

DON'T LEAVE MONEY ON THE TABLE! IRS [MIS]COMPUTATION OF INTEREST

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After resolving federal tax deficiencies or refunds, taxpayers and their representatives must still carefully examine IRS computations of interest, which are frequently wrong. This outline addresses the basis framework for interest computation, common IRS mistakes (for which the law is clear), disputed issues (for which the law is not entirely clear), and certain procedural issues.

1. Basic framework for interest computation

a. Interest payable by taxpayers, on underpayments of tax.

- i. Note: underpayment interest is assessed, collected, and paid in the same manner as taxes, and it is included in most references to “tax” in the Code. But it is not subject to deficiency procedures. IRC § 6601(e)(1).
- ii. General rule – interest is payable on any amount “not paid on or before the last date prescribed for payment” from the last date prescribed for payment to “the date paid.” IRC § 6601(a).
 1. Generally, this is the original due date for filing the return, without regard to any extensions and without regard to an installment agreement to pay the tax due. IRC § 6601(b)(1).
 2. But courts and the IRS recognize that sometimes there is no amount due as of the due date of the return, but an underpayment balance may arise later. In that case, the interest computation period starts when the “tax becomes both due and unpaid.” *Avon Prods., Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978). This can be later than the due date of the return if, for example, the cumulative amount paid drops below the tax due, as result of a refund or credit. See the discussion of “annual netting,” 1.d below, and the discussion of “credit elect transfers,” 2.a below, for examples.
 3. If the amount due is paid by crediting an overpayment due the taxpayer for another tax period, IRC § 6402(a), underpayment interest stops as of the later of:

- a. The “last date prescribed for payment” of the underpayment
- b. The date that interest would begin accruing on the overpayment.

IRC § 6601(f). The two provisions combine to stop underpayment interest in one period and overpayment interest in the other period at the same time. The actual date that the IRS processes the credit is irrelevant.

4. However, if the amount due is paid by crediting an overpayment due another taxpayer – at the taxpayers’ request, since the IRS has no authority under IRC § 6402(a) to make such a credit – the date that the IRS makes the credit is considered the “date paid” for purposes of interest on the underpayment and the date refunded for purposes of interest on the overpayment. In effect, the credit is treated as a simultaneous refund of the overpayment and payment of the underpayment.

iii. Penalties

1. Interest on accuracy-related penalties, fraud penalties, and penalties for failure to file or failure to pay is computed from the return due date, including extensions, until the date paid. IRC § 6601(e)(2)(B).
2. Interest on other assessable penalties or additional amounts is computed only from the date of notice and demand until the date paid. But if payment is made within 21 days of notice and demand (10 business days if the amount is at least \$10,000), no interest is due. IRC § 6601(e)(2)(A).

- iv. Carrybacks – if there is a net operating loss carryback, capital loss carryback, foreign tax credit carryback, or business credit carryback to a taxable year, the resulting decrease in tax for that taxable year “shall not affect the computation of [underpayment] interest” for the period ending with the return due date (determined without regard to extensions) of the year in which the loss/credit arose and from which it was carried back. IRC § 6601(d).

1. This is an awkward way of saying that the tax balance in the year to which a loss/credit is carried back (the “carryback year”) is treated as changing on the return due date of the year in which the loss/credit year arose (the “source year”), rather than the return due date of the carryback year.

2. This rule was originally developed through case law and was applied somewhat more broadly than what was eventually enacted in IRC § 6601(d), to cover not just carrybacks but also the secondary effects of the carrybacks. Any effect that is “directly attributable” to the carryback also is treated as changing the tax liability as of the return due date for the source year. *See* Rev. Rul. 85-65, 1985-1 C.B. 366; G.C.M. 39,359 (May 14, 1984).
 - a. The most common such effect is “credit bumping.” For example, if a loss/credit carryback from 2014 to 2012 triggers a credit carryback from 2012 to 2010, the effective date of the resulting change to the tax liability for 2010 is the return due date for 2014, not the return due date for 2012.
 3. This rule regarding carrybacks applies in both directions – both a reduction in tax liability (and therefore a decrease in the underpayment balance) resulting from the original carryback, and an increase in tax liability (and therefore an increase in the underpayment balance) resulting from a reduction of the carryback on audit.
- v. Restricted interest – situations in which the taxpayer need not pay interest on an underpayment of tax
1. Form 870 waiver: When resolving a tax dispute, the taxpayer may agree to sign Form 870 or Form 870-AD, consenting to an immediate assessment of the deficiency and waiving the 90-day period within which to petition the Tax Court. IRC § 6213(d). The expectation is that the IRS will immediately assess the deficiency and make notice and demand for payment. But if the IRS does not make notice and demand for payment within 30 days after the waiver is filed, underpayment interest is suspended for the period starting on the 31st day and ending when the IRS finally makes notice and demand. IRC § 6601(c).
 2. Payment back-off period: For any amount that is paid within 21 calendar days (or 10 calendar days if the amount is \$100,000 or more) of notice and demand, no underpayment interest is imposed for the period after notice and demand. IRC § 6601(e)(3).
- b. Interest payable to taxpayers, on overpayments of tax
- i. Note: Overpayment interest is **not** considered part of the tax liability. Further, if the IRS pays overpayment interest to the taxpayer and then

determines that too much was paid – for example, because the overpayment was reduced by a later deficiency determined on audit – the IRS cannot use assessment procedures to collect that excessive amount. The only alternatives are an erroneous refund suit or offset against a refund for the same type of tax and the same tax period.

ii. General rule

1. If the overpayment is refunded, interest is payable for the period from the date of the overpayment to the date refunded, but with an interest-free period as discussed below. IRC § 6611(b)(2).
2. If the overpayment is credited to another tax period for which the taxpayer owes the government an underpayment, interest is payable for the period from the date of the overpayment to the due date of the underpayment for the other tax period. IRC § 6611(b)(1). There is a reciprocal provision regarding underpayment interest due on the underpayment in that other tax period, IRC § 6601(f), discussed above. The two provisions together result in stopping underpayment interest in one period and overpayment interest in the other period at the same time. The actual date that the IRS processes the credit is irrelevant.
3. Taxpayers typically make multiple payments on their tax liability, at different times. The “dates of the overpayment” for purposes of computing overpayment interest are the dates of: (a) the first payment resulting in cumulative payments in excess of the tax liability; and (b) all subsequent payments. Treas. Reg. § 301.6611-1(b). For any payments made early – return filed early, withholding, estimated tax, etc. – the date of the payment is considered to be the unextended return due date of the return. Treas. Reg. § 301.6611-1(d).
4. However, an overpayment can also begin after all payments by the taxpayer. For example, the tax liability may decrease, below the level of the amounts paid by the taxpayer, effective as of a later date because of a carryback. See following discussion. In such situations, overpayment interest begins to accrue as of the date when the tax liability as revised is less than the amount of payments before that date.

- iii. Carrybacks – if there is a net operating loss carryback, capital loss carryback, foreign tax credit carryback, or business credit carryback to a taxable year, a resulting overpayment is deemed not to have been made before the unextended return due date for the taxable year in which the loss or credit carried back arose. IRC § 6611(f).

1. As with the equivalent provision for underpayment interest, this is an awkward of saying that the effective date of the tax balance doesn't change as a result of the carryback until the return due date of the source year, rather than the return due date of the year to which it is carried back. The original judicial rulings to this effect before the enactment of IRC § 6611(f) are somewhat broader. The IRS generally computes interest consistently with the case law, even when it is not clear that the situation falls within the literal terms of IRC § 6601(d). As with underpayment interest, the rule applies to both carrybacks (which reduce the tax liability and therefore increase the amount of an overpayment) and later recovery of such carrybacks (which increase the tax liability and therefore decrease the amount of an overpayment).
- iv. Restricted interest – situations in which the government need not pay interest on an overpayment of tax
1. Refund back-off period: To give the IRS time to process refunds, no interest is due for a period “preceding the date of the refund check by not more than 30 days.” IRC § 6611(b)(2). Under current administrative practice, IRM 20.2.4.7.1.1 (2) (9/30/2010), this interest-free period starts:
 - a. Nine days before the refund check date for computer-generated refunds from Business Master File accounts.
 - b. Thirteen days before the refund check date for computer-generated refunds from Individual Master File accounts.

An additional seven days is added to the back-off period if the refund will be direct deposited. There is no refund back-off period for manual refunds.
 2. No interest is payable on any overpayment that is refunded within 45 days after the later of: (a) the return due date, including extensions; or (b) the date the return is actually filed. IRC § 6611(e)(1).
 3. If IRS refunds an overpayment within 45 days after the taxpayer filed the refund claim, no interest is payable on the overpayment for the period after the date the refund claim was filed. IRC § 6611(e)(2). However, overpayment interest is still due the taxpayer for the period from the unextended return due date for the taxable year until the date the refund claim was filed.

4. For IRS-initiated adjustments – refunds other than as requested by the taxpayer on a return or refund claim – there is an additional back-off period of 45 days before the date to which interest would otherwise be computed. IRC § 6611(e)(3).
- c. Interest rates are determined and published by the IRS on a quarterly basis. IRC § 6621(b). The interest rates are:
- i. For underpayments
 1. General rate – the Federal short-term rate plus 3%.
 2. For “large corporate underpayments,” the applicable interest rate is the Federal short-term rate plus 5% for periods after the “applicable date.” IRC § 6621(c)(1). This higher interest rate is often referred to as “hot interest” or “LCU interest.”
 - a. A “large corporate underpayment” is an underpayment of tax by a C corporation that exceeds \$100,000. IRC § 6621(c)(3)(A).
 - b. The “applicable date” is the 30th day after the earlier of the date of a 30-day letter or the date of a notice of deficiency. IRC § 6621(c)(2). If deficiency procedures did not apply to the particular underpayment, the date of the first notice of assessment or proposed assessment is substituted.
 - i. Once hot interest is triggered, it applies to all underpayments outstanding for periods after the applicable date. Thus, even if the taxpayer pays the balance due shown on the letter or notice, hot interest would apply to underpayment balances determined in future letters or notices.
 - ii. Hot interest is intended as an incentive for corporations to promptly pay any large underpayment balances due the government. Payment within 30 days avoids further interest charges, while if the taxpayer does not pay within 30 days, the interest rate is increased.
 - c. If the letter or notice is withdrawn by the IRS, that letter or notice does not trigger hot interest.
 - d. If, within 30 days of any such letter or notice, the taxpayer pays the amount due in full, that letter or notice is

disregarded for purposes of hot interest. IRC § 6621(c)(2)(B)(ii).

- e. Any such letter or notice is also disregarded if the amount of the proposed deficiency is not greater than \$100,000. IRC § 6621(c)(2)(B)(iii).
- f. The Regulations define a “threshold underpayment,” equivalent to the excess of the tax liability for that period over the amount paid on or before the last day prescribed for payment, for purposes of determining whether hot interest is triggered. Treas. Reg. § 301.6621-3(b)(2)(ii). Thus, the proposed deficiency/underpayment may be less than \$100,000 but still trigger hot interest, if the proposed deficiency would have been greater than \$100,000 before a payment made by the taxpayer after the last day prescribed for payment, e.g., with an amended return.
- g. The threshold underpayment is determined only when there is an eventual assessment. Treas. Reg. § 301.6621-3(b)(2)(iii)(A). Thus, even if the IRS issues a letter or notice with a proposed deficiency greater than \$100,000, there is no threshold underpayment if the IRS later reduces that amount below \$100,000 before assessment.
- h. Similarly, if the federal court later reduces the amount of the tax liability, so that the threshold underpayment is reduced below \$100,000, hot interest does not apply. Treas. Reg. § 301.6621-3(b)(2)(iv).

ii. For overpayments

- 1. General rate – the Federal short-term rate plus 2% for corporations, or the Federal short-term rate plus 3% for other taxpayers.
- 2. Overpayments of tax by a corporation that exceed \$10,000 earn interest for periods after 12/31/94 at the Federal short-term rate plus 0.5%. IRC § 6621(a)(1), flush language. This lower interest rate is often referred to as “GATT interest.” It was enacted by 103 Pub. L. 465 (12/8/94), § 713(a), as a revenue enhancer to offset the effects of implementing the Uruguay Round of the General Agreement on Tariffs and Trade.

iii. Interest is compounded daily. IRC § 6622.

- iv. The difference between the overpayment interest rate and the underpayment interest rate
 - 1. There is no difference for taxpayers other than C corporations – both the underpayment rate and the overpayment rate are the Federal short-term rate plus 3%.
 - 2. For C corporations, the difference will range from 1% (if the general rate applies to both) to 4.5% (the difference between “hot interest” and “GATT interest”).

d. “Annual netting”

- i. There may be multiple changes to a taxpayer’s tax liability for a particular year. After the original return is filed, there may be carrybacks from subsequent years, refund claim(s), deficiencies determined in an audit, etc.
- ii. Initially, the IRS treated such changes – with related payments or refunds – as totally separate transactions and computed interest on each transaction in isolation.
- iii. It is now widely accepted, however, that interest is properly computed not separately for each transaction but on the **balance** in the taxpayer’s account for a given tax period. *See, e.g., Central Fibre Prods. Co. v. United States*, 115 F. Supp. 147 (N.D. Ill. 1953); *Avon Prods., Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); *May Dep’t Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), *acq.*, 1997-2 C.B. 1. All the transactions for that year are netted together, and interest is recomputed each time the tax liability changes or a payment or refund is made.
- iv. As a result, even if no interest is due on an underpayment or overpayment transaction, for reasons noted above, the transaction can provide a **tax benefit** by reducing another balance on which interest is due. For example:
 - 1. The taxpayer files its original return for the 2011 tax year on March 15, 2012, showing tax liability of \$200,000, payments of \$300,000, and a refund due of \$100,000. The IRS pays the refund on April 28, 2012. The IRS does not pay overpayment interest on the refund because it was refunded within 45 days. IRC § 6611(e)(1). But there was an overpayment balance of \$100,000 from the period from March 15, 2012, until April 28, 2012, when the refund was made.
 - 2. The IRS later conducts an audit and determines that the proper tax liability was \$290,000, resulting in a deficiency of \$90,000. The taxpayer concedes and pays the deficiency on July 5, 2014.

3. The balance for the period from March 15, 2012, to April 28, 2012, is a net overpayment of \$10,000.
 - a. The revised tax liability is \$290,000. The net amount paid, before the refund on April 28, 2012, is \$300,000. Thus, until April 28, 2012, the taxpayer has overpaid its taxes by \$10,000.
 - b. This balance includes both the original overpayment of \$100,000 (because not refunded until April 28, 2012) and the subsequent deficiency of \$90,000.
4. The balance for the period from April 28, 2012, until the payment of the deficiency on July 5, 2014, is an underpayment of \$90,000.
 - a. The revised tax liability is \$290,000. After the refund on April 28, 2012, the net amount paid is \$200,000. Thus, after the refund, the taxpayer has underpaid its taxes by \$90,000.
 - b. This balance includes only the subsequently determined deficiency, because the overpayment was refunded on April 28, 2012.
5. Without annual netting, the taxpayer would pay underpayment interest on the \$90,000 deficiency starting from March 15, 2012, even though there was no net underpayment balance until April 28, 2012, when the IRS refunded the overpayment shown on the return.
6. As a result of annual netting, the taxpayer instead pays underpayment interest on the balance of \$90,000 only from April 28, 2012, to July 5, 2014. Although the original \$100,000 overpayment does not earn overpayment interest during the period from March 15, 2012, to April 28, 2012, it does provide a **tax benefit** by reducing the amount of the underpayment balance that earns underpayment interest.
7. Annual netting also eliminates the difference between the underpayment interest rate and the overpayment interest rate on overlapping transactions for corporations, because there is only one net balance – overpayment or underpayment – during any period.

- e. Global interest netting (aka “net interest rate of zero”) – applicable to corporations only
 - i. As noted above, the interest rates for overpayments and underpayments may be different at any given time for a corporate taxpayer. The difference can range from 1% (based on the general rates) up to 4.5% (if both “hot interest” and “GATT interest” apply).
 - ii. Taxpayers often may have an underpayment balance in one tax year and an overpayment balance in another tax year (or for another type of tax), both outstanding for the same period of time. As a result of the difference in rates, even if the underpayment and overpayment balances were exactly the same, a corporate taxpayer could wind up owing the government more underpayment interest than the government owes the taxpayer for overpayment interest. Annual netting eliminates this problem only if both transactions involved the same type of tax and the same tax year.
 - iii. Congress enacted IRC § 6621(d) to solve this problem more broadly than annual netting. It provides: “To the extent that, for any period, interest is payable [on an underpayment] and allowable [on an overpayment] on equivalent underpayments and overpayments by the same taxpayer of tax . . . , the net rate of interest under this section on such amounts shall be zero for such period.”
 - iv. IRC § 6621(d) applies to interest for periods beginning after July 22, 1998, the date of enactment. 105 Pub. L. 206, § 3301(a). (The IRS has interpreted “periods” as equivalent to calendar quarters; therefore, “periods **beginning after** July 22, 1998” means periods beginning October 1, 1998, or later. *See* Rev. Proc. 99-43.) There is a special transitional rule, 105 Pub. L. 206, § 3301(c)(2), that also allows global interest netting for earlier periods:
 - 1. “Subject to any applicable statute of limitations not having expired with regard to either a tax underpayment or a tax overpayment,” and
 - 2. If the taxpayer reasonably identifies and establishes the periods for which global interest netting should apply, and
 - 3. If the taxpayer filed a request by December 31, 1999, to apply IRC § 6621(d) to such periods.
 - v. Global interest netting is implemented by changing the interest rate used (for part or all of the balance) in one of the two years. For example, the IRS could increase the overpayment interest rate, in the year with an overpayment balance, to the higher underpayment interest rate. Or the

IRS could decrease the underpayment interest rate, in the year with an underpayment balance, to the lower overpayment interest rate. Under either approach, the interest rate would be the same in both years.

f. Deposits versus payments

- i. Neither the Code nor the Regulations mention the concept of a “deposit,” as opposed to a “payment.” However, the IRS has recognized “deposits” as a matter of administrative practice for many years.
- ii. The primary differences between a deposit and a payment are:
 1. The IRS will return a deposit on request. The taxpayer must file a refund claim/suit, and prove the existence of an overpayment, to recover a payment.
 2. If the IRS or a court finally determines that additional tax was due, both a deposit and a payment will prevent the accrual of underpayment interest from the date of remittance.
 3. If the IRS or a court finally determines that there was no additional tax due, the IRS will refund the payment and pay overpayment interest on the refund. But there is no interest paid on the return of a deposit. In effect, the deposit was an interest-free loan to the government.
 4. If a deposit is returned at the taxpayer’s request, and the IRS later determines additional tax was due for that tax year, the deposit does not prevent the accrual of underpayment interest **even during the time that the IRS held the money.**
 5. The distinctions are discussed and explained in *Ford Motor Co. v. United States*, 768 F.3d 580 (6th Cir. 2014).
 6. The IRS procedures governing deposits, prior to the American Jobs Creation Act of 2004, are set forth in Rev. Proc. 84-58.
- iii. In 2004, Congress enacted IRC § 6603, which provides statutory authority for the treatment of deposits.
 1. It also, for the first time, required the IRS to pay interest on a deposit returned to the taxpayer on request. The applicable interest rate is the Federal short-term rate. IRC § 6603(c), (d)(4).
 2. However, interest is paid only if the deposit was “attributable to a disputable tax” – the reasonable estimate, as of the date of the

deposit, of the maximum tax that would result from disallowing items with respect to which both the taxpayer and the IRS had a reasonable basis. IRC § 6603(d). The amount of a proposed deficiency in a 30-day letter automatically qualifies as a disputable tax.

3. The IRS procedures applicable to deposits under IRC § 6603 are set forth in Rev. Proc. 2005-18.
- iv. Neither Rev. Proc. 84-58 nor Rev. Proc. 2005-18 contemplate that a taxpayer might initially make a deposit and later request that the deposit should be treated as a payment instead.

2. Miscomputation of interest – mistakes

a. “Credit elect transfers”

- i. Taxpayers can elect on their return to have an overpayment applied to the next year’s estimated taxes. IRC § 6402(b). In such cases, no overpayment interest is paid on the overpayment. Treas. Reg. §§ 301.6402-3(b)(5); 301.6611-1(h)(2)(vii).
- ii. If the IRS subsequently determines a deficiency for the first year, underpayment interest depends on when the “tax becomes both due and unpaid.” *Avon Prods., Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978). When it becomes unpaid depends on the effective date of the transfer of the amount shown on the return to the next year’s account for estimated taxes.
 1. Taxpayer’s return for 2012 shows tax liability of \$150,000 and payments of \$160,000. Taxpayer elects on the original return to have the \$10,000 overpayment applied to 2013’s estimated taxes.
 2. Later, the IRS conducts an audit and determines that the correct tax liability for 2012 was \$158,000. As of the original return due date, the tax was not due and unpaid, as Taxpayer had paid \$160,000 – more than the revised tax liability.
 3. The tax is “unpaid,” and interest begins running on the deficiency of \$8,000, only when the cumulative payments are reduced to \$150,000 by the \$10,000 credit transferring the original overpayment to the 2013 tax year. Therefore, we need to know the effective date of the credit elect transfer to know when underpayment interest should start. If the overpayment had been refunded, underpayment interest on the subsequently determined

deficiency would start as of the date of the refund – but what is the effective date of a credit elect transfer?

- iii. Neither the Code nor the Regulations defined the effective date of such credit elect transfers. But the IRS treated the transfer as having been made on the due date of the first installment of estimated taxes for the following year (2013 in the example above). This starts underpayment interest on the deficiency (in the 2012 tax year in the example above) at the earliest possible date and thus maximizes the interest Taxpayer has to pay the IRS.
- iv. In a series of cases, courts decided that the effective date of the credit elect transfer should instead be treated as the due date of the first installment of estimated taxes **for which the transfer was required to avoid the penalty on late payment of estimated taxes** under IRC §§ 6654, 6655. *May Dep't Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), *acq.*, 1997-2 C.B. 1; *Kimberly-Clark Tissue Co. v. United States*, 1997 U.S. Dist. LEXIS 3100 (E.D. Pa. Mar. 18, 1997); *Sequa Corp. v. United States*, 1996 U.S. Dist. LEXIS 5288 (S.D.N.Y. Apr. 19, 1996). If the credit elect was not needed to satisfy any of its estimated tax payments, the effective date is treated as the return due date for the following year.
- v. The correct way to determine the effective date thus is:
 1. Determine the cumulative amount of estimated taxes required as of the due date for each installment.
 2. Determine the cumulative amount paid by the taxpayer – without the credit elect transfer – as of the due date for each installment.
 3. Treat the credit elect transfer as taking place as of the due date for the first installment(s) for which the cumulative amount paid is less than the cumulative estimated tax obligation.
- vi. The IRS now applies this approach, which it sometimes refers to as “*May/Sequa*.” But the IRS personnel computing interest usually won’t have access to a Form 2210 or 2220 for the second year, so they have to make an assumption about the amount of estimated taxes due for each installment. Because there are alternative ways to calculate the required payment by installment, such as the annualized income method, or just because they forget to apply the “*May/Sequa*” approach, the IRS may use the wrong effective date for the transfer or may just treat it as effective as of the due date for the first installment. That usually will mean computing too much underpayment interest.

- b. Carryback analysis
 - i. As noted above, all changes to tax liability that result from or are attributable to a carryback are treated as effective on the unextended return due date for the year in which the loss/credit arose. The IRS reflects its timing analysis on Form 2285.
 - ii. Particularly for complex situations with multiple carrybacks from multiple years, the IRS analysis or application of the effective dates may be incorrect.
 - iii. Taxpayers or their representatives should always carefully review the IRS timing analysis, particularly if there have been multiple adjustments for that tax year.
- c. Hot interest – corporations only
 - i. The rules for hot interest (see above) are complex and depend on information that may not be reflected properly in the account transcript. Hot interest is often applied when it should not be or begins before it should. Taxpayers or their representatives should always carefully review any application of hot interest and verify the factual information on which it is based.
- d. Credit transfers
 - i. The IRS has the discretion to transfer an overpayment in one tax year to another tax year with an underpayment. But if the effective date of the transfer is not the same for both years, the taxpayer may not receive full benefit from the overpayment.
- e. Refund check dates
 - i. The IRS computer system normally computes interest properly on computer-generated refunds. However, the IRS must enter “transaction code 840” in the transcript to properly compute interest on manual refunds. The date of that transcript entry is often inaccurate. Taxpayers or their representatives should check the transcript date and the interest computations to ensure that interest is computed up until the date of the wire transfer or the date on the manual check.
- f. Suspensions of overpayment interest
 - i. Refund back-off periods: For computer-generated refunds, overpayment interest is suspended for a specified period before the date of the refund check – nine days for Business Master File accounts and thirteen days for

Individual Master File Accounts. There is an additional back-off period of seven days if the refund is direct deposited. The IRS usually suspends overpayment interest for the back-off periods properly.

- ii. Timely refunds: If the IRS refunds an overpayment shown on the return within 45 days of the later of the original due date or the actual filing date, no overpayment interest is paid. If the IRS refunds an amount shown on a refund claim within 45 days of the date the claim was filed, no overpayment interest is paid after the date the claim was filed.
- iii. The IRS usually suspends overpayment interest properly for these periods. However, if a deficiency is later assessed, underpayment interest – on an underpayment up to the amount of the previous refund – should also be suspended during the same period. This is a basic consequence of the annual interest netting concept, described above. At one time, the IRS occasionally neglected to apply annual netting properly in these situations. This has been less of a problem in recent years, after the IRS changed its interest computation software, but taxpayers should still check to make sure this was handled properly.

g. Suspensions of underpayment interest

- i. Timely payment: If the taxpayer pays an assessment within 21 calendar days (or ten business days if the assessment is greater than or equal to \$100,000) from the date of notice and demand, no underpayment interest should be imposed from the date of notice and demand to the date of payment.
- ii. Form 870 waivers: If the taxpayer consents to immediate assessment of a proposed deficiency, waiving the right to contest the deficiency in Tax Court, the IRS should make the assessment and issue notice and demand for payment within 30 days. If it does not, no underpayment interest should be imposed from 30 days after the date of the Form 870 until the date of notice and demand.
- iii. Underpayment interest on the assessment amount should be, but is not always, suspended during these periods.

h. Penalties

- i. Interest on accuracy-related penalties, fraud penalties, and penalties for failure to file or failure to pay is computed from the return due date, **including** extensions.
- ii. Interest on certain other penalties is due only from the date of notice and demand, and no interest is due at all if the penalties are paid within 21

days of notice and demand (or 10 business days if the amount is at least \$100,000).

- iii. The IRS sometimes mistakenly computes interest from the return due date **without** extensions, which is the general rule for interest on tax liabilities, rather than from the extended return due date or the date of notice and demand.

- i. Deposits

- i. Because of the different treatment of deposits versus payments, taxpayers should carefully consider which is more appropriate for their circumstances and then verify that the remittance was properly classified in IRS interest computations.

- 3. Miscomputation of interest – disputed issues

- a. Hot interest – corporations only

- i. Neither the Code nor the Regulations address a situation in which a corporation initially underpays tax by more than \$100,000 but then carries back a tax loss or other item, reducing the underpayment below \$100,000. Is the threshold for hot interest measured *before* carrybacks (so that hot interest would apply in this situation) or measured *after* carrybacks (in which case hot interest would not apply)?
 - ii. The Tax Court addressed the issue in *Med James, Inc. v. Comm’r*, 121 T.C. 147 (2003) and concluded that for purposes of determining whether hot interest applied, the IRS must take into account carrybacks if the carrybacks were pre-assessment.
 - iii. The IRS Office of Chief Counsel disagreed with the Court’s ruling, in CCA 201120026 (May 20, 2011), indicating that the IRS will continue litigating the issue. Chief Counsel concluded that a carryback is the same as a “payment,” and payments after the return due date do not reduce the “threshold underpayment.” This is a highly questionable conclusion.

- b. Netting – corporations only

- i. “Same taxpayer”

- 1. IRC § 6621(d) allows netting on equivalent underpayments and overpayments “by the same taxpayer,” but does not define “same taxpayer.”

2. The IRS initially interpreted “same taxpayer” broadly, in FSA 200212028:
 - a. Consolidated groups:
 - i. An overpayment by subsidiary A (e.g., on an excise tax return) and an underpayment by the consolidated group cannot be netted if the group’s underpayment arose prior to A joining the group, because subsidiary A was not jointly and severally liable for the consolidated group’s underpayment. *Situations 3 and 4*. This implies that an overpayment by a subsidiary can be netted against the group’s underpayment if the subsidiary was part of the group for the tax year in which the underpayment arose.
 - ii. It is “theoretically possible” that an underpayment by subsidiary A and an overpayment by the consolidated group could be netted if facts and circumstances showed that the overpayment is attributable to the subsidiary A. *Situations 1 and 2*.
 - iii. An underpayment of the consolidated group cannot be netted against overpayments by a subsidiary that is not a member of the consolidated group, because the subsidiary is not jointly and severally liable for the group’s underpayment. *Situations 8 and 9*.
 - b. Mergers:
 - i. An overpayment by company A and an underpayment by company B, both prior to the A-B merger, can be netted if B is no longer in existence, because A assumed B’s liabilities as a matter of law. *Situations 5 and 7*.
 - ii. If A and B both survived the merger, however, their pre-merger overpayments and underpayments cannot be netted, because they remain separate taxpayers. *Situation 6*.
3. The IRS also addressed the possibility of netting a consolidated group’s overpayment with a subsidiary’s underpayment in CCA 200411003. The CCA concluded that the subsidiary would be considered the “same taxpayer” with respect to its own

underpayment and its “share” of the group’s overpayment. This went beyond the “theoretically possible” statement in FSA 200212028. It implied that all that was necessary was that the facts and circumstances supported allocation of a certain part of the group’s overpayment to the subsidiary.

4. The IRS later issued CCA 200707002, which undermined both FSA 200212028 and CCA 200411003. It concluded that a subsidiary could not net its own underpayment against the group’s overpayment: “Given that a consolidated return is a combined return for multiple corporations, all of which are liable for the associated tax, and any overpayment is not deemed an overpayment of any single member, there does not appear to be a basis to treat a member with a separate underpayment as the same taxpayer responsible for a consolidated overpayment.”
5. In recent litigation, the government has taken the position that netting is only permissible if both the overpayment and the underpayment are for tax returns filed under the same TIN. In fact, the government has suggested that a consolidated group cannot net its overpayment for one tax year against its underpayment for another tax year unless the consolidated group is **exactly identical** – that is, the same subsidiaries are included in the group – in both years. Effectively, this radical position would eliminate the benefits of global interest netting for many large consolidated groups. However, no courts have accepted this view to date.
6. In *Energy East Corp. v. United States*, 645 F.3d 1358 (Fed. Cir. 2011), the consolidated group sought to net its underpayment for the 1999 tax year with overpayments by two subsidiaries in 1995-97. However, the subsidiaries did not join the consolidated group until 2000 and 2002.
 - a. Under FSA 200212028, netting would have been permissible if the underpayment by the consolidated group had **arisen** in tax years after the subsidiaries had joined the group. The basis for that conclusion was that the subsidiaries are jointly and severally liable for the group’s underpayment. However, the government has retreated from that interpretation.
 - b. The taxpayer argued for an extension of the principle under the FSA: that netting would be permissible if the overpayment and underpayment balances were **outstanding** while the subsidiaries were part of the

consolidated group. The court disagreed and ruled for the government.

7. In *Magma Power Co. v. United States*, 101 Fed. Cl. 562 (2011), the taxpayer sought to net its underpayment (for a year in which it was an independent corporate entity) with the overpayment of a consolidated group for a year in which the taxpayer had been included in the group. The court held that the subsidiary and consolidated group should be considered the same taxpayer “to the extent the consolidated group’s overpayment can be traced to the company.”
 - a. This conclusion is consistent with the analysis in FSA 200212028, Situations 1 and 2, and CCA 200411003.
 - b. As with those earlier rulings by the IRS, the court’s decision did not directly decide whether the facts and circumstances in this particular case would support a conclusion that the consolidated group’s overpayment was attributable to the subsidiary. But the court did allow the principle.
8. In *Wells Fargo v. United States*, 2014 WL 5318260 (Fed. Cl. Oct. 20, 2014), the court addressed netting of balances by predecessors of the surviving corporation in a statutory merger. The taxpayer argued for netting because the entities became one and the same entity as a matter of law. The court rejected the government’s argument that “same taxpayer” meant the same TIN at the time the overpayment or underpayment balances arose.
 - a. This conclusion is consistent with the analysis in FSA 200212028, Situations 5 and 7.
 - b. In this amended opinion – the original opinion is at 117 Fed. Cl. 30 (June 27, 2014) – the court certified the “same taxpayer” question for immediate appeal. We may have guidance from the Federal Circuit on this issue soon.

ii. Direction of netting

1. Global interest netting requires that the interest rates, in the two years netted against each other, be equalized. But the Code does not specify how interest rates are to be equalized.
2. This could be accomplished by either increasing the rate for overpayment interest in one year or decreasing the rate for

underpayment interest in the other year. Logically, the change can be accomplished in either year, as long as the relevant statute of limitations is still open.

3. Under Rev. Proc. 99-43 and 2000-26, the IRS will generally equalize by decreasing the rate for underpayment interest. The IRS will only equalize by increasing the rate for overpayment interest if, when the netting claim is filed, the statute of limitations is open for the tax year with the overpayment balance and closed for the tax year with the underpayment balance.
4. There is no statutory authority for the IRS preference, if the statutes of limitations are open for both years, to equalize by decreasing the rate for underpayment interest. Depending on the circumstances, it may be to the taxpayer's benefit to equalize the overpayment rate instead.

iii. Use of closed tax years (transitional rules)

1. Global interest netting involves two different tax periods – one with an overpayment balance and one with an underpayment balance.
2. For periods beginning after July 22, 1998, netting is permitted as long as the statute of limitations (for a refund of underpayment interest or recovery of additional overpayment interest) is still open for **either** of the two tax periods.
3. For periods beginning before July 22, 1998, the transitional rule states that netting is permitted “[s]ubject to any applicable statute of limitations not having expired with regard to either a tax underpayment or a tax overpayment.”
4. The IRS interprets this as meaning the applicable statute of limitations must be open for **both** tax periods to allow netting for period beginning before July 22, 1998.
5. The Federal Circuit agreed that both statutes of limitation must be open, in *Fed. Nat’l Mortg. Ass’n v. United States*, 379 F.3d 1303 (Fed. Cir. 2004).
6. But more recently the Second Circuit concluded that only one of the two statutes of limitation must be open, in *Exxon Mobil Corp. v. Comm’r*, 689 F.3d 191 (2d Cir. 2012).

iv. Use of interest-free periods

1. Netting equalizes the interest rates in the tax years being netted. If overpayment balances on which interest was not allowed can be netting against underpayment balances on which the taxpayer paid interest, the taxpayer would save the entire amount of underpayment interest paid for the period of overlap rather than just the differential between the overpayment rate and the underpayment rate.
2. The Court of Federal Claims concluded, in *Computervision Corp. v. United States*, 62 Fed. Cl. 299 (2004), that netting is only permitted if interest is “payable” on an underpayment and “allowable” on an overpayment. Thus, if the IRS refunded an overpayment without interest, that balance cannot later be used for global interest netting.
3. Although there is no case law supporting netting against an interest-free period, under appropriate circumstances it may be worthwhile for a taxpayer to argue for this approach.

c. Credit application ordering

- i. Annual netting is well established, but those cases did not resolve a question that sometimes arises when there is a net overpayment balance resulting from multiple transactions, including a refund without interest, a refund with interest, and an assessment. For example:
 1. The taxpayer timely files its 2008 tax return on 9/15/09, showing tax liability of \$320,000, payments of \$370,000, and an overpayment of \$50,000. The IRS refunds the \$50,000 on 10/15/09, within the 45-day period, without interest.
 2. The taxpayer files a refund claim on 5/15/11 and the IRS abated tax of \$60,000, refunded on 6/5/11. (That is, the proper tax liability was \$260,000.) Because the refund was within 45 days of the refund claim, interest is payable from 3/15/09 to 5/15/11 but not from 5/15/11 to 6/5/11.
 3. On 8/20/12, there was a tax assessment of \$75,000. (That is, the proper tax liability was \$335,000).
 4. For the period from 3/15/90 to 10/15/90, before the refunds, there was a net overpayment balance of \$35,000 (proper tax liability of \$335,000 and payments of \$370,000). This net overpayment balance includes or is composed of:

- a. The \$50,000 overpayment on the original return, which did not earn interest because it was refunded timely.
 - b. The \$60,000 overpayment, which did earn interest during the period 3/15/90 to 10/15/90.
 - c. The \$75,000 underpayment, on which underpayment interest would be due.
- 5. When recomputing interest for the tax year, is overpayment interest due the taxpayer for the \$35,000 net balance for the period from 3/15/90 – 10/15/90? Is the net overpayment balance part of the \$50,000 overpayment on the original return (in which case the government would not pay overpayment interest on the net overpayment balance)? Or is it part of the later \$60,000 overpayment (in which case the government should pay overpayment interest on the net overpayment balance)?
 - ii. There is no clear answer to this questions and no neutral ordering rule that would determine which overpayment transaction is the source of the net balance.
 - iii. The government takes the position that in these situations, it must pay the taxpayer overpayment interest only on the portion of the net balance in excess of the amount of the overpayment transaction that was not entitled to interest when originally refunded. In other words, the assessment is applied first against the overpayment transaction that is entitled to interest and the net balance comes first from the overpayment transaction that is not entitled to interest.
 - iv. To date, two cases in the Court of Federal Claims have addressed this issue, with different results. In *Soo Line R.R. Co. v. United States*, 44 Fed. Cl. 760 (1999), the court ruled for the government, while in *Coca-Cola Co. v. United States*, 87 Fed. Cl. 253 (2009), the court ruled for the taxpayer. It is questionable whether the factual differences in the cases were really sufficient to explain the different results.
 - v. This is still a relatively unsettled issue and taxpayers may want to pursue under appropriate circumstances.
- d. Deposits
 - i. There is no clear authority for the treatment of an amount that a taxpayer remits as a deposit but later converts to a payment. In *Ford Motor Co. v. United States*, 768 F.3d 580 (6th Cir. 2014), the taxpayer sought

overpayment interest from the original date of remittance rather than from the date of designation as a payment.

- ii. The Sixth Circuit first ruled against the taxpayer in *Ford Motor Co. v. United States*, 508 Fed. Appx. 506 (6th Cir. 2012). The Sixth Circuit relied on the canon of statutory construction that a waiver of sovereign immunity is construed narrowly. Interpreting IRC § 6611, which is the money-mandating statute, as a waiver of sovereign immunity led the court to rule for the government.
- iii. The taxpayer filed a petition for a writ of certiorari, challenging whether IRC § 6611 was a waiver of sovereign immunity. Most of the discussion in the petition and reply focused on this question, although the government also raised a question regarding whether the District Court in Michigan even had jurisdiction to hear the case.
- iv. The Supreme Court granted certiorari and remanded the case for consideration of the jurisdictional issue.
- v. On remand, the Sixth Circuit declined to reconsider its decision in *E.W. Scripps Co. v. United States*, 420 F.3d 589 (6th Cir.2005), which held that District Courts have concurrent jurisdiction with the Court of Federal Claims over suits for overpayment interest in excess of \$10,000.
 1. Both courts have jurisdiction, without any restrictions as to amount, over tax refund suits. 28 U.S.C. §§ 1346(a)(1); 1491.
 2. Both courts have jurisdiction over suits under the Tucker Act for recovery of amounts due under the Constitution, statutes, regulations, or contracts. The District Courts' jurisdiction is limited to suits for \$10,000 or less; the Court of Federal Claims' jurisdiction is not limited. 28 U.S.C. §§ 1346(a)(2); 1491(a)(1).
 3. Overpayment interest is not considered equivalent to "tax." *Alexander Proudfoot Co. v. United States*, 454 F.2d 1379 (Ct. Cl. 1972); *see also* additional discussion below. The *Scripps* court concluded that District Courts have jurisdiction over suits for additional overpayment interest because 28 U.S.C. § 1346(a)(1) provides jurisdiction for suits seeking recover not only of tax alleged to have been erroneously or illegally assessed or collected but also "any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws." Failure to pay the taxpayer the amount of overpayment interest properly due means that the government has retained more money than it is due – an "excessive sum."

- vi. The Sixth Circuit then concluded that in fact IRC § 6611 was not a waiver of sovereign immunity; therefore the canon of narrow construction did not apply. But the court still ruled against the taxpayer on the merits. *Ford Motor Co. v. United States*, 768 F.3d 580 (6th Cir. 2014).
 - vii. It is uncertain at this point whether the case will return to the Supreme Court for consideration of:
 1. Whether the District Court and the Sixth Circuit had jurisdiction to hear the case at all.
 2. Whether IRC § 6611 is a waiver of sovereign immunity to be construed narrowly.
 3. Whether, on the merits, a taxpayer is entitled to overpayment interest on a deposit converted to a payment from the date of remittance or only from the date of conversion.
- e. GATT interest – corporations only
- i. An issue arises in the computation of GATT interest because the lower overpayment interest rate only applies to overpayments in excess of \$10,000.
 - ii. The IRS separates an overpayment, from the time it arose, into two buckets: the first \$10,000 and the remainder. Interest accrues on both buckets at the standard overpayment rate through 12/31/94. Starting 1/1/95, the IRS accrues interest on the first bucket (including accrued interest) at the standard overpayment rate and accrues interest on the second bucket at the lower GATT rate.
 - iii. The issue concerns compounding of the accrued interest in the second bucket after 1/1/95, specifically whether the lower GATT rate applies only to the tax or also to the pre-1/1/95 accrued interest.
 1. Under the IRS’s original method (“Old GATT”), applied from 1995-1998), all interest that had accrued before 1995 compounded at the higher standard rate.
 2. Under the IRS’s current method (“New GATT”), previously accrued interest in the second bucket begins to compound at the lower GATT rate on 1/1/95.
 3. When the IRS switched from “Old GATT” to the less taxpayer-favorable “New GATT” in 1999, the IRS made a policy decision

that it would not recapture overpayment interest already allowed under the old methodology.

4. The Federal Circuit rejected a taxpayer's claim for interest computed using the "Old GATT" methodology, in *General Electric Co. v. United States*, 384 F.3d 1307 (Fed. Cir. 2004). *See also Exxon Mobil Corp. v. Comm'r*, 484 F.3d 731 (5th Cir. 2007).
5. Taxpayers may be able to argue for "Old GATT" under various different theories, depending on the forum.

4. Procedural issues

a. Statutes of limitation

i. Underpayment interest

1. Taxpayer seeking refund of excessive underpayment interest. Underpayment interest is treated as part of the tax to which it relates. Therefore, it is subject to the same statutes of limitation for refund claims and refund suits. IRC §§ 6511, 6532(a). Taxpayers should not rely on the IRS to correct interest computations; they must file refund claims, and possibly refund suits, to preserve their rights to challenge the computations.
2. Government seeking additional underpayment interest. The IRS can assess and collect deficiency interest for ten years after the underlying tax has been assessed. IRC §§ 6601(g), 6502(a).

ii. Overpayment interest

1. Taxpayer seeking additional overpayment interest. Overpayment interest is not treated as part of the overpayment to which it relates. In fact, payment of overpayment interest is not a "tax refund" at all. It is instead a debt owed by the government. *Sunoco, Inc. v. Comm'r*, 663 F.3d 181 (3d Cir. 2011); *Alexander Proudfoot Co. v. United States*, 454 F.2d 1379 (Ct. Cl. 1972). Therefore, the refund claim procedures do not apply and filing a refund claim does not preserve the taxpayer's right to challenge interest computations. The taxpayer may file a claim for additional overpayment interest in an effort to resolve the issue administratively. But if that effort is unsuccessful, the taxpayer must file suit within six years from the date the overpayment was scheduled in order to preserve its rights. 28 U.S.C. §§ 1491(a)(1), 2401(a), 2501; IRC § 6407.

2. Government seeking recovery of excessive overpayment interest.
If the government claims that it paid the taxpayer excessive overpayment interest, it cannot recover the excess by the assessment procedures, since overpayment interest is not part of the tax. Instead, it must either file an erroneous refund suit within two years of the date the overpayment interest was paid, IRC § 6532(b), or offset the excess amount paid against a refund claim by the taxpayer for the same year. *Fischer v United States*, 80 F.3d 1576 (Fed. Cir. 1996); *Lewis v. Reynolds*, 284 U.S. 281 (1932).
 - a. In *Pacific Gas & Electric Co. v. United States*, 417 F.3d 1375 (Fed. Cir. 2005), the court decided that recovery of excessive overpayment interest by offset is subject to the same two-year statute of limitations as recovery by an erroneous refund suit. .
 - b. The IRS agrees that its only recourse to recover excessive overpayment interest paid to a taxpayer is through an erroneous refund suit or by offset against a refund claim for the same year. TAM 201335013. However, the IRS contends that recovery by offset is not subject to a two-year statute of limitations and therefore will not follow the decision in *PG&E*, even in cases appealable to the Federal Circuit. AOD 2006-02.

b. Tax Court Rule 155 computations

- i. At one time, it was common for the parties in a Tax Court case to wait to resolve any issues concerning interest computations until after entry of the Tax Court’s decision.
- ii. Deficiency decisions cannot include interest, which must be determined by a supplemental proceeding after the decision. IRC § 7481(c); Tax Court Rules 260 and 261.
- iii. But that approach can create problems if the Tax Court is making an overpayment determination. In *Estate of Smith v. Comm’r*, 123 T.C. 15 (2004), the court held that an “overpayment” by the taxpayer is reduced by any underpayment interest. (Account balances may fluctuate over time, so the final balance may be an overpayment even though there was an interim underpayment balance that accrued interest.) Thus, the court’s final decision cannot be changed to adjust the amount of underpayment interest.
- iv. The taxpayer benefited in this case, because the government was not able to reduce the amount to be funded by additional deficiency interest. But the same principle would apply if the government had accrued too much

underpayment interest; the taxpayer could no longer challenge that determination.

- v. Taxpayers should always carefully review any underpayment interest included in the IRS's proposed Rule 155 computations that determines an overpayment and resolve disputes concerning interest before submitting the computations to the court.