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Federal Tax ADVISORY ■

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Important No-Rule Changes

Rev. Proc. 2014-3

The Annual Rev. Proc.

One of the most important bellwethers of what the IRS is thinking is the annual revenue procedure that announces the issues on which the IRS ordinarily will not rule, or never will rule, or will not rule because the issue is under study. The IRS always numbers the procedure "3" and issues it on New Year's Day. Perhaps for that reason, and also general lack of awareness of its significance, the procedure tends to be overlooked. That is a mistake. The procedure should always be checked in connection with any analysis of an uncertain issue. If the IRS knows enough about an issue to say it will not rule on it, that carries the implication that the ruling, if issued, would not be favorable to the taxpayer, or at least that the IRS is uncertain about the answer, and so the taxpayer probably should be uncertain, too. The one exception to the implication is for "comfort rulings."

Rev. Proc. 2014-3 contains some particularly probative additions.

Granite Trust

The IRS now will not rule on "[t]he treatment of transactions in which stock of a corporation is transferred with a plan or intention that the corporation be liquidated in a transaction intended to qualify under § 331." If this sounds familiar, it should. It describes the facts in *Granite Trust Co. v. United States*, 238 F.2d 670 (1st Cir. 1956). The corporation that was the sole owner of the stock of a subsidiary had decided to liquidate the subsidiary, but wanted to recognize its loss in the stock of the subsidiary. It could not recognize that loss—indeed, the basis in the stock would disappear—if the subsidiary liquidated under Section 332. Therefore, the parent sold 20.5 percent of the stock to a "friendly buyer" (at a loss) and then caused the subsidiary to adopt a plan of liquidation and to liquidate. The parent claimed that it recognized the loss on the retained 79.5 percent of the stock in a Section 331 liquidation of the subsidiary; the IRS disagreed due to the plan to liquidate; the trial court agreed with the IRS; the First Circuit reversed and allowed the loss.

The Chief Counsel ruled favorably on such facts as recently as May 2, 2013. LTR 201334006 involved a consolidated group's sale of 21 percent of the stock of a group member to an unaffiliated controlled corporation. Subsequently, the sold subsidiary liquidated and the group claimed Section 331 applied to the liquidation and the ruling agreed, without any discussion of the *Granite Trust* issue. The ruling did require that the loss on the sale of the 21 percent be suspended under the "supersecret rule" of the consolidated return intercompany transactions regulation, which suspends that loss on the theory that the liquidation is really controlled by Section 332. This is an odd result indeed, but is pretty clearly the law now that the Treasury has finalized the supersecret rule regulation. The letter ruling reflected a change from an earlier plan in LTR 201330004.

Presumably, government officials will be asked about the change and will offer some explanation claiming that the substantive law has not changed. However, it will be hard for taxpayers to be as completely comfortable with relying on *Granite Trust* as they have been. That decision has been widely identified as a possible candidate for being overturned by an application of the economic substance doctrine. Indeed, *Fidelity Advisor International Currency A Fund v. United States*, 106 AFTR 2d 2010-6567 (D MA 2010), casts doubt on *Granite Trust* under the doctrine.

Rescission

Whether a completed transaction can be rescinded, and thus ignored, for federal income tax purposes will not be ruled on. Previously, this issue was under study and not ruled on for that reason; now, it is no longer under study and will not be ruled on.

Rev. Rul. 80-58, 1980-1 C.B. 181, is still on the books. It is the principal published guidance that supports the efficacy of rescission. Everyone knows that the core requirement for reliance on this ruling is to rescind the transaction within the same tax year that it occurred and to place all parties in status quo ante.

In contrast with the *Granite Trust* no-rule discussed above, this one likely should be less troubling to taxpayers. IRS officials have stated that taxpayers can "do rescissions at home." This means no ruling is needed. Given the resource constraints of the IRS, it is likely that the adoption of a flat no-rule mostly means that the IRS expects taxpayers to do this at home, without their help.

Resource Constraints

The procedure always has given the IRS a wild card excuse for declining to rule "in the best interests of tax administration." Taxpayers frequently have failed to understand this. There is no constitutional or statutory right to get the IRS to tell you the answer to a tax question in advance of an audit. However, Chief Counsel has been somewhat reluctant to decline to rule on this basis. Instead, it has addressed the issue by cutting back rulings in defined areas, like mergers, and then specific issues in spinoffs—and now all spinoffs. Now, it has given itself an additional official reason to "cover" refusals in the best interests of tax administration: resource constraints.

Previously, the "tax administration" ground was used sparingly to decline to rule where the taxpayer had some basis for the position it advocated, but the IRS did not want to give aid and comfort to that basis. The publication of letter rulings, which began in the early 1980s as the result of Tax Analysts' lawsuits, produced many changes in IRS ruling patterns, and that was one of the lesser-noticed changes.

It remains to be seen how much this ground will be used. It will vary from division to division of Chief Counsel.

Stock Abandonment Losses

Now, the IRS ordinarily will not rule on the deductibility under Section 165 of the abandonment of stock. This likely was prompted by the litigation of that issue in *Pilgrim's Pride Corp. v. CIR*, 141 T.C. No. 17 (2013).

Hook Stock

Stock in a parent corporation owned by a subsidiary is called "hook stock." It became important in connection with corporate inversion transactions, usually involving expatriations, in the 1990s. Treasury issued Reg. Section 1.7874-1T to address it in 2005. Now the IRS will ordinarily not rule on the consequences of hook equity if the parent owns 50 percent or more of the corporation owning the parent's stock and the treatment of the hook stock is significant.

Conclusion

Remember to check the current no-rule rev. proc. in analyzing any transaction for which there is not clear guidance.

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