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Coca-Cola Company v. U.S.:

6411 versus 6611 and Other Adventures of Deficiency and Statutory Interest



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TAX MANAGEMENT

MEMORANDUM

***Coca-Cola Company v. U.S.:* 6411 versus 6611 and Other Adventures of Deficiency And Statutory Interest**

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* At Milbank, Tweed, Hadley and McCloy LLP the authors focus in part on Milbank's Tax Account Analysis and Recovery Services (TAARS®). A specialized tax service pioneered by Milbank, TAARS® identifies errors by the Internal Revenue Service (IRS) and state revenue authorities (principally involving determinations of interest and penalties) and recovers for clients overcharged or underrefunded amounts.

Before joining Milbank, Michael J. Grace, Managing Director, specialized in taxation with law firms, accounting firms, and the federal government. During the 1980s, he served at the IRS National Office in Washington, DC as the Principal Author of the "passive loss" regulations under Internal Revenue Code §469. Mr. Grace earned his B.S. in Accountancy from the University of Illinois at Urbana-Champaign and his J.D. from the University of Michigan Law School.

Joseph M. Persinger, Of Counsel, and Gilbert M. Polt, Deputy Counsel, represented the taxpayer in *Coca-Cola v. U.S.*, decided by the United States Court of Federal Claims in June 2009. Mr. Persinger's and Mr. Polt's practices include federal, state and city tax controversies. They have handled audit issues, administrative appeals,

To the uninitiated, the Internal Revenue Code's provisions governing interest on underpayments and overpayments of tax seem on first impression relatively straightforward.¹ How complicated, after all, can calculating interest be? Upon examining merely one or two pertinent sections of the Code, however, complexities quickly emerge. Within the typical reader's lifetime or at least professional career, the rules have grown increasingly complex. Evolutions that evidence increasing complexity in this area of the tax law include daily compounding of interest,² differential interest rates on corporate underpayments and overpayments,³ increased underpayment rates on "large corporate underpayments,"⁴ and "interest netting."⁵

In addition, the question previously stated, "How complicated, after all, can calculating

tax litigation and collection matters involving public corporations, individuals and tax-exempt organizations. Before entering private practice, Mr. Persinger served as a trial attorney in the Tax Division of the U.S. Department of Justice. He holds an undergraduate degree from Xavier University (Ohio) and a J.D. and an LL.M. in Taxation from Georgetown University. Mr. Polt earned his undergraduate degree from the University of Maryland (cum laude) and his J.D. from the University of Baltimore School of Law.

¹ The principally effective provisions consist of §§6601 through 6631. All section references are to the Internal Revenue Code of 1986, as amended, and applicable as of May 28, 2010.

² §6622 (enacted 1982).

³ §6621(a) (1985).

⁴ §6621(c) (1990), informally known as "hot interest."

⁵ §6621(d) (1998); see "Interest Netting" below.

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interest be?” misapprehends and understates the relevant inquiry. Multiplying the correct interest rate by the number of days (or other relevant period) for which interest must be determined represents merely an initial step. Determining the correct amount of interest in any given case typically requires also applying an expanding body of relevant tax law including statutes, court decisions, regulations, published rulings, and other administrative determinations.⁶ “Anecdotal” guidance consisting of informal positions within the IRS, which like sand on a beach continually shift, also must be considered.

In *The Coca-Cola Co. and Subsidiaries v. U.S.*,⁷ the United States Court of Federal Claims⁸ parsed the relationship between two provisions of the Code that address interest on overpayments of tax: the general rule that entitles the taxpayer to interest on an overpayment⁹ and special rules that excuse the IRS from paying interest if it refunds an overpayment within 45 days after a “return” was filed.¹⁰

Granting the taxpayer’s motion for summary judgment, the court in *Coca-Cola* held that the IRS must pay interest on an overpayment following the IRS’s examining and adjusting a carryback “claim” even though the IRS originally had refunded the unadjusted overpayment within 45 days (and thus without interest) after the taxpayer requested it from the IRS.¹¹ The court thus directed the IRS to pay The Coca-Cola Company approximately \$2.6 million of additional interest on overpaid tax.¹² However, the length and detail to which the court went in so holding reinforces

the point that the business of determining interest can prove dazzlingly complex.

This Memorandum explains and analyzes the ruling in *Coca-Cola*, pointing out opportunities the Opinion suggests for other taxpayers. The Memorandum also discusses selected other complexities in determining interest that frequently arise.

Milbank, Tweed, Hadley & McCloy LLP represented The Coca-Cola Company.

ESSENTIAL FACTS AND ISSUE

Coca-Cola essentially addressed the following situation and legal issue.¹³ A corporation incurs a net operating loss (NOL). Filing with the IRS a Form 1139 (Corporation Application for Tentative Refund), the corporation carries the NOL back to a previous taxable year, generating an overpayment of tax for the carryback year.¹⁴ Within 45 days of receiving the Form 1139, the IRS issues the company a tentative refund attributable to the carryback without any interest.¹⁵ Later the IRS examines the Form 1139, decreases the carryback adjustment, and assesses the corporation additional tax. The corporation pays the additional tax (plus interest). The corporation then files a formal claim for refund (Form 1120X) based upon carrying back the same NOL on which the filing of the Form 1139 had been premised. A court determines that the IRS erroneously recaptured the carryback, thereby validating most of the NOL carryback. The court’s adjustment causes an interim overpayment in the corporation’s account with the IRS in the carryback year. *Coca-Cola* addressed the following issue: may the IRS avoid paying interest on this incremental overpayment by reason of having paid the tentative refund within 45 days after the taxpayer sought it from the IRS?

CODE PROVISIONS PRINCIPALLY IMPLICATED

Interest generally shall be allowed and paid on any overpayment in respect of any internal revenue tax at

June 30, 2003, plus additional interest thereon until paid.”

¹³ See also “Dispute and Detailed Facts” below, setting forth the specific facts.

¹⁴ Carrying back an NOL or other eligible item by filing a Form 1139 typically is referred to as a “quickie” refund claim distinguishable from a “formal” or “regular” claim for refund made, for example, by filing an amended tax return (e.g., a Form 1120X). Cf. §§6402 and 6411.

¹⁵ Section 6611(e), detailed below, allows the IRS this 45-day “grace period.”

⁶ See, e.g., *Avon Products, Inc. v. U.S.*, 588 F.2d 342 (3d Cir. 1978); *May Department Stores Co. v. U.S.*, 36 Fed. Cl. 680 (1996); *Sequa Corp. v. U.S.*, 80 AFTR 2d 97-7824 (S.D.N.Y. 1996), further proceeding, 99-1 USTC ¶50,379 (S.D.N.Y. 1998); *Marsh & McLennan Companies, Inc. v. U.S.*, 50 Fed. Cl. 140 (2001); *General Electric Co. and Subsidiaries v. U.S.*, 87 Fed. Cl. 221 (2009); *AT&T Corp. and Subsidiaries v. U.S.*, 62 Fed. Cl. 490 (2004), *reh’g denied*, 63 Fed. Cl. 209 (2004).

⁷ 87 Fed. Cl. 253 (2009) (“*Coca-Cola*”).

⁸ For brevity’s sake, references in this Memorandum to “Court” and “Claims Court” refer, unless the context otherwise requires, to the tribunal now known as the United States Court of Federal Claims.

⁹ §6611(a).

¹⁰ §6611(e). As this Memorandum discusses, these “45-day rules” transcend tax returns. The 45-day rules also may apply, for example, to situations in which a taxpayer other than by filing or amending a “return” seeks a refund of tax upon carrying back a net operating loss or other item.

¹¹ The term “unadjusted overpayment” appears in neither the relevant provisions of the Code nor in the court’s ruling. It is used here solely for convenience of shorthand reference. The terms “claim” and “claimed” have particular technical meanings that this Memorandum addresses.

¹² The court’s conclusion reads in relevant part: “Defendant shall pay plaintiff \$162,263.62 in overassessed deficiency interest and \$2,587,589.36 in allowable overpayment interest through

the overpayment rate established under §6621.¹⁶ In general, the IRS must pay interest on a refund from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days.¹⁷

Notwithstanding these general rules, no interest is allowed if the IRS refunds an overpayment within 45 days after the later of (i) the last day prescribed for filing the return of the subject tax (determined without regard to extensions of time for filing the return) and (ii) the date the return is filed.¹⁸ Similarly, if the taxpayer files a claim for a credit or refund of any overpayment of tax, and the IRS refunds the overpayment within 45 days after the claim was filed, then no interest is allowed on the overpayment from the date the claim was filed until the day the refund is made.¹⁹

For purposes of determining whether the IRS owes a taxpayer interest on an overpayment of tax, special rules apply to particular categories of carrybacks. For example, if any overpayment of tax results from carrying back an NOL, the overpayment is deemed not to have been made prior to the filing date for the taxable year in which the NOL arose.²⁰ For this purpose, “filing date” means the last date prescribed for filing the return for the taxable year (determined without regard to extensions).²¹

Example 1. Corporation XYZ uses the calendar year as its taxable year. For tax year 2009, XYZ incurs an NOL. XYZ decides to carry the NOL back to tax year 2007, generating a refund of tax for 2007. For purposes of determining whether the IRS owes XYZ interest on the refund, the overpayment is deemed not to arise before March 15, 2010, the date (without regard to extensions) prescribed for filing the return for 2009.²²

Special rules also apply for purposes of applying the 45-day exception when NOLs and other items are carried back. For purposes of the 45-day rule, any overpayment resulting from carrying back an NOL is treated as an overpayment for the loss year. For this purpose, “loss year” means the taxable year in which the loss arises. The 45-day exception is applied with respect to such an overpayment by treating the return

for the loss year as not filed before the claim for refund of the overpayment is filed.²³

Example 2. The facts are the same as in preceding Example 1. On June 1, 2010, XYZ files a formal claim for refund of the overpayment resulting from carrying back the NOL from 2009 to 2007. For purposes of determining whether the IRS owes XYZ interest on the overpayment resulting from carrying back the NOL, the return for tax year 2009 (the loss year) is treated as not filed before June 1, 2010, the date on which XYZ filed the claim for refund. Thus, if the IRS within 45 days of June 1, 2010, refunds the overpayment attributable to the carryback, then the IRS owes XYZ no interest on the overpayment.

A company ascertaining that carrying back an NOL or other eligible item will generate an overpayment of tax has alternatives. The taxpayer may file with the IRS a claim for refund. Alternatively, the taxpayer may file a claim for credit, i.e., a request that the IRS offset the refund against an amount the taxpayer owes the IRS. A taxpayer may file a claim for credit or refund in various ways. Perhaps most commonly, the taxpayer may file a Form 843, Claim for Refund and Request for Abatement. Alternatively, a credit or refund may be claimed by amending tax returns for one or more prior years. For example, Corporation XYZ in the preceding Example 1 could claim a refund, attributable to carrying back the NOL, by amending its corporate income tax return for tax year 2007.²⁴

Instead of filing a “regular” or “formal” claim for credit or refund, a taxpayer may file an application for a tentative carryback adjustment of tax for a prior taxable year affected by a net operating loss carryback.²⁵ The application may be filed any time (i) on or after the date for filing the return for the taxable year in which the NOL arose and (ii) within 12 months after the close of that year. Section 6411(a) lists categories of information that applications for such adjustments must provide. The required information, to be provided by filing Form 1139, Corporate Application for

¹⁶ §6611(a). The “overpayment rate” and associated “underpayment rate” are discussed below under “Interest Netting.”

¹⁷ §6611(b)(2). Similarly, if an overpayment is credited against a taxpayer’s liability to the IRS, interest shall be allowed from the date of the overpayment to the due date of the amount against which the credit is taken.

¹⁸ §6611(e)(1).

¹⁹ §6611(e)(2). *Coca-Cola* and this Memorandum explain the scope of the 45-day rule with respect to claims for credit or refund and applications for tentative refund.

²⁰ §6611(f)(1)(A).

²¹ §6611(f)(4)(A).

²² See §6072(b).

²³ §6611(f)(4)(B).

²⁴ Section 6402(a) authorizes the IRS to offset overpayments against outstanding tax liabilities and against certain other debts of the taxpayer: “In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to [§6402(c)–(f)] refund any balance to such person.” Section 6402(c) through (f) are discussed below under “Other Issues Concerning Interest on Underpayments and Overpayments: Right of Offset.”

²⁵ See §6411(a). Similarly, a taxpayer may file an application for a tentative carryback adjustment of tax for a prior taxable year affected by a business credit carryback or a capital loss carryback. *Id.*

Tentative Refund, includes the amount of the NOL and the amount by which carrying back the NOL decreases tax for the prior year or years to which the NOL is carried.

Within 90 days from the date on which an application for a tentative carryback adjustment (i.e., Form 1139) is filed, the IRS is required to make “a limited examination” of the application in order to discover computational omissions or errors.²⁶ Upon finding no computational omissions or errors, the IRS must determine the amount of the decrease in tax attributable to the carryback, based on the application, and refund or credit the decrease. However, the IRS may later examine the application more carefully and partially or fully disallow it.²⁷ In view of this deadline, applications under §6411(a) have come to be known informally as “quickie” claims as distinguished from the “regular” or “formal” claims for refund or credit previously discussed.

Except for purposes of applying §6611(f)(4)(B) (the 45-day rule), an application for a tentative carryback adjustment does not constitute a claim for credit or refund.²⁸ This exception essentially places regular claims and quickie claims in the same category for the limited purpose of the 45-day grace period afforded the IRS for paying a refund without interest. Section 6611(f)(4)(B), as previously explained, prescribes that the 45-day grace period applies to an overpayment resulting from carrying back an NOL by treating the return for the loss year as not filed before claim for the overpayment is filed. If the IRS within 45 days after the filing of a regular claim credits or refunds an overpayment, then the IRS owes no interest. Similarly, the 45-day exception applies to an overpayment resulting from carrying back an NOL by treating the return for the loss year as not filed before an application under §6411(a) is filed. If the IRS within 45 days after the filing of a quickie claim credits or refunds an overpayment, then the IRS owes no interest.²⁹

DISPUTE AND DETAILED FACTS

In *Coca-Cola*, the parties disputed whether the government owed the taxpayer interest on an overpayment of tax that through a series of events was found to exist between March 15, 1985, and September 27,

²⁶ §6411(b).

²⁷ *Id.* The IRS, in fact, did just that in *Coca-Cola*. See “Dispute and Detailed Facts” below.

²⁸ §6411(a) (flush language).

²⁹ A taxpayer seeking to carry back an NOL may initially file a regular claim for refund and then file a quickie claim. Under that scenario, the later filing date triggers the 45-day grace period within which the IRS may issue a credit or refund without paying interest. See §6611(f)(4)(C).

1985.³⁰ The relevant sequence of events began when Coca-Cola incurred a taxable loss for its 1984 tax year. On September 15, 1985, Coca-Cola filed with the IRS a Form 1139 applying for a tentative refund from its 1981 tax year, based on carrying back to 1981 an NOL from 1984.³¹ The application sought a refund of \$18,682,973. Twelve days later, on September 27, 1985, the IRS allowed the carryback and issued Coca-Cola the tentative refund without interest. Under the 45-day rule, the IRS clearly owed Coca-Cola no interest on that refund.³²

In January 1991, the IRS upon examining the Form 1139 determined that the amount of Coca-Cola’s claimed carryback from 1984 to 1981 was incorrect. The IRS recaptured approximately 2/3 of the carryback, thereby increasing Coca-Cola’s tax liability, and issued Coca-Cola a statutory notice of deficiency for 1981. The Company paid additional tax of \$9,772,827 and deficiency interest of \$3,780,719.

On April 8, 1991, Coca-Cola filed a claim for refund of \$13,086,842 plus interest.³³ The IRS denied the claim, and Coca-Cola petitioned the United States Tax Court to review, *inter alia*, the IRS’s recapture of the NOL carried back from 1984 to 1981.

In January 1997, the Tax Court, effectively rejecting the IRS’s recapture of the carryback, determined that Coca-Cola in fact had overpaid income tax for tax year 1981.³⁴ Pursuant to the Tax Court’s decision, the IRS in May 1997 abated \$12,352,648 in taxes for tax year 1981 and \$5,531,965.47 of deficiency interest. This abatement, the Claims Court observed, “originated from an increase in the carryback that [Coca-Cola] initially asserted in 1985.” Even though it abated tax, the IRS in May 1997 did not post any overpayment interest to Coca-Cola’s account.

On May 6, 2003, Coca-Cola filed a complaint in the Claims Court, claiming interest on the overpayment that existed between March 15, 1985 and September 27, 1985 created by the IRS’s abatement of the Company’s 1981 taxes. The Company determined these beginning and ending dates as follows. If an overpayment of tax results from carrying back an NOL, then the overpayment is deemed not to have been made

³⁰ “The question presented is a narrow, but prickly one — namely, whether the plaintiff, the Coca-Cola Company, is entitled to interest on the overpayment of its taxes between March 15, 1985 and September 27, 1985,” the court said. How these dates were determined is explained below.

³¹ Under the law then in effect, a corporation could carry a NOL back as far as three years. See §172(b)(1)(A) (1977).

³² See §6611(f)(4)(B), (e).

³³ The amount of the claimed refund (\$13,086,842) was less than the total of the additional tax and interest the Company paid the IRS (\$13,553,546) because the claim for refund (Form 1120X) requested only a refund of tax paid.

³⁴ *Coca-Cola Co. v. Comr.*, No. 17171-91 (Jan. 8, 1997).

prior to the filing date for the taxable year in which the NOL arose.³⁵ For this purpose, “filing date” means the last date prescribed for filing the return for the relevant taxable year (determined without regard to extensions).³⁶ The overpayment the Tax Court determined for Coca-Cola’s 1981 tax year resulted from the Company’s having carried back to 1981 an NOL that arose in 1984. The filing date for the 1984 tax year, based on Coca-Cola’s using the calendar year as its taxable year, was March 15, 1985.³⁷ Based on the Form 1139, the IRS, on September 27, 1985, issued the Company a tentative refund, without interest. Coca-Cola took the position in the Claims Court that the IRS owed the Company interest on an overpay-

ment between March 15, 1985, and September 27, 1985.

The government insisted that it owed Coca-Cola no overpayment interest for the period from March 15 to September 27, 1985, because the IRS had issued the “quickie” refund on the latter date, based on Form 1139, within 45 days (in fact within 12 days) after the Company had applied for the refund. In effect, the government argued that once an amount had been paid to the taxpayer pursuant to an adjustment request per Form 1139, that amount would never bear allowable interest — even if, as in this case, the amount had been repaid with interest and subsequently requested again via a separate, formal claim and Tax Court petition. Both parties moved for summary judgment.

The following table summarizes the pertinent events and associated numbers (tax only).³⁸

³⁵ §6611(f)(1).

³⁶ §6611(f)(4)(A).

³⁷ Annual income tax returns of corporations made on the basis of the calendar year must be filed (disregarding allowable extensions) on or before March 15 following the close of the calendar year. §6072(b).

³⁸ Neither this nor a similar table appears in the court’s opinion. The authors are supplying the table to help readers better and more quickly understand the relevant facts.

<u>Tentative Refund</u>	<u>Recapture by IRS</u>	<u>Net Refund After Recapture</u>	<u>Overpayment Per Tax Court</u>	<u>Cumulative Refund</u>
\$18,682,973	\$12,448,079	\$6,234,894	\$12,352,648	\$18,587,542

CLAIMS COURT’S ANALYSIS

Procedural Question

Before analyzing the substantive issue presented, the court addressed whether Coca-Cola had timely filed its complaint. The Company had filed its complaint in the Claims Court on May 6, 2003. Section 2501, Title 28, United States Code, provides in pertinent part that “[e]very claim of which the United States Court of Federal Claims has jurisdiction shall be barred unless the petition thereon is filed within six years after such claim first accrues.” The government argued that this statute of limitations began to run on September 27, 1985, the date on which the IRS had paid the Company the tentative refund based on the Form 1139. Thus, the government asserted, Coca-Cola’s claim must be barred because it was not filed before September 27, 1991.

Agreeing that 28 USC §2501 prescribed the applicable deadline for filing its complaint in the Claims Court, Coca-Cola disagreed as to when its claim began to accrue. The Company argued that a claim for overpayment interest begins to accrue when “a reasonable taxpayer should have become aware that [its] cause of action started to accrue.” Thus, Coca-Cola concluded that the claim began to accrue no earlier than May 19, 1997, the date on which the IRS abated the Company’s tax without interest, thereby placing the Company on notice that the government owed it overpayment interest.

In an order issued in September 2008, the court conjectured that possibly neither party had correctly interpreted the six-year statute of limitations. Accordingly, “out of an abundance of caution and with due regard to fairness,” the court ordered the parties to address its concerns in supplemental briefings.

In March 2009, the parties submitted to the court a joint response agreeing that Coca-Cola’s claim accrued when an IRS official signed the relevant form (Form 2188)³⁹ authorizing the scheduling of the abatement of the Company’s 1981 taxes based on the Tax Court’s decision. The parties determined that the IRS official had signed the relevant Form 2188 on May 19, 1997. Accordingly, the parties concluded that Coca-Cola’s cause of action regarding the government’s failure to pay interest on the refund received in 1997 accrued on May 19, 1997, fewer than six years before May 6, 2003, the date on which Coca-Cola had filed its complaint. Based on these stipulations, the court concluded that 28 USC §2501 did not bar Coca-Cola’s claim for overpayment interest.

Substantive Issue

The Claims Court then turned to the substantive issue presented. The court acknowledged that the par-

³⁹ IRS Form 2188, Voucher and Schedule of Overpayment and Overassessment.

ties had narrowed their dispute to one question of law: Is Coca-Cola entitled to interest on the overpayment of its 1981 corporate taxes that existed between March 15, 1985, and September 27, 1985?

The court began its analysis by comparing “regular” claims for refund to “quickie” claims and reviewing the mechanics of the latter. The court then observed that while an application for a tentative refund under §6411 does not constitute a claim upon which a taxpayer may maintain a suit in court, such an application can trigger the government’s liability to pay overpayment interest. To support this proposition the court referenced §6411(a), providing that *except for purposes of applying §6611(f)(4)(B), an application for a tentative refund shall not constitute a claim for credit or refund (emphasis added)*. “Thus,” the court concluded, “for the limited purposes of determining entitlement to overpayment interest, a tentative refund application also acts as a claim for refund.”

Citing the rule in §6611(a) generally requiring the IRS to pay interest on an overpayment, the court also acknowledged §6611(e)(1), providing the 45-day grace periods. However, the court characterized as “far from straightforward” the issue of how the 45-day exception applies to a tentative application for refund under §6411 “and thus requires some explanation.”

The court provided the following explanation:

Rather than set forth a rule stating that no interest is allowed on an overpayment attributable to a[n] NOL carryback if the IRS refunds the overpayment within 45 days of the taxpayer filing its claim, the Code reaches the same result via §6611(f)(4)(B). Section 6611(f)(4)(B) first deems an overpayment attributable to a[n] NOL carryback as an overpayment for the “loss year,” i.e., as an overpayment for the year in which the taxpayer sustained the NOL. [Citing §6611(f)(4)(B)(i)(I), (ii).] Then it treats the return for the loss year as not filed until the taxpayer files the claim for the overpayment itself. [Citing §6611(f)(4)(B)(i)(II).] And, as noted above, the Code treats §6411 tentative refund applications in the same manner as §6402 claims when applying the 45-day rule. See §6411(a) (“Except for purposes of applying §6611(f)(4)(B), an application under this subsection [§6411(a)] shall not constitute a claim for credit or refund.”).

Based on the foregoing interpretation of the relevant provisions, the court analyzed the facts essentially to determine, first, at what point or points in

time did Coca-Cola have an overpayment of tax, and second, whether the IRS had paid the Company interest on the overpayment within 45 days after Coca-Cola “claimed” it. From this perspective, two “claims” were relevant.

1. *Application for tentative carryback adjustment under §6411(a)*. Coca-Cola filed its Form 1139 with the IRS on September 12, 1985. The IRS issued the Company the claimed refund 12 days later, on September 27, 1985. Thus, the court, citing §6611(e), concluded that the “45-day rule blocked plaintiff’s entitlement to overpayment interest.”

2. *Regular claim for refund under §6402*. After the IRS had audited and recaptured most of the refund based on the application for tentative carryback adjustment, the Claims Court observed that “plaintiff’s only avenue of redress was to file a regular §6402 claim.” The court did not explain why filing a regular claim for refund represented at that point Coca-Cola’s only avenue of redress. This in fact was because a quickie refund claim must be filed within 12 months after the end of the taxable year in which the subject NOL arose.⁴⁰ The relevant NOL arose in 1984. Thus, by April 1991, the opportunity to file a second quickie refund claim clearly had expired.

Coca-Cola filed a regular claim for refund on April 8, 1991. “It is undisputed,” the court observed, that the IRS failed to issue a refund within 45 days of this claim. The court then referenced the decision of the Tax Court which (i) found that Coca-Cola had an overpayment of tax for taxable year 1981 (\$12,352,648), (ii) also found that Coca-Cola had filed a claim for refund of the overpayment of tax, and (iii) did not address the tentative application for refund the Company had filed in 1985. The Claims Court concluded: “Thus, it was the six-years-unpaid claim from 1991 that led to the overpayment in plaintiff’s 1981 tax account, and it is the 1991 claim that entitles plaintiff to overpayment interest today” [under §6611(a)].

The government in its brief urged the Claims Court to disregard the claim for refund filed in 1991 (“Claim #2” above). The government insisted that, because the refund was issued within 45 days after Coca-Cola had “claimed” it in 1985 (by filing the application for a tentative refund), the IRS owed the Company no interest. The Court responded as follows to this argument:

Defendant urges this court to disregard the 1991 claim and instead focus on the ephemeral 1985 tentative refund. . . . Defendant argues that because the IRS originally returned

⁴⁰ §6411(a).

the requested amount within Section 6611(e)'s 45-day grace period, no interest is now due. . . . Assuming this court could look past plaintiff's statutory entitlement to overpayment interest based on its 1991 claim — which it cannot — defendant's interpretation of Section 6611(e) is entirely unreasonable and would lead to absurd results.

The court acknowledged that §6611(e) literally states: “if any overpayment of tax is refunded within 45 days . . . no interest shall be allowed.” But surely, the court insisted, the term “refunded” necessarily implies that the taxpayer was permitted to keep the amount returned. The IRS's “wooden interpretation” of §6611(e), the court observed, demands that the court ignore subsequent events — the IRS's recapture in 1991 of the tentative refund claim and withholding of money from January 1991 to May 1997.

According to the court, the IRS “at best” had raised “some doubt” as to what exactly constitutes a “refund” for purposes of §6611. The court resolved any such doubt in two ways. First, it cited cases establishing that in tax refund cases doubts should be resolved in the taxpayer's favor. Second, the court observed that were it to adopt defendant's position, the IRS could routinely issue tentative refunds within 45 days of taxpayers' claims, recapture those refunds the next day, and thus escape any potential liability under §6611(a) for overpayment interest. Section 6611, the court concluded, “cannot be so impotent.”

In its brief, the government had relied heavily on *Soo Line Railroad Company v. U.S.*⁴¹ The court found *Soo Line* “easily distinguishable” and “if anything,” supportive of Coca-Cola's position.

In *Soo Line*, the court explained, the plaintiff had filed its application for a tentative refund in September 1984, from its 1980 tax year, based on asserting a net operating loss carryback from its 1983 tax year. Within 22 days, the IRS allowed the carryback and issued a tentative refund. Thus, under the 45-day rule, plaintiff at that time was not entitled to overpayment interest. Two months later, the plaintiff filed suit in Tax Court seeking other adjustments to its tax liability for 1980. The Tax Court determined that plaintiff in fact had underestimated its net operating loss carryback from 1983 to 1980. However, the Tax Court also found that *Soo Line* had an offsetting increase in its tax liability for 1980 of an even larger amount. Thus, plaintiff had overpaid its 1980 taxes by a net amount less than the tentative refund it had received. Taking into account all the offsetting adjustments, *Soo Line* had overpaid its taxes for 1980 by \$2,415,776

⁴¹ 44 Fed. Cl. 760 (1999).

but had received a tentative refund of \$2,860,785. Consequently, the company as a result of the Tax Court's decision had a net underpayment of \$445,009.

Later, the plaintiff in *Soo Line* filed suit in the Court of Federal Claims seeking interest on the overpayment of \$2,415,776. The court held that it could not ignore the prior tentative refund of any even larger amount. The IRS having paid the taxpayer, within 45 days of the application for a tentative refund, an amount greater than the overpayment the taxpayer later asserted, the Court of Federal Claims concluded the government had correctly asserted that §6611(e) barred interest on the overpayment.

In *Coca-Cola*, the court distinguished *Soo Line* based on differences in the facts:

What distinguishes *Soo Line* from the instant case is that there, the IRS tentatively refunded and permitted the *Soo Line* plaintiff to retain an amount greater than that to which it was entitled. In other words, after the IRS made the necessary adjustments to the *Soo Line* plaintiff's tax account, the account reflected an *underpayment*. . . . In the instant case, the IRS's tentative refund, errant recapture, and subsequent abatement caused an *overpayment* in plaintiff's tax account; i.e., the IRS permitted the plaintiff to retain an amount less than that to which it was entitled. [Emphasis in original.]

The court in *Coca-Cola* found its opinion in *Soo Line* “nevertheless, instructive” in that if awarding interest in the earlier case “would render Section 6611(e) a nullity,” [quoting from *Soo Line*] “failing to award interest in the present case would similarly castrate Section 6611(a).” “Just as the *Soo Line* court could not ‘ignore’ the prior tentative refund, this court cannot ‘ignore’ the IRS's subsequent recapture of plaintiff's tentative refund.”

“To be sure,” the court acknowledged, the IRS correctly stated that the imposition of interest to be paid by the government is not favored, and is never imposed by implication, absent a clear and unmistakable command to do so. However, according to the court, §6611(a) is such a command in emphatically providing that interest *shall* be allowed and paid upon any overpayment in respect of any internal revenue tax (emphasis in original).

Conclusion

The court concluded its analysis by recapitalizing the essential facts. Coca-Cola had filed its claim for refund in 1991. The IRS did not issue the requested refund within 45 days. Coca-Cola brought suit and es-

tablished, six years later, that it was entitled to the refund. Therefore, the court concluded, §6611 requires the IRS to pay Coca-Cola interest on the overpayment. Granting the taxpayer's motion for summary judgment, the court directed the IRS to pay Coca-Cola \$2,587,589.36 in allowable overpayment interest through June 30, 2003, plus additional interest thereon until paid.⁴²

OTHER ISSUES CONCERNING INTEREST ON UNDERPAYMENTS AND OVERPAYMENTS

The decision in *Coca-Cola* emanated from an unusual although not unique confluence of facts. Other issues arise comparatively more frequently in analyzing whether interest on an underpayment or overpayment of tax (or both) has been correctly determined. These issues, discussed below, include statutes of limitation, the IRS right to offset overpayments against underpayments of tax, the variance doctrine, and "interest netting" of overlapping underpayments and overpayments of tax.

Statutes of Limitation

With respect to statutes of limitation governing interest, two fundamental principles should be heeded. First, statutes of limitation within which a taxpayer may claim erroneously charged interest on underpayments of tax and underallowed interest on overpayments of tax resemble but do not exactly parallel the statutes of limitation applicable to underpayments and overpayments of tax itself. Second, different statutes of limitation apply for purposes of claiming erroneously charged interest on underpayments (referred to below as "Deficiency Interest") compared to underallowed interest on overpayments (referred to below as "Statutory Interest").

It is often observed, even by seasoned tax practitioners, that the Code treats interest in the same manner as tax. Technically, however, that observation proves overly broad. Section 6601(e)(1) provides that interest prescribed "under this section" [6601] on any tax shall be paid upon notice and demand, and it shall be assessed, collected, and paid in the same manner as taxes. Section 6601(e)(1) also provides that any reference in the Code (except designated provisions governing deficiency procedures) to any tax imposed by the Code shall be deemed also to refer to interest imposed "by this section" [6601] on such tax. This language technically applies only to interest on under-

⁴² The court also directed the IRS to pay Coca-Cola \$162,263.62 in overassessed deficiency interest.

payments of tax, i.e., situations in which a taxpayer owes the government interest on underpaid taxes. Given its limited scope, this language in fact does not equate interest to taxes under the Code for all purposes. Statutes of limitation with respect to claiming erroneously charged deficiency interest and underallowed statutory interest, respectively, are discussed below.

Deficiency Interest

Interest on underpayments commonly is referred to as "deficiency interest." That is because the potential to file a claim for interest typically arises once the IRS has examined returns and asserted deficiencies in tax and interest (and perhaps penalties), and the taxpayer disagrees with the amount of interest charged.

A claim for credit or refund of deficiency interest generally must be filed within the later of three years after the affected return of tax was filed or two years after a payment of tax or interest was made.⁴³ The IRS rarely if ever finishes examining a return and asserting a deficiency within three years after the return was filed. Consequently, in practice, the two-year deadline (within two years after the deficiency interest was paid) operates as the general rule.⁴⁴

A taxpayer, however, may have longer than two years to claim overcharged deficiency interest if the taxpayer and the IRS have agreed to extend the period of limitations within which the IRS may assess a deficiency in tax. In the course of examining tax returns or resolving examination results in IRS Appeals, a taxpayer and the IRS frequently agree to extend this period.⁴⁵ If the period has been extended by agreement, then the taxpayer may file a claim for deficiency interest within the later of (i) two years after the interest was paid or (ii) six months after the extended limitations period for assessments expired.⁴⁶ However, the Code limits amounts that may be claimed under both deadlines. Under the two-year deadline, the amount of credit or refund that may be claimed may not exceed the amount paid within two years immediately preceding the filing of the claim.⁴⁷

Statutory Interest

In other situations, the IRS may refund an overpayment of tax (or credit an overpayment against an un-

⁴³ §6511(a).

⁴⁴ The IRS has summarized as follows the applicable statute of limitations: "A claim for credit or refund of interest paid on an underpayment pursuant to Section 6601 or 6602 generally must be filed within three years from the time the tax return was filed or two years from the time the interest was paid, whichever period expires later, pursuant to Section 6511." Rev. Proc. 99-19, 1999-1 C.B. 842, §2.04(1).

⁴⁵ See §6501(c)(4).

⁴⁶ §6511(c)(1).

⁴⁷ §6511(b)(2)(B).

derpayment of other tax) and pay the taxpayer interest on the overpayment. For example, an examination by the IRS or a decision by a court may result in adjustments in a taxpayer's favor, i.e., a finding that the taxpayer in fact overpaid tax for the relevant period. A taxpayer may amend a return, reporting a refund. The IRS may fail to pay interest on a request for tentative carryback adjustment (made by filing Form 1139) within 45 days after the filing. In any of these situations, the taxpayer may believe that the IRS has not paid sufficient interest on an overpayment.

Statutes of limitation within which to claim such additional interest ("refund" or "statutory" interest) are found not in the Internal Revenue Code, but rather in Title 28 of the United States Code. A taxpayer generally must file a claim for credit or refund of statutory interest within six years after the right to the interest first accrued.⁴⁸ That date may differ from the date on which the refund was actually paid.⁴⁹ This issue was addressed in *Coca-Cola* (see preceding discussion).

Right of Offset

In determining interest potentially due on an overpayment of tax, a taxpayer should bear in mind an important right of offset the Code affords the IRS. By exercising this right the IRS significantly can affect the amount of interest payable on an overpayment, and the amount of any interest the taxpayer may owe the IRS on an underpayment when, for example, an examination encompasses returns for more than one tax year.

Example. A taxpayer overpaid tax for tax year 2007 and without regard to other events is entitled to a refund of that overpayment plus interest. Before the IRS pays the overpayment plus interest (or before the taxpayer claims those amounts, as the case may be), the IRS examines the taxpayer's return for tax year 2008 and assesses a deficiency for 2008 plus interest. Under one scenario, the taxpayer could file a claim for refund of the overpayment from 2007 plus interest. The IRS could pay that claim. The IRS then could demand from the taxpayer payment of the deficiency for 2008 plus interest.

Section 6402(a) alternatively allows the IRS a right of offset:

(a) **General Rule.** — In the case of any overpayment, the Secretary, within the applicable

⁴⁸ 28 USC §§2401 and 2501; Rev. Rul. 56-506, 1956-2 C.B. 959.

⁴⁹ The IRS has summarized as follows the applicable statute of limitations: "A claim for payment of additional interest allowable on an overpayment pursuant to Section 6611 must be filed within the 6-year period in which a suit must be filed pursuant to 28 USC §§2401 and 2501." Rev. Proc. 99-19, 1999-1 C.B. 842, §2.04(2).

period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), (e), and (f) refund any amount to such person.

Sections 6402(c) through (f) authorize the IRS to offset overpayments against particular amounts that other agencies have notified the IRS the taxpayer owes the government. The items that may be offset consist of past-due support under the Social Security Act, past-due legally enforceable debt owed federal agencies, past-due legally enforceable state income tax obligations, and unemployment compensation debts resulting from fraud.⁵⁰ Thus, the IRS may offset an overpayment (including interest) against not only an underpayment of tax but also against the other specified liabilities, and refund to the taxpayer only the remaining (if any) net overpayment.

If the IRS in exercising this right of offset reduces a claim for refund, the IRS must provide the taxpayer an explanation of the disallowance.⁵¹ However, the IRS's offsetting an overpayment against obligations other than internal revenue taxes essentially may not be appealed. A taxpayer may not seek judicial or administrative review of the IRS's action or file suit against the United States. A disagreeing taxpayer's only recourse consists of taking legal, equitable, or administrative action against the federal agency or state to which the disputed offset was paid.⁵²

Note that under §6402(a) the Secretary (i.e., the IRS) "may" but is not required to offset an overpayment against a liability. Thus, the IRS on a case-by-case basis can decide whether or not to effect an offset. The IRS may exercise this right of offset across categories of taxes. For example, the IRS may offset an overpayment of income tax against an underpayment of employment taxes, or vice versa.

On its face, this right of offset seems merely a rule of administrative convenience. However, the IRS by offsetting an overpayment against a liability, instead of refunding the overpayment and separately seeking to recover the liability, can reduce the amount of interest it owes the taxpayer on any net overpayment. Unfortunately, the Code does not enable a taxpayer to block such an offset even when the offset may reduce the amount of interest the IRS otherwise would pay the taxpayer. In other words, the IRS has the option

⁵⁰ For details including conditions on the IRS right to offset overpayments against these items, see §6402(c) through (f).

⁵¹ §6402(1).

⁵² §6402(g).

of whether to exercise its right of offset, but the taxpayer has no choice but to accept the IRS decision and application.

Variance Doctrine

Section 7422(a) of the Code states:

(a) **No Suit Prior to Filing Claim for Refund.** — No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

Referred to informally as the “variance” doctrine, this precept has the purpose of ensuring that the IRS and ultimately the government is put on notice of the nature of the taxpayer’s potential claim for refund and has a chance to consider it administratively. As the doctrine relates to a claim requesting abatement and refund of deficiency interest (i.e., a request for a reduction of an amount of allegedly excessively or erroneously assessed and paid deficiency interest), both the taxpayer and its tax adviser need be cautioned that the mere request for an abatement and refund of *tax* does not necessarily entitle the taxpayer to an abatement and refund of all the associated *interest* that was improperly assessed and paid. Rather, judicial precedent suggests that unless the claim for interest on tax is timely and specifically articulated, the most that can be expected as an *interest* refund attendant to the *tax* refund is some pro rata amount of interest.⁵³ Even language appearing in the IRS’s tax forms stating that a taxpayer is entitled to an overassessment “plus interest as provided by law” (e.g., Form 870, Form 870-AD)⁵⁴ does not mitigate the severity of the doctrine.

Therefore, when filing or considering the filing of a claim for refund of tax, the taxpayer or tax professional should consider whether stand-alone deficiency interest issues exist, or risk forfeiting potential interest claims should the statute of limitations for filing a

refund claim expire.⁵⁵ In such event the IRS and courts typically have cited §6511(b)(1) as authority to bar a later, separate claim for interest: “No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in [Section 6511(a)] for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.” Pursuant to §7422, if the separate claim for interest is time-barred, certainly the taxpayer cannot maintain a lawsuit. In other words, separate claims for the underlying tax and interest, respectively, must be timely filed.⁵⁶ Under this trap for the unwary, a claim for refund of underlying tax that fails to articulate a separate claim for interest may cause a taxpayer not to receive the amount of interest to which it is entitled and preclude it from judicial remedy.

Example. A company disagrees with the IRS assertion of tax upon the examination of a return, but the taxpayer wants to stop additional deficiency interest from accruing while it contests the results of the examination. The company pays the IRS the disputed tax (and, typically, the amount of interest (if any) the IRS has asserted) and then files a claim for refund.⁵⁷ The IRS, as expected, denies the claim; the company files a suit for refund of the tax.⁵⁸ A court eventually agrees with the company that the tax was overcharged and directs the IRS to refund the overcharged tax. The IRS abates the tax and issues a refund but either fails to abate interest or abates too little interest. The company now wants to dispute the assessed interest amount (or a previously assessed and paid deficiency interest amount). However, more than two years have elapsed since the company made a payment in the account (in an amount equal to or greater than the requested adjustments), and other legal devices such as a waiver (Form 872 or Form 872-A)⁵⁹ that would keep the statute of limitations open do not apply under this set of facts.

Courts applying the variance doctrine have held that because the company in this example generally

⁵⁵ See *Computervision Corp. v. U.S.*, 445 F.3d 1355 (Fed. Cir. 2006), *reh’g denied*, 467 F.3d 1322 (Fed. Cir. 2006). See also “Other Issues Concerning Interest on Underpayments and Overpayments: Statutes of Limitation,” above.

⁵⁶ See §6511(b)(2)(C) and “Other Issues Concerning Interest on Underpayments and Overpayments: Statutes of Limitation,” above.

⁵⁷ Section 6603 prescribes that a taxpayer may place with the IRS a cash deposit of disputed amounts that in effect suspends the accrual of interest for the period during which the IRS holds the deposit.

⁵⁸ In general, a taxpayer may sue the IRS for a refund in either an appropriate federal district court or the United States Court of Federal Claims.

⁵⁹ Form 872 (“Consent to Extend the Time to Assess Tax”); Form 872-A (“Special Consent to Extend the Time to Assess Tax”).

⁵³ See *Alexander Proudfoot Co. v. U.S.*, 454 F.2d 1379 (Ct. Cl. 1972); *Deluxe Check Printers, Inc. v. U.S.*, 15 Cl. Ct. 175 (1988).

⁵⁴ Form 870 (“Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment”); Form 870-AD (“Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment”).

cannot administratively recover the improperly charged and paid deficiency interest, it also cannot judicially recover the interest. To avoid missing opportunities to receive interest on overcharged tax, a taxpayer in this situation should file with the IRS both a claim for refund of the underlying tax and, if appropriate, a separate claim for refund of the overcharged interest. Similarly, the complaint in the suit for refund should state separate counts for the allegedly overcharged tax and interest. The claims/counts should state the separate dollar amounts (tax and interest, respectively) the taxpayer seeks to recover. Otherwise, assuming that the statute of limitations has expired, the taxpayer later may find itself barred from recovering all the interest it should have received.

Interest Netting

Statutory Provisions

Section 6621(d) provides for the elimination of interest on overlapping periods of equivalent overpayments and underpayments of tax by the same taxpayer. As enacted by the Internal Revenue Service Restructuring and Reform Act of 1998 (the “RRA”),⁶⁰ the statute and the doctrine have come to be known as “interest netting” (or “global interest netting”). Section 6621(d) reads:

(d) Elimination of Interest on Overlapping Periods of Tax Overpayments and Underpayments. — To the extent that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period.⁶¹

History

Conceptually, interest netting dates from the mid-1980s. The issue arose once the Tax Reform Act of 1986⁶² had amended the Code to provide for differential interest rates on overpayments compared to underpayments of tax. Before the 1986 Act, taxpayers received interest on overpayments (referred to as “overpayment interest,” “allowable interest” or “statutory interest”) at the same rate at which the IRS

⁶⁰ P.L. 105-206, §3301(a), 112 Stat. 685, 741, as amended by §4402(d) of the Tax & Trade Relief Extension Act of 1998, P.L. 105-277, 112 Stat. 2681.

⁶¹ In §6621(d), “subchapter A” refers to the subdivision of Code Chapter 67 addressing interest on underpayments, and “subchapter B” refers to the subdivision of Code Chapter 67 addressing interest on overpayments.

⁶² P.L. 99-514, enacted Oct. 22, 1986 (the “1986 Act”).

charged taxpayers interest on underpayments (referred to as “deficiency interest”).⁶³

Section 6621(a), as amended by the 1986 Act, required the IRS to charge interest on underpayments at the federal short-term rate plus three percentage points (the “Underpayment Rate”), but to pay interest on overpayments at the federal short-term rate plus two percentage points (the “Overpayment Rate”).⁶⁴ In 1994, the Uruguay Round Agreements Act widened this differential. Under §6621(a), as further amended, the overpayment rate applicable to corporate overpayments exceeding \$10,000 consists of the federal short-term rate plus 0.5 percentage points.⁶⁵

Initially, the differential interest rates imposed by the 1986 Act applied to all taxpayers. The RRA eliminated the differential for noncorporate taxpayers.⁶⁶ Corporate taxpayers remained subject to the previously described differentials and, in addition, to an increased underpayment rate on “large corporate underpayments” enacted in 1990. The underpayment rate on large corporate underpayments consists of the federal short-term rate plus five percentage points.⁶⁷ For purposes of these rules, “large corporate underpayment” means an underpayment of tax by a C corporation exceeding \$100,000 for a taxable period.⁶⁸ Thus, C corporations remain subject to an overpayment rate consisting of the federal short-term rate plus two percentage points (0.5 percentage points for overpayments exceeding \$10,000) and an underpayment rate consisting of the federal short-term rate plus three percentage points (five percentage points for underpayments exceeding \$100,000).

Initial Results

The IRS began applying differential interest rates following their enactment even when the taxpayer had underpayments on one tax form (e.g., Form 1120)⁶⁹ and overpayments of tax (on another tax form (e.g., Form 941)⁷⁰ for the same taxable period.

Example 1. For the period from April 1 through June 30, 1987, Corporation ABC overpaid its income

⁶³ See §6621(a), before its amendment by P.L. 99-514, effective for purposes of determining interest for periods before Jan. 1, 1987.

⁶⁴ §6621(a), as amended by P.L. 99-514, §1511(a).

⁶⁵ P.L. 103-465, §713(a), effective for purposes of determining interest for periods after Dec. 31, 1994.

⁶⁶ §6621(a)(1)(B), as amended by P.L. 105-206, §3302(a), effective for interest for the second and succeeding calendar quarters beginning after July 22, 1998.

⁶⁷ §6621(c)(1), added by P.L. 101-508, §11341(a), effective for purposes of determining interest for periods after Dec. 31, 1990, informally known as “hot interest.”

⁶⁸ §6621(c)(3).

⁶⁹ U.S. Corporation Income Tax Return.

⁷⁰ Employer’s Quarterly Federal Tax Return.

tax by \$200,000. For the same period, ABC underpaid employment taxes by \$500,000. Typically, the government would pay ABC interest on the overpayment of income tax at the federal short-term rate plus two percent and charge ABC interest on the underpayment of employment tax at the federal short-term rate plus three percent.⁷¹

Under circumstances Example 1 describes, the IRS could effectively net the underlying overpayments and underpayments of tax under §6402(a) using the “Right of Offset” discussed in this Memorandum. However, this result is discretionary and available only if the overpayment has yet to be credited or refunded, and the underpayment is unsatisfied. Whether or not the IRS exercises its right of offset, §6621(a) states that differential rates apply in determining interest on the overpayment and underpayment.

Legislative Response

Numerous taxpayers petitioned Congress for relief from the types of situations that Example 1 illustrates. Initially and for a number of years, Congress instructed the IRS to study “netting” and develop appropriate administrative relief. “Congress did not believe that the Federal Government should charge taxpayers a higher interest rate than the Federal Government pays to the extent interest is owed by and to the Federal Government for the same period on equivalent amounts.”⁷² As simplistically depicted in an example prepared in 1997 by Staff of the Joint Committee on Taxation, the prior existing law created the following issue:

If a taxpayer has an underpayment of tax from one year and an overpayment of tax from a different year that are outstanding at the same time, the taxpayer is typically assessed interest on the underpayment at the higher underpayment rate and credited with interest on the overpayment at the lower overpayment rate. This results in the taxpayer being assessed interest, even if the amounts of the overpayment and the underpayment are the same.

Congress has previously directed the Internal Revenue Service to consider procedures for “netting” such overpayments and underpayments and assessing the proper interest rate to

the net overpayment or underpayment. To date, effective procedures have not been successfully developed.⁷³

Not only did the prior law create interest disparity, but the IRS’s attempt to address differential interest rates by means of offset (§6402(a)) proved to be limited in its application.

If a taxpayer has an underpayment of tax from one year and an overpayment of tax from a different year that are outstanding at the same time, the IRS will typically offset the overpayment against the underpayment and apply the appropriate interest to the resulting net underpayment or overpayment. However, if either the underpayment or overpayment has been satisfied, the IRS will not typically offset the two amounts, but rather will assess or credit interest on the full underpayment or overpayment at the underpayment or overpayment rate. This has the effect of assessing the underpayment at the higher underpayment rate and crediting the overpayment at the lower overpayment rate. This results in the taxpayer being assessed a net interest charge, even if the amounts of the overpayment and the underpayment are the same.⁷⁴

Congress was further concerned as a matter of policy that “prior practices provided an incentive to taxpayers to delay the payment of underpayments they do not contest, so that the underpayments will be available to offset any overpayments that are later determined.”⁷⁵ “Congress believed this contrary to sound tax administrative practice and that taxpayers should not be disadvantaged solely because they promptly pay their tax bills.”⁷⁶ The intent to remedy this particular issue is articulated in the “Explanation of Provision” section of the Joint Committee explanation:

It is anticipated that the Secretary will take into account interest paid on previously deter-

⁷¹ Note that under applicable provisions in effect today (May 2010), the overpayment rate would consist of the federal short-term rate plus .5%, and the underpayment rate would consist of the federal short-term rate plus five percent. See preceding discussion.

⁷² *General Explanation of Tax Legislation Enacted in 1998*, prepared by the Staff of the Joint Committee on Taxation (Nov. 24, 1998), pages 73, 74.

⁷³ *Description of the “Internal Revenue Service Restructuring and Reform Act of 1997,”* prepared by the Staff of the Joint Committee on Taxation (JCX-62-97) (Oct. 21, 1997), page 26.

⁷⁴ *Description and Analysis of Proposals Relating to the Recommendation of the National Commission on Restructuring the Internal Revenue Service, S. 1096, and H.R. 2676 as Passed by the House*, prepared by the Staff of the Joint Committee on Taxation (Jan. 23, 1998), page 91. See also H. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998).

⁷⁵ *General Explanation of Tax Legislation Enacted in 1998*, prepared by the Staff of the Joint Committee on Taxation (Nov. 24, 1998), pages 73, 74.

⁷⁶ *Id.*

mined deficiencies or refunds for the purpose of determining the rate of interest in periods for which this provision is effective without regard to whether the underpayments or overpayments are currently outstanding.⁷⁷

Eventually, Congress in the RRA legislatively addressed “netting” by adding §6621(d). Section 6621(d) generally applies in determining interest for periods beginning after July 22, 1998.⁷⁸

Revised Results

Example 2. The facts are the same as in Example 1, except that ABC has the referenced overlapping overpayment and underpayment for the period from April 1, 1999 through June 30, 1999. Section 6621(d) requires the netting of the overlapping \$200,000 overpayment and underpayment and imposes on it a net rate of interest of zero, leaving a net underpayment of \$300,000. On this net underpayment, interest is charged at the underpayment rate.

Mechanically, “netting” under §6621(d) can be effected in either of two ways or “directions.” The interest rate payable on a deficiency may be reduced to the same rate applicable to an overpayment for the overlapping period of time (producing a refund of deficiency interest if the interest has been paid). Alternatively, the interest rate applicable to an overpayment may be increased to the same rate paid on a deficiency for the overlapping period of time (producing an additional payment of allowable interest). The netting theory or methodology employed may have substantive ramifications. This may occur because of differences in the statutes of limitation within which a taxpayer may claim from the IRS overassessed deficiency interest as compared to requesting additional allowable interest.⁷⁹ A taxpayer’s claim that the IRS net overlapping underpayments and underpayments, in determining interest due or payable, must be crafted in view of available statutes of limitation.

On its face seemingly straightforward, the one sentence of which §6621(d) consists has proven challenging and complicated to apply. More than a decade af-

ter its enactment, the provision’s scope remains subject to interpretation and litigation. For one thing, taxpayers should never assume that the IRS will take the initiative to net overlapping underpayments and overpayments in determining interest due or payable. The taxpayer bears the responsibility to request netting by making a formal claim. Whenever reviewing determinations of interest due to or from the IRS, opportunities to effect netting should never be overlooked.⁸⁰

Netting Across Entity Lines

An especially controversial aspect of netting under §6621(d) has proven to be the circumstances under which equivalent underpayments and overpayments may be netted across entity lines. The statutory language addresses equivalent underpayments and overpayments *by the same taxpayer*.⁸¹ Who is “the same taxpayer”? At what time should “the same taxpayer” be identified?

Example 3. Corporation UP, which uses the calendar year as its taxable year, has a \$20 deficiency in tax for taxable year 2007. On June 30, 2009, UP acquired Corporation OP. As a result of this acquisition, OP became a subsidiary of UP and joined UP’s consolidated federal income tax return beginning in taxable year 2009. UP paid the deficiency for 2007, plus appropriate deficiency interest, on March 15, 2010. OP had overpaid tax of \$20 for its taxable year 2006. On December 31, 2009, the IRS refunded to OP the \$20 plus allowable statutory interest. For the period from March 15, 2008 (due date without extensions of UP’s 2007 return) through December 31, 2009, UP had a deficiency of \$20 and OP had an overpayment of \$20. Under §6621(d), may UP’s underpayment of \$20 be netted with OP’s overpayment of \$20, in effect producing a net interest rate of zero? If so, then UP may recover from the IRS the deficiency interest it had paid on the \$20 underpayment for that period.

The IRS has sparingly addressed the issue of netting across entity lines. No known “published” guidance such as a revenue ruling or revenue procedure addresses the issue. However, the IRS has provided advice to particular taxpayers in the form of letter rulings and other nonprecedential communications. In a Chief Counsel Advice, the IRS has permitted the netting of an overpayment from a pre-acquisition year of an acquired company against a post acquisition defi-

⁷⁷ *Id.*

⁷⁸ P.L. 105-206, §3301(a). Taxpayers were granted the option under prescribed conditions to net overpayments and underpayments for earlier periods. This transition relief had to be requested no later than Dec. 31, 1999. See P.L. 105-206, §3301(c)(2), as amended by P.L. 105-277, §4002(d); Rev. Proc. 99-19, 1999-13 I.R.B. 10, 1999-1 C.B. 842; and Rev. Proc. 2000-26, 2000-1 C.B. 1257. For discussion of factors that influenced Congress to endorse interest netting, see H. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998); H. Rep. No. 364 (Part 1), 105th Cong., 1st Sess. 64 (1998); S. Rep. No. 174, 105th Cong., 2d Sess. 62 (1998).

⁷⁹ See above, “Other Issues Concerning Interest on Underpayments and Overpayments: Statutes of Limitation.”

⁸⁰ Similarly, opportunities to achieve netting in determining interest due to or payable by a particular state should be explored in the case of states that one way or another have adopted the principles of §6621(d).

⁸¹ See §6621(d).

ciency of the acquiring company.⁸² In other situations, the IRS has not permitted netting across entity lines.

In March 2010, the Claims Court addressed netting across entity lines in *Energy East Corp. v. U.S.*⁸³ Energy East Corporation acquired Central Maine Power Company (CMP) in 2000 and Rochester Gas & Electric Corporation (RGE) in 2002. Following these acquisitions, CMP and RGE joined with Energy East in filing consolidated federal income tax returns. Later it was determined that CMP had overpaid its income taxes for taxable years 1995, 1996, and 1997, that RGE had overpaid its income taxes for taxable years 1996 and 1997, and that Energy East had underpaid its income tax for taxable year 1999. Under §6621(d), Energy East claimed a net interest rate of zero on its deficiency for 1999 for certain periods of time be-

cause deficiency interest running on its underpayment overlapped with allowable interest running on the overpayments by CMP and RGE for their respective tax years. The Claims Court denied the netting claim: “Because these subsidiaries were separate and different taxpayers wholly unrelated to Energy East both at the time the underpayment was due and the overpayments were made, the Court concludes they were not the ‘same taxpayer’ as Energy East within the meaning of Section 6621(d).”

Other cases docketed in the courts probe the scope of possibly netting across entity lines under §6621(d). The “rules” presumably will develop slowly and decision-by-decision. Meanwhile, in the absence of authoritative, published administrative guidance addressing the issue, taxpayers should not necessarily capitulate on possibly netting concurrent underpayments and overpayments across entity lines.

⁸² CCA 200407015.

⁸³ 105 AFTR 2d 2010-1364 (Fed. Cl. 2010).