Whither Guidance?

One of the more noticeable trends in recent years has been the lack of formal guidance forthcoming from the Internal Revenue Service and Labor Department on key employee benefit issues. With the Internal Revenue Service the falloff in formal guidance has not been limited to the Employee Plans Division, but rather affects all areas of the tax law. *Tax Notes* magazine has devoted a fair amount of study to this phenomenon and has published considerable statistical evidence of this so-called guidance deficit. (See, "The Guidance Deficit, An Ongoing Statistical Study," *Tax Notes*, June 24, 1996, p. 1817 and "Who Killed Guidance?," *Tax Notes*, October 14, 1996, p. 221.)

As these articles point out, it is not that the IRS guidance has fallen off. Indeed, with the publication of private letter rulings, technical advice memos, audit guidelines, and IRS training manuals, the sheer volume of interpretative material has increased mightily. What is clearly different, though, is the decrease in the number of published revenue rulings and the increased use of second-tier authorities such as General Counsel Memorandums (GCMs), Technical Advice Memorandums (TAMs), and field service advice.

While all areas of the tax law have been affected by the proliferation of this "second-tier" guidance, the employee benefits area seems unique in one respect—and that has to do with the relative importance of the legal questions addressed by these memos and pronouncements. The phenomenon is not entirely new. The more senior of our brethren well remember the Service's acrobatic switch from the "multiple contract" to the "single contract" interpretation under Code Section 72 in the early 1980s. The change merely affected the taxation of millions of pensioners and was announced in a series of private rulings.

In more recent years, the "same desk" issue presents the most notorious case. Fundamental to the operation of every pension plan is the question of when distributions can be made. The pre-ERISA regulations under Code Section 401(a) warn that a pension plan may not make a distribution until a participant "retires," but there is no formal guidance on the question whether the sale of a business

results in a distribution-triggering termination of employment. Does it make any sense that in 1998 the only IRS-published authority on this question can be found in a 1986 private letter ruling and a 1990 IRS General Counsel Memorandum, which, it turns out, are inconsistent with each other? If, as many practitioners seem to believe, the GCM represents the Service's position, would not it make sense for the Service to embody the answer in some more formal way and give plans a last-clear-chance to say whether they intend to provide for distributions in these cases?

The "same desk" issue is but one example of the phenomenon. There are scores of others in the qualified plan area, many of which involve merger and acquisition-related issues. For example, the deductibility of pension plan costs attributable to liabilities assumed in an acquisition was addressed in some 1984 private rulings and a well-known General Counsel Memorandum—this is the now famous "Webb-case" GCM. More recently, there have been questions about the applicability of the pension reversion excise tax to a pension surplus transferred to a buyer in a business combination. A 1996 technical advice memorandum is the source of this concern. Another issue of recent interest among taxpayers involves the application of the "exclusive benefit" rule of Code Section 401 to the merger of nonqualified plan liabilities into a qualified plan. What little authority there is appears in technical advice memos and private rulings. The same applies to the retiree-medical prefunding rules of Code Section 401(h). A 1995 private ruling provides the only meaningful advice to the operation of these accounts.

ESOPs are another area where most of the IRS guidance on the law appears in private rulings and technical advice memos. These rulings cover basic questions dealing with ESOP plan terminations, loan refinancings, the use of pre-tax employee contributions to pay off an ESOP loan, and qualification under Code Section 1042. The most recent ESOP "pronouncement" involved the application of Code Section 415. After the Service issued a series of unfavorable rulings on the application of the Code Section 415 "annual additions" to sales of stock from an ESOP suspense account, the ESOP community mobilized in opposition, only to have the problem "fixed" by a 1998 TAM indicating a fundamental change of the IRS's position.

The phenomenon is even more pronounced with welfare plans. Consider, for example, the recent IRS technical advice memos on corporate-owned life insurance and split dollar insurance. The current versions of these insurance products have been around for years and have been no secret to the Service—and yet the Service decided

to use the technical advice medium to announce what many practitioners view as fundamental changes in interpretation. Flexible benefits are another case in point. After all the years of dealing with issues involving employee elections in structuring benefits, the Service apparently concluded in 1994 that the "assignment of income" doctrine is the weapon of choice in attacking flexible benefit arrangements that fall outside of Code Section 125. How did the IRS relay this striking conclusion? In a series of private letter rulings, of course.

Labor Department Guidance

Things are not much different at the Labor Department. The only interpretation of the "top hat" plan exception that the Labor Department has offered over the years is found in a bunch of old advisory opinion letters. If you ever have examined the Department's interpretation of the exclusive benefit rule in the context of plan mergers, you also find the legal interpretations set forth a number of advisory opinion letters and information letters. Employee-contributory welfare plans are yet another example. The Labor Department has conducted fairly widespread audits of employee-contributory welfare plans to ensure that the employees share in any experience credits or rebates, but you have to search the Department's settlement agreements to determine the agency's legal positions in this area. Finally, the granddaddy of them all has to be the law of prohibited transactions, which is in a class by itself. One has to scour the preambles of administrative exemptions to figure out the Labor Department's basic legal interpretation of the prohibited transaction provisions.

Most practitioners would agree that the "guidance deficit" is more severe at the Labor Department than at the IRS and more accurately can be described as a "guidance drought." The IRS, at least, publishes lots of the second-tier authorities. The same cannot be said for the Labor Department. The Labor Department issued only 23 advisory opinion letters in 1997 and has averaged only one letter per month in the first eight months of this year. The Labor Department also has pioneered a unique form of public guidance—which is guidance by amicus brief. The Department tried to elevate this form of guidance to a new height in the *Harris Trust* litigation by arguing that the position taken in their *Harris Trust* legal brief should be accorded deference because it represented the agency's interpretation of the law. Unfortunately, the Supreme Court found it unnecessary to address the question whether deference is due an agency position first articulated in a legal brief.

Expedience Versus Fairness and Reliability

In sum, it seems quite clear that at both the IRS and the Labor Department many very fundamental issues are being handled with less formal authority. It is easy to explain why these informal authorities are favored by the agencies—the agencies can more quickly respond to questions in this fashion. Certainly, in some areas the quick answer is appropriate, if only to fire an early warning shot for adventuresome taxpayers or plan sponsors. Doubtless, the Service wishes it had published some early VEBA rulings to fend off *General Signal*-type deduction claims. In the long run, however, it is doubtful this continued use of these lesser authorities saves the agencies any time. Practitioners are never quite sure whether a particular ruling is the real thing or an outlier. Even where there are favorable private rulings on point, taxpayers will be compelled to seek their own rulings.

Overuse of these secondary authorities also raises questions of fairness, especially on tax issues. The Service views that they have spoken on an issue and can feel free to say, "I told you so," if they proceed against some future taxpayer based on the positions announced in these rulings. Taxpayers, on the other hand, cannot safely rely on these authorities in court since a private ruling or technical advice memo is binding only on the taxpayer obtaining the ruling. The Service is in a win-win situation—they can point to a ruling when it is to their advantage and can freely distance themselves from these positions when they need to.

So what is the right answer? Certainly we are not advocating the elimination of these rulings, nor that they should be hidden from public view. It would help practitioners if some of these key issues get handled at a higher level of review and work themselves into more general pronouncements. The playing field also could be leveled by allowing taxpayers to rely on these authorities. For whatever reason, and apparently without Labor Department endorsement, the courts have come to elevate the importance of DOL advisory letters to a fairly lofty state, with a line of cases holding that these letters should be accorded judicial deference as indicative of the Department's position.

The courts have reached this conclusion despite the clear statement in the Labor Department's advisory opinion procedure that these letters are applicable only to the applying party. In all likelihood, the courts have elevated the importance of these rulings out of desperation because of the dearth of formal guidance from the

Department. If the IRS is going to channel more and more important answers into secondary authorities, perhaps the same rule should apply to IRS rulings as well so that taxpayers can rely on those rare rulings that fall in their favor.

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