

## Tax Opinion or Private Letter Ruling? A 12-Point Comparison

By Robert W. Wood



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In this article, Wood examines the basics of private letter rulings and tax opinions and gives a 12-point comparison.

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### A. Introduction

“Do you want a tax opinion or a private letter ruling?” may sound like a simple question, yet it is hardly like asking whether you want sparkling water or still. You may not have a choice, and even if you do, it is almost never a simple one. Cost, speed, certainty, and risk must be considered.

Not all factors point to seeking a ruling either. A ruling involves costs and delays, and there are risks of asking for a ruling and not getting it. At a minimum, you will have alerted the IRS. It is better not to ask than to ask and be denied. On some level, most tax professionals understand the mix of these issues.

Most clients do not. Even among sophisticated business people and savvy investors, the reasons for wanting one or the other should be teased out. Because the subject is invariably taxes, there are invariably technical issues, too. Adding the technical and practical issues surrounding each path makes the discussion harder. When one adds the inside-baseball terminology, it can all be downright dizzying.

**1. Binding versus not.** Start with the rule that rulings are binding and tax opinions are not. Opin-

ions never bind the IRS, rulings always do. That is one reason you must attach a copy of the ruling to the pertinent tax return when you file it.<sup>1</sup> You never attach an opinion to a tax return.

An opinion may bind the author, but never binds the IRS. Of course, most opinion authors leave plenty of room for disagreement.<sup>2</sup> Saying that it is more likely than not that the IRS or the courts will uphold a given tax treatment is not a guarantee that they will.

Rulings are formal and certain, and certainty is good. Every tax lawyer has seen a situation in which, despite strong taxpayer positions, taxing agencies audit, become entrenched in their positions, and then litigate them against the taxpayer. The costs and time spent on those efforts can be substantial even if they are ultimately successful. A ruling avoids that risk.

**2. No-rule areas.** A tax opinion can be written on just about anything. Not rulings. The IRS has long lists of subjects on which it will not rule. The lists change periodically. A first line of inquiry should be whether your subject is on a no-rule list.

**3. Appropriate ruling questions.** A tax opinion can be about anything. But for rulings, there is a subjective sweet spot. If the tax issue is plain vanilla in character, it may not be possible to get a ruling even if it is not on a no-rule list. If the issue is plain vanilla and the result is well established, the IRS will often decline to rule and call your request one for a “comfort ruling,” something the IRS generally will not issue.<sup>3</sup>

Conversely, if the tax issue is unique or difficult, it may be outside the realm of rulings on the other extreme. Many taxpayers feel that the middle ground — when you *can* get a ruling from the IRS — is generally when you do not need one. Rulings can typically be obtained only on issues and fact patterns within a narrow bandwidth. If the law is unclear and you really need a ruling, you may not be able to get it. If the law is settled and you are perceived as too needy for comfort, you can’t get that either. Opinions fill the gaps.

<sup>1</sup>See Rev. Proc. 2015-1, 2015-1 C.B. 1, section 7.05.

<sup>2</sup>See Robert W. Wood, “Debunking 10 Myths About Tax Opinions,” *Tax Notes*, Aug. 17, 2015, p. 789.

<sup>3</sup>See Rev. Proc. 2015-1, section 6.11.

**4. Don't ask unless you know.** An old adage says you should not ask a witness a question if you do not know the answer, and it applies to rulings. One generally should not *ask* for a ruling unless there is a high likelihood that you can get the answer you want. A ruling is gold-plated certainty, but the IRS does not usually give it in close or tough cases. There are also consequences for asking.

When you request a ruling, you generally must pay a fee. There is a range of fees, but one common fee is \$28,300.<sup>4</sup> If the IRS's answer is no, practitioners customarily withdraw their ruling request, and they may get their fee back. Still, one generally does not want a "no" answer on the books.

If the IRS says that it can't rule and you withdraw your request, the IRS sends an audit notice to the IRS field office in your area. The notice does not direct an audit; however, it informs field IRS employees that you asked for a ruling, didn't get one, and withdrew your request. If you proceed with the transaction, your return could be flagged.

**5. Rulings take time.** An opinion can be knocked out in days or weeks. A ruling takes weeks or months (usually you should assume six months or more). There are exceptions and ways to leapfrog, but rulings are always more time-consuming than opinions.

**6. Opinions are interactive, rulings are not.** You need to be specific in a ruling request and typically cannot tweak facts and keep modifying your transaction and your ruling request. It is static. In contrast, simultaneously planning a transaction and writing an opinion can make sense. An opinion can be done in parallel with the transaction to help shape it.

There are often adjustments that can be made in the transaction. The tax opinion may be prepared pre- or post-transaction before the filing of the return. Often, some aspect of the transaction can be tweaked and made better because the spadework of the opinion is being done while it can have maximum benefit.

The opinion can become part of shaping the transaction itself. In contrast, the ruling request is static. Even when the transaction is closing or closed at the time the opinion is being written, it is common for additional documentation to be solicited and provided as part of the opinion due diligence. Certificates and declarations may help the strength and scope of the opinion.

Opinions that shore up documentation and plug perceived holes are likely to be more helpful if prepared contemporaneously with the closing or, at the latest, at tax return time when the transaction is

being reported. Certificates, declarations, and the like are rarely effective if prepared several years later during an audit. Conversely, they can often be helpful if prepared simultaneously with the closing or in connection with an opinion written before returns are filed.

**7. Pre-ruling conference.** Today almost no ruling is submitted without an informal trial run. You talk to the IRS and get its general view on your proposed ruling. After talking, you submit a short (five pages or so) memo about the facts, the client, the issue, and the ruling you want.

The IRS meets informally in person or by phone, usually with two to five IRS attorneys covering different areas or aspects of the topic. The IRS reacts orally to the memo and often suggests a tentative positive or negative result. If all is positive, you prepare and submit your ruling request. If not, you don't.

Either way, the informal request is not official and triggers no fee. If it doesn't go well or if you never make a formal ruling request, it triggers no audit notice (that I know about!). But given the limited IRS resources, you must proceed in good faith in a pre-ruling conference and actually *intend* to make a formal ruling request if all goes well. You might change your mind or the situation might change, but the IRS does not like fishing expeditions.

**8. Opinions cover pro and con, rulings do not.** Rulings give a binding conclusion by the IRS. Although they give the reasons for the conclusion, the reader generally just wants the answer. In contrast, a good opinion should argue both sides.

The opinion's bottom line may be that there is substantial authority (or some other level of confidence) for the position. But for the opinion's conclusion to have meaning, it should be accompanied by a thorough examination of the facts and relevant authorities. Moreover, an opinion should develop and document the reasons against the tax position as well as the reasons for it.

**9. Penalty protection.** You do not need to consider penalty protection if you get a ruling. In contrast, the most commonly stated reason to get a tax opinion is to avoid penalties. Depending on the standard of the opinion (reasonable basis, substantial authority, or more likely than not), there are varying degrees of protection from an assertion of penalties.

Even so, I do not believe most tax opinions are written primarily for purposes of penalty protection. True, clients want penalty protection, so penalties are not added to taxes due. But no client wants or expects the claimed tax position to fail. If the opinion merely saves penalties, it has largely

<sup>4</sup>See Rev. Proc. 2015-1, Appendix A.

failed. Clients want to win, to have their tax position upheld. At the very least, they want to compromise it on an acceptable basis. An opinion is really not all about the penalties, or it *should not* be anyway.

**10. Opinions when audited.** If you get a ruling, you shouldn't worry about an audit unless you go outside your opinion or change the facts. But if you want an opinion, don't wait until an audit. There is rarely time to obtain a good and thoughtful opinion at the audit stage. Even if there were, it would hardly be the same as one done before the transaction or before tax return filing.

Besides, if an opinion is to have any value for penalty protection, it must be done before the tax return is filed. Clients commonly think writing an opinion later if the IRS audits is sensible. I have three responses.

First, if the return position precedes the opinion, a reliance defense may not apply. A taxpayer must first *receive* tax advice to claim good-faith reliance on it.<sup>5</sup> Although tax advice may be oral,<sup>6</sup> it might be risky to file the return before a written opinion is issued. The timing and content of verbal advice can be challenging to prove if it is not well documented.<sup>7</sup> At a minimum, the opinion may fluctuate until it is nailed down in writing.

Second, if the tax position has been attacked, it is unlikely that anyone at that point will take a reasoned or balanced view of both sides of the equation. At that stage, all writing will understandably be geared toward advocacy.

Third, the nuances about reporting and disclosure should be explored when developing the opinion and assessing the positive and negative. Whether and how to disclose the tax position must be considered *before* the return is filed.

**11. Opinions and disclosure.** A copy of a ruling is attached to a tax return. In contrast, a legal opinion is usually prepared by a lawyer for a client and is subject to attorney-client privilege. Be careful whom you copy, including return preparers, because that simple act may waive the privilege. For preparers, a short directive letter about what to put on the return and what to disclose that also states that the opinion is privileged and will not be provided should work.

Also, watch out for the implied waiver doctrine. Invoking reliance on counsel as a defense to penalties can be an implied waiver of attorney-client

privilege.<sup>8</sup> If proponents of the "it's all about the penalties" mantra were to be believed, wouldn't they be willing to hand over the legal opinion to the IRS in order to achieve penalty protection? In my experience, they rarely are.

Handing the IRS a veritable roadmap of all the authorities and all the arguments, both good and bad, usually won't make sense unless the tax position has entirely failed and the only thing left on the table is the penalties. The opinion may make arguments that the IRS might not discover or that it might not make with the skill or thoroughness of the opinion.

If penalty protection is the real goal, the prudent course may be to assume that the opinion will ultimately wind up in the hands of the IRS. But unless the "I want penalty protection" white flag is raised, the courts have not been liberal in granting the IRS access to tax opinions. The most famous instances of disclosure have occurred in tax shelter cases, in which it often seems that the rules are different. The worse the shelter, the more the opinions will be fair game.

**12. Controversies.** If you have a ruling, there should be no controversy unless the IRS claims you went outside the ruling or changed your transaction. With an opinion, you usually do not have a controversy, but you might. And in that setting, opinions can be helpful, usually not as a whole, but as a resource to mine for ready-made advocacy materials.

For the small percentage of tax cases that ultimately end up in controversy, audit, Appeals, or court, there will be deadlines. If a client has 30 days to respond to an information document request or a notice about why a particular return position was claimed, that might be enough to do a thorough job. There is rarely enough time to do everything you want to do. To be able to open the file and pull out a thorough legal opinion on the very facts and covering the pertinent authorities is a luxury. It can often spell the difference between a good and a bad result, or at least between an outstanding and a middling one.

## B. Conclusions

The nature of ruling dynamics can seem counter-intuitive. If the taxpayer's position is weak or uncertain, the government will not rule. Conversely, if the taxpayer's position is plainly correct, the government may also not rule, considering it a comfort ruling. If you are in the sweet spot, a ruling

<sup>5</sup>See *Long Term Capital Holdings et al. v. United States*, 330 F. Supp.2d 122, 206-207 (D. Conn. 2004), *aff'd*, 150 Fed. Appx. 40 (2d Cir. 2005); *Cordes Finance Corp v. Commissioner*, T.C. Memo. 1997-162, *aff'd without pub. opinion*, 162 F.3d 1172 (10th Cir. 1998).

<sup>6</sup>Reg. section 1.6664-4(b), (c).

<sup>7</sup>See, e.g., *Long Term Capital Holdings*, 330 F. Supp.2d at 207.

<sup>8</sup>See, e.g., *Evergreen Trading LLC v. United States*, 80 Fed. Cl. 122 (2007) (requiring production of a tax opinion unless taxpayer disavowed reliance on counsel as a defense to accuracy penalties); *Johnston v. Commissioner*, 119 T.C. 27 (2002).

can make sense. And, if the dollar consequences of being wrong are catastrophic, say with a section 355 spinoff, a ruling may be the only practical option.

Elsewhere, rulings and tax opinions each have their place. Sometimes you can actually debate pluses and minuses of each. Sometimes you cannot get a ruling and should not ask. Opinions, in contrast, are a kind of everyman, a more flexible and adaptable document. And they probably deserve more credit.

It is too bad that many people think tax opinions are just about penalty protection. If *any* tax opinion is all about the penalties, it is surely those of the shelter variety. The more sanguine variety of tax opinion (which I hope and believe is a far larger category) can be viewed quite differently.

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