponsor wants the party providing funding to be given some "credit," the sponsorship ID tag may read: "Sponsored by the [Tax Exempt Organization], with funding provided by [Company X]."

3. The sponsorship ID tag may also include, as a nonmandatory option, "and aired in cooperation with the ___ Broadcasters Association and this station."

4. It appears that one key to sustaining the tax-exempt nature of NCSA/PEP programs is to use the money generated by the programs to carry out the SBA's mission as described to the IRS when it granted the SBA tax-exempt status. The language used by each SBA in their Articles of Incorporation and in their original requests for tax-exempt status may be different. However, the overarching goal of all SBAs is to enhance the ability of their stations to be financially strong, and competitive as well as to serve the public interest, and that is achieved through educational programs, conferences, seminars, etc. Working with your tax advisors, make sure that your filings with the IRS are consistent with the reasons why your SBA sought, and the IRS granted, tax-exempt status in the first place. Avoid describing the program in commercial terms, i.e., avoid using language that makes it sound like the SBA is operating as an ad agency working for "clients" or "customers."

5. Avoid accepting NCSA/PEP announcements that contain the reasonably identifiable image or voice of legally qualified candidates or those who are about to become legally qualified candidates. An NCSA/PEP announcement that could trigger equal opportunities is either going to (a) not be aired by member stations, who cannot afford to provide equal opportunities to all of that candidate's opponents, or (b) result in blowback against the SBA by member stations that aired the spot without realizing it creates equal opportunities obligations until stations are inundated with requests for airtime by others running for the same office.

6. Consider not accepting an NCSA/PEP announcement that features any elected official. There is always the risk when elected officials are involved that the opposition political party will become so offended that it will try to use the legislative "purse strings" process to deny the NCSA/PEP campaign funding, and threaten funding for future NCSA/PEP campaigns.

7. Use a form of NCSA/PEP program contract that deals with all the issues that are covered by the contract template used for the Army National Guard. In programs like NCSA/PEP that depend heavily on parties' goodwill toward each other, the best way of ensuring those relationships do not sour is to ensure the contract addresses the most likely issues for future conflict. If an SBA is

"forced" to use a state's own template, use an attachment/supplement/exhibit to tailor the form of contract to a customary NCSA/PEP program contract.

8. Be aware of your Board's guidance/limitations on the types of organizations that may be solicited as potential NCSA/PEP sponsors, and guard against internal conflicts of interest by board members, e.g., where one member tries to dictate which NCSA/PEP sponsors are to be "off limits" to the SBA. A sitting Board member has a fiduciary duty to its SBA.

9. If you want to engage a person not employed by your SBA to help you identify potential NCSA/PEP Sponsors, avoid any "commission" structure as such a structure may violate Federal and possibly also State laws. If an SBA wishes to use a nonemployee to perform that function, the nonemployee should be engaged in all facets of the process, including administering the program during the full term of the contract, and his/her compensations should be paid over the contract term, rather than upfront.

10. No NCSA/PEP income should be used to pay for lobbying expenses. The principal rational is this: If you are lobbying a Federal, State or local official, and are asked whether you are using Federal, state or local government monies to lobby him/her, I want to be honest in saying "no" to avoid the official taking the next possible step, admonishing you and saying that he/she will make sure that that does not happen again. A secondary rationale is: use of NCSA/PEP dollars to lobby a particular matter may violate some law that should always be checked out first. Rather, such expenses should only be paid with income generated from non-NCSA/PEP sources, i.e., dues, convention and seminar revenues, etc. To help ensure a cleaner paper-trail, it is recommended that each SBA use two income accounts, one built upon NCSA/PEP income deposits, and a separate one containing deposits from all other income sources. If NCSA/PEP income is needed, from time to time, to subsidize the SBA's general operating expenses, a periodic transfer of funds is of course permissible.

11. If your Board wants your SBA to get into the "ad agency" business, consider forming a separate, subsidiary legal entity to carry on that business, and seek advice from your tax advisor.