IRS Expands Scope of Private Letter Ruling Program for Spin-Offs and Other Corporate Transactions

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On January 2, 2024, the Internal Revenue Service (IRS) released two revenue procedures updating the IRS guidelines for private letter ruling (PLR) requests, Revenue Procedure 2024-1 and Revenue Procedure 2024-3 (the 2024 Ruling Procedures).

Among other updates, the 2024 Ruling Procedures provide notable changes to the PLR guidelines relating to:

- Tax-free spin-offs and other divisive transactions (collectively, "spin-offs").
- Wholly or partially tax-free mergers and acquisitions and various other transactions governed by the corporate nonrecognition provisions of the Internal Revenue Code (the Code).

Although these changes are generally a welcome development, it remains unclear how much of an impact they will have in the transactional market.

Expanded Spin-Off Rulings

For a spin-off to qualify for tax-free treatment under the Code, numerous complex and fact-intensive requirements must be satisfied. In recognition of these myriad requirements, as well as the significant business objectives of spin-offs and the importance of such transactions in the marketplace, the IRS has devoted increased attention and resources to PLRs in this area in recent years, including through the creation of "fast-track" procedures for processing spin-off PLR requests in certain cases.[1]

Notwithstanding this heightened focus, the IRS has generally continued its long-standing "no-rule" policies (in effect since 2003) whereby, in an otherwise favorable spin-off PLR, the IRS would decline to address three key aspects of the Code's spin-off rules:

- The corporate business purpose requirement.
- The so-called "device" prohibition, which assesses whether a spin-off is motivated by an impermissible purpose to avoid the dividend provisions of the Code.
- Whether a spin-off is part of a proscribed "plan" with an acquisition of a 50% or greater interest in the distributing parent or spin-off company (the "planned acquisition rule").

A spin-off that runs afoul of the planned acquisition rule is generally taxable at the corporate level, whereas a violation of the corporate business purpose requirement or the device prohibition renders a spin-off fully taxable to both the distributing parent and its shareholders. As a result of the IRS's historic no-rule policies, companies undertaking spin-offs have typically obtained an opinion of counsel on these issues, even if the IRS has also issued a favorable PLR.

The 2024 Ruling Procedures eliminate the no-rule policies relating to the device prohibition and the planned acquisition rule, indicating that the IRS will address those requirements (alongside the numerous other requirements for tax-free treatment) in requests for spin-off PLRs going forward. The 2024 Ruling Procedures leave in place the existing no-rule policy relating to the corporate business purpose requirement.

Rulings for Other Corporate Transactions

For many years, the IRS has offered a very limited PLR program for corporate transactions other than spin-offs, including wholly or partially tax-free mergers, recapitalizations, incorporation transactions, subsidiary liquidations and certain tax-free share exchanges.

[1] For commentary on the fast-track procedures, see our July 27, 2023, client alert.

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Prior to the issuance of the 2024 Ruling Procedures, the IRS would only entertain PLR requests in these areas to answer specific technical questions for which little or no applicable authority existed (so-called "significant issues"). Favorable PLRs would be limited in scope to the specific significant issue or issues presented and would not rule more generally that the transaction in question qualified for the intended tax treatment under the Code.

The 2024 Ruling Procedures remove the IRS's historic no-rule policies for these types of transactions, signifying that the IRS is now poised to consider requests for comprehensive "transactional" PLRs in these areas, similar to the IRS's usual ruling practice for spin-offs. The 2024 Ruling Procedures also explicitly permit the issuance of PLRs with respect to such transactions even in situations where relevant law and its application to the transaction are relatively clear (*i.e.*, where the transaction does not raise any significant issues).

Observations and Potential Market Impact

Although the changes to the PLR guidelines reflected in the 2024 Ruling Procedures are a generally positive development, the ultimate impact of these changes remains to be seen.

With respect to mergers, acquisitions and other "non-divisive" corporate transactions, PLRs currently have somewhat limited recognition and understanding in the market as compared to opinions of counsel, particularly in the context of public company mergers and acquisitions.

In many of these transactions, the obligation of one or more of the parties to complete the deal is conditioned on the receipt of a "will-level" opinion of counsel regarding the transaction's qualification for the intended tax treatment. Such tax opinions have come to be quite well understood and accepted by market participants and are customary in these types of transactions.

For that reason, it appears unlikely that the expanded PLR program under the 2024 Ruling Procedures will, at least in the short term, supplant or replace tax opinions in public company transactions. However, the expanded PLR program may provide a useful tool to deter potential strategic behavior inherent in tax opinion conditions — for example, as an alternative to the receipt of a tax opinion if the opinion provider becomes unwilling or unable to deliver one. The expanded PLR program may also prove more useful in nonpublic situations, such as an internal restructuring of a parent company's subsidiaries.

Generally, for both spin-offs and other corporate transactions, the utility of the expanded PLR program will depend in large part on how the IRS administers the program and what further guidance, if any, is issued by the IRS to implement the changes. Given that the prior no-rule policies were in place for many years, there is currently limited (and, in certain cases, outdated or nonexistent) guidance regarding what specific representations and undertakings the IRS may require for spin-off PLRs addressing the device prohibition and the planned acquisition rule, or for PLRs on other types of corporate transactions.

As one example, the removal of the no-rule policy relating to the planned acquisition rule may prompt the IRS to require novel factual representations with respect to pre-spin-off activities, which would need to be monitored during the often substantial period between the issuance of the PLR and completion of the spin-off.

To the extent the IRS imposes requirements and conditions for such PLRs (whether in published guidance or on an informal, *ad hoc* basis in particular PLR requests) that are substantially more onerous or exacting than what may be required for a "will-level" tax opinion, some companies may be more likely (not less) to proceed with their transactions based only on tax opinions.

Depending on how the 2024 Ruling Procedures are administered, the elimination of the no-rule policies relating to the device prohibition and the planned acquisition rule could materially impact the current market practice for post-spin-off acquisitions and stock issuance transactions. Frequently, a company that wishes to pursue a transaction like this would first obtain an opinion of counsel to the effect that the transaction will not impact the tax-free status of the prior spin-off. Such an opinion often requires a significant degree of judgment in evaluating the facts and circumstances, and in interpreting and applying the IRS's highly technical device and "non-plan" regulations. Although uncertain, the 2024 Ruling Procedures open the possibility that the IRS might entertain requests for "no-impact" PLRs on these types of issues in appropriate post-spin-off settings.

As a general matter, however, it is important to emphasize that the IRS's apparent willingness to entertain PLR requests on a broader range of issues does not necessarily imply that the IRS will be willing to grant rulings in a broad set of circumstances.

In the spin-off context, for example, it is possible that the 2024 Ruling Procedures could make the IRS more hesitant to issue PLRs in some cases, because it will now need to rule affirmatively on the device prohibition and the planned acquisition rule (as opposed to caveating on those issues, as it has done historically). To the extent the IRS limits its ruling practice to circumstances where the law is clear and the result well established, or is otherwise not willing to rule when the applicable law is uncertain or developing, the benefits of the 2024 Ruling Procedures may be limited.