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World's Longest Letter Ruling

LTR 201240017 is the world's longest letter ruling, 111 pages in PDF format. Not surprisingly, it is a Section 355 ruling. It was issued three-and-a-half months after the original submission, with those dates bridging Christmas and New Year's Day. There were seven additional submissions from the taxpayer in the interim. The release of the ruling was delayed for a couple of months.

As best as this reader can tell from spending a couple of hours with the ruling, there is not groundbreaking legal news in it, but then you can't be sure about 111 pages. Probably the most interesting points about the ruling are points that normally escape attention: (1) why did the taxpayer go to the trouble and expense to get this ruling, and (2) why does the Chief Counsel provide this sort of super service?

As to the super service, a top-flight law firm with a couple of partners working full time would have been hard pressed to write this letter ruling from scratch in under a month. Of course, a top-flight law firm or accounting firm must have written the submission from scratch. But how did a couple of Chief Counsel attorneys write the ruling in the period given, assuming they did anything else at all?

The answer has to be that the taxpayer supplied a draft ruling in electronic format. Once the ruling request was created and supplied on electronic format, this would have been fairly easy. It also explains those 200-plus-page Tax Court opinions: the winning litigant commonly supplies the facts, at least on disk.

So what does the Chief Counsel attorney look for? He or she can only hope to categorize the proposed transactions by type and compare the representations made with the required representations, which are fairly standardized. How about big picture issues? Presumably, the taxpayer's representatives sought a pre-submission conference with Chief Counsel and explained in big picture terms what the taxpayer was trying to accomplish.

Facts

The group is topped by a foreign corporate public holding company ("Parent"). The group includes 55 entities and two U.S. consolidated groups. The ruling describes three lines of business. The ultimate object of the transactions is for Parent to spin-off Controlled 1 and Controlled 2, one foreign and the other domestic, to its public shareholders. Each Controlled corporation will own one of the three lines of business, each of which had been operated by one of the two consolidated groups.

The numerous transactions leading up to the spin-off were grouped by the ruling into 34 groups, which comprise subgroups of 11 contributions plus distributions, eight liquidations, seven distributions, five reorganizations, one contribution and two other sets of transactions. 263 separate rulings were made. Each contribution plus distribution was a D reorganization. There were three F reorganizations and two A reorganizations. Each liquidation was under Section 332, and each distribution was under Section 355.

All three of the F reorganizations were accomplished by contributing stock of the target to a new company and effecting a deemed liquidation under the check the box regulation. One of the liquidations was effected by merger up, one by actual asset transfer, and six under the check-the-box regulation.

Observations

This reader charted the 55 entities and had to tape an additional page to the bottom of the first page to get them all in the picture. One fact that jumps out, in addition to the multiplication of entities, is that this foreign-headed group contained not one, but two, domestic consolidated groups. Unfortunately, this is not unusual. It usually results from either separate acquisitions or a tendency of some foreign parents to create multiple separate U.S. subsidiaries, rather than subsidiaries within one group.

This tendency frequently leads to a scramble to combine consolidated groups, or add sister members to a consolidated group, when one of them develops losses. That can be done, but having one U.S. consolidated group should be considered when the opportunity first presents itself.

A second observation is of the heavy use of the check-the-box regime, primarily involving foreign entities. One wonders how the corporate world got along without it, and it is no wonder that the genie cannot now be put back into the bottle. It is likely that no small part of the reason for the explosion of spinoffs in recent years, as well as longer and longer rulings like this one, is due to being able to shuffle entities around using check-the-box liquidations. Another reason is the creation of the separate affiliated group (SAG) concept allowed to identify active businesses under Section 355(b).

Third, why did the taxpayer want this ruling and why does Chief Counsel sell these things at $18,000 a pop? Assuming the guess above—that no novel tax issues were involved—is correct, it is likely that the Parent (a foreign corporation) wanted the ruling as audit insurance for its domestic subsidiaries that engaged in a variety of liquidations, mergers and spinoffs facilitating the ultimate double spins to the public shareholders.

The taxpayer was going to have to write all this down for its own benefit anyway, simply as discipline to prove to itself that it was not creating structural, much less tax, problems for itself. Also, its tax department was going to have to make sure that the transactions complied with federal and foreign tax law. Being a foreign corporation, the Parent may not have a domestic internal tax department, outside of its two domestic consolidated groups, which may not have responsibility for other parts of the Parent's group. Therefore, it is likely that the taxpayer was forced to engage domestic outside counsel. Once that expense was incurred, and the factual descriptions and legal analysis created, it was probably not much more expensive (maybe another 25 percent of the legal costs?), plus the IRS' $18,000 ruling fee, to obtain the ruling.

That ruling can be displayed to any IRS auditor who wants to know what happened and it is highly unlikely the auditor would look behind the ruling.

What about the Chief Counsel? It turned this request around and issued a 111-page ruling in three-and-a-half months, over the Christmas and New Year's periods, and found time to ask for (or receive) seven supplemental letters from the taxpayer. Quite frankly, that would be a good turnaround for someone spending full time on the project, and Chief Counsel is not so staffed that attorneys can spend full time on any project (Corporate Division is now down 20 or more in staff attorney positions from past years).

Putting the most favorable light on the subject, one can say this is good government at work for you. Of the 109 letter rulings issued by the Corporate Division in the last year, about one quarter have been Section 355 rulings. When the 35 9100 relief rulings are removed from the set, the Section 355 rulings rise to more than one third, and they are surely the more complicated rulings on average. Therefore, it is fair to say that a very substantial part of the Corporate Division's efforts are devoted to Section 355 rulings.

At a rate of $18,000 per ruling, these Section 355 rulings could have produced about half a million dollars in revenue for the IRS over the last year. However, this does not nearly cover the cost.

How Is the Transaction Planned?

The planning of this type of transaction surely does not start with Parent deciding it will liquidate this subsidiary and merge that subsidiary. Rather it decides at a high level that it will place two of its businesses in the hands of its shareholders, usually to increase the aggregate share value. Then it identifies where those businesses sit within its corporate structure. Then it turns the project over to the tax lawyers to figure out how to extract those businesses from the structure with no tax cost and without creating ancillary problems.

There is no one way to accomplish the end result. That is why the key to transactions like these is in the step-by-step planning of how to reach the end result. Such planning requires up-to-the-minute knowledge of the state-of-the-art in corporate reorganization law and lore, as applied by the Chief Counsel.

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