REPORT #666

TAX SECTION

New York State Bar Association

Proposed Private Letter Rulings Program

September 13, 1990

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The Honorable Abraham N.M. Shashy
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Proposed Private Letter Rulings Program

Dear Mr. Shashy:

We understand that in connection with the planned elimination of "comfort" letter rulings, the Service is considering what its policy should be as to issuing rulings with respect to: (i) specific issues that depend upon the treatment of a prior or simultaneous transaction on which the Service would no longer rule ("ancillary" issues); and (ii) specific issues relevant to an overall legal conclusion where the Service would no longer issue ruling as to the overall result of the transaction ("embedded" issues). This letter sets forth the views of the Executive Committee of the New York State Bar Association Tax Section on those questions.

Recommendations

The Service should continue to rule on both ancillary and embedded issues with appropriate safeguards outlined below. Not to rule on such issues risks an undesirable, and we believe unnecessary, restriction of the function

that the letter rulings process can provide in rendering assistance where a taxpayer lacks adequate guidance and in stimulating consideration of issues that would benefit from wider professional discussion before a final position is taken in actions applicable for all taxpayers. Moreover, while the adoption of a non "comfort" ruling policy puts greater stress on the procedural rules, we believe our recommendations warrant - adoption even if the Service were to continue issuing "comfort" rulings.

To permit continued or separate consideration of >~ "ancillary" or "embedded" rulings, the following safeguards should be incorporated in the Service's ruling practices:

(1) The taxpayer should be required to represent, under penalties of perjury: (a) how the prior or surrounding transaction must be interpreted to make the requested ruling applicable and (b) that it believes that the transaction should be so interpreted. If the taxpayer makes such a representation, the Service should accept it without independent review, in the absence of blatant error. If the taxpayer's representation as to the appropriate treatment later proves ; incorrect (on audit or otherwise), then the ruling would be of no effect since the ruling would be conditional on the correctness of the representation.

(2) The Service should modify its standard disclaimer language to make it patent beyond misunderstanding that the ruling has been given under the special limited "ancillary" or "embedded" issues procedures. Examples of specific language are suggested below.

Forceful statements should also be made in the audit manual to emphasize the proper treatment to be accorded such rulings.

In addition, we believe that the Service should reserve the right to decline to rule (without right of taxpayer appeal for at least an initial trial period) if it determines that the consideration of one or more of the rulings requested still requires its review of the facts or circumstances of the prior or surrounding transaction, provided that the Service also takes appropriate steps to insure that no negative inference is suggested from its refusal (as might arise from a normal refusal to rule). We believe that it would be adequate for the National

Office in such case to state in its refusal to rule that its action was based solely on procedural grounds without any consideration of the merits.

Discussion

Requests for letter rulings addressed to specific "ancillary" or "embedded" issues raise administrative concerns that need to be addressed, whether or not the Service decides to limit comfort rulings. To illustrate, assume that a ruling is requested only on an "ancillary" issue in the form of a question as to the accounting method that would be applicable under Section"381(c)(4) as a result of a proposed or recently completed merger that, under the particular facts, may not actually qualify as a tax-free reorganization under Section 368(a)(1)(A). This ruling request likely would be assigned to Assistant Chief Counsel (Income Tax and Accounting), a unit with no jurisdiction and presumably no expertise with respect to tax-free reorganizations. Reorganization issues are within the jurisdiction of Assistant Chief Counsel (Corporate), which generally does not handle accounting method issues. Thus, the branch to which the ancillary accounting method issue was assigned most likely would have neither jurisdiction over nor experience with respect to the primary issue of whether the reorganization actually qualified under Section 368.[1]

Although this accounting method ruling request would not seek rulings under Section 368, it would fully disclose all the facts of the reorganization including facts that might render qualification under Section 368 doubtful. While the branch to which the request was assigned (the "primary branch") theoretically could request assistance on the merger from Assistant Chief Counsel (Corporate), such assistance might not be requested unless someone in the primary branch spotted a Section 368 issue. As a consequence, a favorable ruling letter addressing only the narrow issue but describing the overall merger transaction might be issued.

Three administrative concerns are raised by such a narrow letter ruling request. First, if the prior or simultaneous

[1] The Service has installed procedures designed to prevent forum shopping on the part of taxpayers where several branches under an Assistant Chief Counsel have jurisdiction over the issue addressed 'in the ruling request. Those procedures presumably would not be an effective safeguard where, as in the case described here, overlapping jurisdiction does not exist.

merger did not qualify under Section 368(a)(1)(A), the Service is ruling on the basis of a hypothetical legal setting.

Second, upon audit, examiners might decide (either of their own initiative or in response to taxpayer assertions) that the overall transaction had been fully disclosed to the National Office and that the National Office implicitly viewed the larger transaction favorably, since an unfavorable position on the overall (or earlier) transaction would have been inconsistent with the favorable ruling on the specific issue.

Third, incentives might be created for taxpayers to try to manipulate the system by structuring limited rulings to obtain favorable benefits on other, unstated issues which were in no way considered by the National Office personnel most familiar with those other issues.

Similar issues may be raised by an "embedded" issue. Suppose, for example, that the question presented to the Service is whether a drop-down to a second-tier subsidiary is permissible under Section 368(a)(2)(C) after a merger. The third administrative concern noted above might be lessened since the request presumably would go to the National Office unit having jurisdiction over Section 368(a)(2)(C) issues, but the first two concerns would still exist.

Up to the present, the basic approach of the Service has been a rather broadly applied policy of ruling on ancillary or embedded issues only in conjunction with ruling on the overall or prior transaction (or at least doing the review needed to be satisfied that the tax treatment of the overall or prior transaction should be consistent). Section 3.07 of Rev. Proc. 90-1, 1990-1 I.R.B. 8, 14, provides in part that:

> If the [ruling] request deals with only one step of a larger integrated transaction, the facts, circumstances, etc. relating to the entire transaction must be submitted. However, see section 18.04 of the revenue procedure....

Section 18.04 of Rev. Proc. 90-1 states that "[t]he National Office ordinarily will not issue rulings on only part of an integrated transaction." 1990-1 I.R.B. at 36. It has also been our experience that the branch to which a ruling request is assigned generally will spot larger or related issues within the jurisdiction of another branch, and seek formal or informal

guidance from such other branch if those issues have a potentially adverse impact on the requested rulings even if they are not necessarily "integrated."

In addition to these threshold restrictions on the issuance of ruling letters, the Service has routinely included the following standard disclaimer language in the published ruling:

> No opinion is expressed concerning the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any condition existing at the time of, or effects resulting from/ the proposed transaction that are not specifically addressed in the above rulings.

As a practical matter/ however/ the force of that general disclaimer may have been undermined by the National Office's thoroughness in applying the policy of requiring disclosure and consideration of all of an integrated transaction and in identifying and reviewing other issues that may be involved with the rulings requested. On occasion/ the National Office also has supplemented the general disclaimer with a caveat identifying other specific issues that the National Office has not considered/ but that might be regarded as relevant with respect to the transactions described in the letter ruling or the rulings issued. Recent examples of such additional specific disclaimers are set forth in the attached appendix.

A letter ruling program makes important contributions to the tax system by providing assistance to taxpayers on issues where existing guidance leaves unresolved questions. With the broader dissemination and review that private practitioners and other interested groups now routinely give letter rulings/ such a program can also provide a valuable mechanism for focusing attention on the importance of particular issues and prompting considered assessment of the appropriate resolution of those issues. We have previously expressed our support for the implementation of a program to eliminate/ or at least reduce/ "comfort" letter rulings as a means of allocating limited resources to maximize both those objectives.

Where, as in the past, "no ruling" areas were very limited in scope, broader latitude existed to deal with the conflicting administrative concerns described above by a relatively wide-sweeping insistence on considering the entirety

APPENDIX

Examples of Specific Caveats in Recent
Letter Rulings Identifying Issues Not Addressed

PLR 8933048 (May 23, 1989) (good "F" reorganization of mutual savings and loan association to stock association): ". . .no opinion is expressed as to whether bad debt reserves will be required to be restored to the gross income of either Mutual or Stock Association for the taxable year of the transfer if Stock Association fails to meet the requirements of Section 593(a) of the Code during such taxable year."

PLR 9008028 (November 21, 1989) (good "(a)(2)(E)• subject to certain enumerated factual conditions): "No opinion is expressed concerning the basis of the Target stock in the hands of Parent immediately following the consummation of the proposed transaction. Specifically, no opinion is expressed as to the qualification of the incentive stock options under Section 422(A) of the Code. Moreover, no opinion is expressed regarding the tax treatment of the proposed transaction under Section 280(G). In this regard, you should note that Q & A #13(c) of the proposed regulations under Section 280(G), published in 1989-25 I.R.B. 18, 25, provides that the issue of whether an option to which Section 421 applies will be treated as a payment for purposes of Section 280(G) at the time of the grant or at a later time is reserved for future regulations."

PLR 8933001 (August 22, 1988) (exchanges of claims for subsidiary's stock and that stock for parent's stock): "... No ruling has been requested and no opinion is expressed as to the tax consequences of a consolidated return change of

ownership, as defined in Section 1.1502-(1)(g} of the regulations, under the facts described herein.) PLR 8933003 (May 5, 1989) ("good cause" for late filing of Form 8716): "This ruling is limited to the filing of Form 8716. It has no effect on the requirement that the tapayer timely file Form 720, Quarterly Federal Excise Tax Return, and make any required payments pursuant to section 7519 of the Code."

* * *

Similar caveats have also been used in technical advice memoranda. See PLR 8941004 (July 11, 1989): "This memorandum addresses solely the application of the business purpose requirement to Section 368 reorganizations. No opinion is expressed as to whether the transaction described herein satisfies any of the statutory or other judicial requirements, if any, of a Section- 351 exchange."