

*How Can the Private Letter Ruling Process Benefit the Gift Planner?*¹

When structuring a sophisticated planned gift, an analysis of the Internal Revenue Code, the Treasury Regulations, IRS pronouncements and the case law may not produce a clear answer with respect to a particular federal tax issue. In fact, a lack of clarity may arise with some frequency, as many different technical tax disciplines collide.

For instance, rules originally intended to apply to private foundations were made applicable to certain charitable gift planning vehicles; income, estate and gift tax issues often overlap; and the body of law for charitable gift planning is relatively new, devoid of significant case law and continually evolving. Therefore, a taxpayer, either a donor or a charity, may want to confirm the tax consequences of a particular charitable gift structure by obtaining a private letter ruling (PLR).

For this reason, gift planners may need to address the benefits and burdens of submitting a PLR request to the IRS. If significant tax dollars are at risk and a guarantee of tax result is desired, gift planners should consider the propriety of requesting a PLR.

1st & 4th RevProcs

The first revenue procedure of each calendar year updates the process for issuing letter rulings, determination letters and information letters on certain federal tax issues. The fourth revenue procedure also has the processes that specifically relate to certain exempt organization issues. These pronouncements will be referred to as the “1st RevProc” or the “4th RevProc”, or together as the “RevProcs”.

The procedures detailed in the RevProcs are highly technical, and tedious compliance is necessary for a successful filing. This Article does not contain an exhaustive analysis of the RevProcs; however, a careful review of all relevant revenue procedures must be done for each potential filing with the IRS, and the RevProcs are the right place to start.

Consider the Propriety of Submitting a PLR Request

Gift planners can assist a donor or a charity in considering whether to submit a PLR request; however, the taxpayer must make the ultimate business decision. Obtaining a level of certainty in the federal tax treatment of a charitable gift transaction will be the number one priority. If a favorable letter ruling is obtained, the taxpayer may rely upon it. In addition, in the negotiation process, the proposed transaction may be restructured with the assistance and blessing of the IRS in a fashion that may be acceptable to the taxpayer.

One of the burdens of filing a PLR request is the cost. The professional fees incurred by the taxpayer in the preparation and negotiation process may render the ruling request too costly, when compared to the amount involved in the gift transaction. The fact that the IRS Fee has been increasing dramatically over the last 8 years may deter a request for a PLR. For instance, the IRS Fee to file a PLR request under the 1st RevProc is now generally \$10,000 (up from \$3,650 in 1998), and to file under the 4th RevProc is now generally \$8,700 (up from \$2,100 in 1998).

If time is of the essence with respect to the closing of the gift transaction, obtaining a ruling may not be feasible. The IRS generally attempts to process the ruling request within 60 – 90 days. If multiple branches of the IRS need to review the ruling or other extenuating circumstances exist, the ruling process can take more than 6 months. However, and based upon a recent discussion with the IRS rulings division head, the number of employees in the rulings division has significantly decreased for different reasons, and the current ruling process may take anywhere from 2 to 12 months (in certain circumstances).

In addition, the IRS has yet again accomplished an organizational restructuring at the National level. Except for a few divisional name changes, the organizational structure and the PLR process itself have not substantively changed.

If a gift transaction is complete or cannot be altered, disclosure of the gift transaction may not be in the best interest of the taxpayer. If uncertainty exists, drawing attention to those issues without the opportunity to remedy them may not be a recommended course of action. In addition, if the taxpayer files a ruling request and then decides to withdraw the ruling or the

IRS declines to issue a letter ruling, the IRS will ordinarily notify the local IRS District Director and may provide its views on the transaction.

Lastly, a potential risk in filing a letter ruling request is the possibility that sensitive information may be disclosed to the public. As a general rule, the IRS must publicly disclose a private letter ruling and the background file documents relating to the ruling; however, the identifying facts in the ruling request, such as the taxpayer's name, address, social security or taxpayer identification number and other identifying details, will not be disclosed to the public. Although the taxpayer has the right to protest the disclosure by the IRS, these rules should be carefully considered in advance, if especially sensitive information is involved in the ruling request.

Understand the Effect of a PLR

The taxpayer must also consider the effect of a favorable ruling. In general, the taxpayer may rely on a PLR received from the IRS, but may not rely on a PLR issued to another taxpayer. In addition, a letter ruling that is issued on a particular transaction applies only to that transaction and not to a similar transaction in the same taxable year or any other taxable year.

A favorable PLR will provide a definitive response on a specific set of facts. However, the ruling is not an absolute guarantee of tax results, because a PLR can be revoked or modified at any time if found to be in error or not in accord with the current views of the IRS. Such revocation can be applied either retroactively or prospectively.

However, retroactive revocation of a PLR will only occur in rare or unusual circumstances, provided that (i) there has been no misstatement or omission of material facts, (ii) the facts at the time of the transaction are not materially different from the facts on which the letter ruling was based, (iii) there has been no change in the applicable law, (iv) the letter ruling was originally issued for a proposed transaction and (v) the taxpayer directly involved in the letter ruling acted in good faith in relying on the ruling and revoking the ruling would be to the detriment of the taxpayer. If these conditions are met, the ruling will also not be affected by the subsequent issuance of Regulations.

A PLR may also be retroactively revoked if the transaction is entered into prior to the issuance of the PLR or after a change in the material facts. If

however, a specific request is made under Code Section 7805(b) for limiting the retroactive effect of the ruling request, the taxpayer may be able to avoid the retroactive revocation to all years open under the statute of limitations.

As an example in the charitable gift planning area, the IRS issued PLR 9714010 (December 20, 1996), which revoked PLR 9233053 (May 22, 1992). The prior letter ruling held that a donor's creation of a charitable remainder trust to fulfill a legally enforceable charitable pledge was not an act of self-dealing. The IRS, however, exercised its discretionary authority under Code Section 7805(b) to delay the revocation's effective date until the trust terminates and distributes all its assets. Thus, the distribution of the trust's assets to the charity in satisfaction of the donor's pledge did not result in the imposition of the self-dealing excise tax.

Will the IRS Rule on Your Particular Issue?

The 1st RevProc controls the tax issues to be ruled on by the *Chief Counsel's Office*, while the 4th RevProc deals with tax issues under the jurisdiction of the *Office of the Commissioner – IRS*. However, there may be an overlap between these offices, and they sometimes act in concert when a unified conclusion is desired in an area which will have a widespread impact on taxpayers or in a complex or novel case.

Section 3 of the 1st RevProc provides a specific listing of issues on which the different branches of the *Office of Associate Chief Counsel* will provide guidance. For instance, in charitable gift planning related areas, Associate Chief Counsel (Income Tax and Accounting) will provide guidance on income tax deductions, sales and exchanges and capital gains and losses. Associate Chief Counsel (Passthroughs and Special Industries) will rule on trusts, and estate and gift tax issues.

On the *Office of Commissioner* side of the table, the Office of Division Commissioner, Tax Exempt and Government Entities (“TE/GE”) has, pursuant to the 4th RevProc, the jurisdiction and will issue letter rulings involving: (i) tax-exempt organizations, including private foundations, (ii) public charities, (iii) trusts described in Code Section 4947(a), and (iv) Sections 501 – 514 (including the UBIT rules), 4940 through 4948 (the private foundations rules) and 4958 (the intermediate sanctions rules). Any issue that TE/GE does not have jurisdiction to rule on, the Office of Division

Counsel/Associate Chief Counsel (Tax Exempt and Governmental Entities) may so rule.

Circumstances Under Which the IRS Will Rule

Section 5 of the 1st RevProc provides circumstances under which the IRS will issue rulings. In income and gift tax matters, the National Office generally issues a letter ruling on proposed and completed transactions. However, the letter ruling request must be submitted before the return is filed for the year in which the transaction that is the subject of the request was completed.

In estate tax matters, the Associate Office issues prospective letter rulings on transactions affecting the estate tax on the prospective estate of a living person and affecting the estate tax on the estate of a decedent before the decedent's estate tax return is filed. However, and of special interest to gift planners, the Associate Office will not issue letter rulings for prospective estates on computations of tax, actuarial factors, and factual matters.

Charitable gift planners have in the past had to evaluate the Proposed Regulations promulgated under Code Section 664. In some instances, a taxpayer may await the issuance of final regulations for guidance. However, a taxpayer may desire to engage in a gift transaction related to those yet-to-be-published regulations and receive advance approval from the IRS.

The Associate Office will issue a letter ruling before issuing temporary or final regulations, if the letter ruling request presents an issue for which the answer seems clear by applying the Code to the facts or for which the answer seems reasonably certain but not entirely free from doubt. If the answer does not seem reasonably certain, the Associate Office will use its best efforts to issue a letter ruling. If the answer cannot be readily resolved prior to publishing regulations, a PLR will not be issued.

IRS Discretion to Rule

Section 8 of the 1st RevProc provides a list of certain general areas in which the IRS has discretion to issue letter rulings due to the factual nature of the problem involved or due to other reasons. This list is not all-inclusive, because the IRS may decline to issue a letter ruling when appropriate in the

interest of sound tax administration or on other grounds whenever warranted by the facts or circumstances of a particular case.

For instance, a letter ruling will not be issued on alternative plans of proposed transactions or on hypothetical situations. In addition, the Associate Office ordinarily will not issue a letter ruling on only part of an integrated transaction. These general rules also apply to the issuance of letter rulings by TE/GE pursuant to the 4th RevProc.

IRS No-Rule Posture

The third annual revenue procedure (“3rd RevProc”) updates the areas in which, because of the inherently factual nature of the problems involved or for other reasons, the IRS will not issue advance rulings. Changes are published throughout the year and are incorporated annually into this revenue procedure. The 3rd RevProc establishes three general no ruling areas: areas in which the IRS will not issue a ruling, areas in which the IRS will not ordinarily issue a ruling and areas which are under extensive study.

IRS Will Not Rule

In general, the Associate Office will not issue rulings on:

- results of transactions lacking a bona fide business purpose or having reduction of federal tax as a principal purpose;
- matters involving a decision of a court which is adverse to the government and the IRS has not yet determined whether or not to contest such decision;
- whether reasonable cause, due diligence, good faith, or other similar terms requiring a factual determination exists under subtitle F (Procedure and Administration), such as the substantial additions to tax under the accuracy-related and fraud penalties;
- whether a proposed transaction would subject a taxpayer to a criminal penalty; and
- a request that does not meet the requirements of the 1st RevProc.

In addition, the IRS will not rule on the following specific issues relating to charitable gift planning:

- Section 170 -- Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.
- Section 642(c) -- Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.
- Section 664 -- Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.
- Section 2031 -- Actuarial factors for valuing interests in the prospective gross estate of a living person.
- Section 2512 -- Actuarial factors for valuing prospective or hypothetical gifts of a donor.

IRS Will Not “Ordinarily” Rule

Section 4 of the 3rd RevProc provides the areas in which the IRS will not “ordinarily” issue letter rulings. “Ordinarily” means that unique and compelling reasons must be demonstrated to justify the issuance of the ruling. In general, the IRS will not ordinarily issue rulings relating to:

- Any matter in which the determination requested is primarily one of fact, e.g., market value of property, or whether an interest in a corporation is to be treated as stock or indebtedness.
- The tax effect of any transaction to be consummated at some indefinite future time
- The federal tax consequences of any proposed federal, state, local or municipal legislation; however, the IRS may provide general information in response to an inquiry;
- Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business, i.e., “dealer” status, raising the specter of UBIT and the ordinary income reduction rules of Code Section 170(e).
- The tax effect of a transaction if any part of the transaction is involved in litigation among the parties affected by the transaction, except for transactions involving bankruptcy reorganizations.

The IRS will not ordinarily rule relating to the following specific topics (some of which just changed due to the issuance of new CRT specimen forms and explanations):

- Sections 170, 2055 and 2522 -- Whether a transfer to a pooled income fund described in Code Section 642(c)(5) qualifies for a charitable contribution deduction under Code Sections 170(f)(2)(A), 2055(e)(2)(A) and 2522(c)(2)(A).
- Section 170(c) -- Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.
- Section 170 -- Whether a transfer to a charitable remainder trust described in Code Section 664 that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under Code Sections 170(f)(2)(A).
- Sections 2055 and 2522 -- Whether a transfer to a charitable remainder trust described in Code Section 664 that provides for annuity or unitrust payments for one or two measuring lives or for a term of years qualifies for a charitable deduction under Code Sections 2055(e)(2)(A) and 2522(c)(2)(A).
- Section 642 -- Whether a pooled income fund satisfies the requirements described in Code Section 642(c)(5).
- Section 664 -- Whether a charitable remainder trust that provides for annuity or unitrust payments for one or two measuring lives or for a term of years satisfies the requirements described in Code Section 664.
- Section 664 -- whether a trust that will calculate the unitrust amount under Code Section 664(d)(3) qualifies as a charitable remainder trust when a grantor, a trustee, a beneficiary or a person related or subordinate to a grantor, a trustee or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under Code Section 643(b) and income for federal income tax purposes for the benefit of the unitrust recipient.

Areas Under Extensive Study

Section 5 of the 3rd RevProc provides areas under which the IRS is not temporarily issuing letter rulings because those matters are under extensive study. However, the IRS will rule once it resolves the issue through the publication of a revenue ruling, revenue procedure, regulations or otherwise.

Revenue Procedure 97-23 was a good example of an area under extensive study that affects charitable gift planners. The IRS and Treasury announced that they will study the use of the so-called “spigot trust”: whether creating or using net income with makeup charitable remainder unitrusts to control the timing of the trust’s receipt of trust income for the benefit of the unitrust recipient causes the trust to fail to function exclusively as a charitable remainder trust.

Specifically, the IRS amended Section 5 of the 3rd RevProc and announced that it will not rule on requests pending with the IRS on April 17, 1997 and for rulings requests received after that date on this subject. Several years later, the IRS moved this subject from the category “under extensive study” to the “not ordinarily rule on” category.

Get a Favorable Ruling

The taxpayer and the taxpayer’s representative should fully cooperate with IRS personnel and understand the perspective of the branch representative. First and foremost, he or she will desire to reduce their caseload, which can become very oppressive. Second, the branch representatives are specialists in their respective fields. Treated with proper respect, the branch representative can assist the donor in obtaining a successful ruling. Third, the branch representative will have to report to a technical reviewer to justify a favorable position.

For these reasons, the taxpayer should take all action that will reduce the branch representative's workload and make it easier to justify a favorable result. For starters, the taxpayer should be certain that the initial request fully complies with the applicable RevProc, including a fully completed Checklist and user fee. The taxpayer should offer to prepare a draft ruling, even if the branch representative does not request it and should submit additional information by fax, as soon as the information is available. Cite contrary authority and distinguish it. Lastly, the taxpayer should deliver as many

copies of the ruling request as the branch representative needs to distribute to the necessary IRS personnel, either for the purpose of preparing for a conference or distributing to multiple branches.

In addition, the taxpayer should fully disclose all material facts to the IRS and provide copies of all relevant documents in the proposed gift transaction. The IRS may then have the opportunity to raise new or unexpected concerns, which could still be favorably resolved.

Notwithstanding the absolute need to fully comply with the technical process requirements, sound legal arguments, common sense and courtesy will increase your chances of receiving a favorable PLR. The IRS should be viewed as a partner in reaching equitable tax results in a proposed gift transaction, as opposed to a combatant in a tax controversy waiting to happen.

Of course, filing a PLR request may not suit the needs of every taxpayer. Some taxpayers may not desire to disclose the nature of the gift transaction to anyone for many different reasons. Others may not want to go forward without an IRS stamp of approval. For these taxpayers, the IRS may actually be a partner in facilitating the placement of a major planned gift.

¹ This article contains portions of, and updates, an article which was published in the 3rd quarter, 1998, The Journal of Gift Planning, a quarterly publication of the National Committee on Planned Giving. The original article gets into much more detail and a string of citations. If you are interested in the full original article, it has also been reprinted on the Planned Giving Design Center and on Jonathan Ackerman's website, www.ackermanlaw.net.