INTEREST ON OVERPAYMENTS AND UNDERPAYMENTS OF TAX[1]

I. Interest Provisions of the Internal Revenue Code.

A. Overview. Liabilities for interest on underpayments and overpayments of internal revenue taxes are determined pursuant to Chapter 67 of the Internal Revenue Code, §§ 6601 - 6631. The basic issues with respect to interest liabilities under the Code – as with all types of interest computations – are (1) the principal amount upon which the interest accrues, (2) the date upon which interest begins to accrue, (3) the date upon which interest stops accruing, and (4) the rate at which the interest accrues. While these elements of interest computations each involve the determination of a simple, objective fact, the rules regarding how each of these facts is determined can be extraordinarily complex. Further, the rules themselves are not always free from doubt. Also, an interest computation may be subject to a variety of restrictions and adjustments. The successful handling of tax litigation requires at least a basic understanding of these various interest rules. Interest often accounts for a very large portion of the amount in controversy in a tax case and may even exceed the amount of tax in dispute. In fact, cases involving only disputes over interest, where the underlying tax liability itself has been resolved, have become increasingly common in recent years.

In dealing with interest disputes, the governing provisions of the Code must always be the starting point. Interest on tax liabilities is strictly a creature of statute and the United States may not be held liable for interest on a tax overpayment beyond what is provided for by statute. In fact, the United States was not liable for interest on tax overpayments at all until 1921, when an overpayment interest provision was first enacted.[2] Internal Revenue Act of 1921, Pub. L. No.

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[1] This material was originally prepared in 2004 by William K. Drew, senior trial attorney/reviewer, Court of Federal Claims Section, Tax Division, for use with Tax Division training programs. It was updated by Robert Markham of the Office of Review in 2007. The views expressed herein are solely those of the author and do not necessarily reflect positions of the Department of Justice.

[2] In contrast, federal law has provided for interest on underpayments of tax since the 1800s.

67-98, § 1324, 42 Stat. 227, 316. While case law is important in interpreting these statutes, interest liability may not be extended beyond what the statute prescribes.[3] For example, the "use-of-money" principle is frequently invoked in tax cases. This principle, which is stated to be the rationale for charging interest, is a useful guide for interpreting interest statutes where the statute is ambiguous or where the application of the statute to a particular fact situation is unclear. Nonetheless, the use-of-money principle is not a principle of substantive law and (contrary to arguments sometimes advanced by taxpayers) cannot impose liability for interest that is beyond the scope of the Code's interest provisions.

The Code sets out separately the provisions for the payment of interest on overpayments and for interest on underpayments of tax. These provisions are similar to each other in many respects and, to the extent that overpayment and underpayment provisions are identical, they should be construed in a consistent manner. The overpayment and underpayment provisions, however, do not exactly mirror each other. Attorneys, therefore, must be especially cautious when dealing with differences between the overpayment and underpayment interest provisions of the Code. Further, the attorney must take care to determine whether, and to what extent, a claim involves underpayment interest or overpayment interest. In situations where the taxable year in suit was many years ago and the account for the year has had many adjustments (especially adjustments based upon carrybacks and credits), it is not always obvious whether overpayment interest or underpayment interest is involved.

In analyzing interest issues under the Code, attorneys must take care to refer to the proper versions of the applicable Code sections. The interest provisions of the Code have been amended many times over the last 20 or so years. The effective dates of these amendments are sometimes stated in terms of the taxable years to which the amendments apply and are sometimes stated in terms of the periods of

[3] Thus, while interest claims by and against the Government may be compromised, as may the tax liability itself, a settlement of an interest dispute may not provide for the payment by the United States of more interest than is provided for by statute.

interest accrual (irrespective of the taxable year) to which the amendments apply. Also, these amendments have often redesignated the subsection number of various interest provisions, thus further adding to potential confusion as to the applicable law.

B. Principal Amount. Analyzing interest issues requires determining the principal amount upon which interest may accrue. This principal amount is the difference between the total amount of payments and credits and the amount of the involved tax liability of the taxpayer during the periods of interest accrual. The principal amount often will not be the same as the balance reflected on the transcript of account at any given time. The principal amount is determined based upon the actual tax liability of the taxpayer, which often will differ from the amount of assessments at any given time. Assessment amounts can be in error, and assessments at most times will not be up to date with respect to accrued interest on overpayments or underpayments. Further, when amounts are transferred between different accounts (such as accounts for different taxable years), the rules for determining the effective date of the crediting can be complicated, as discussed below with respect to starting dates and ending dates. Therefore, it is vital that interest computations be obtained from a computation specialist in the Office of Review whenever computations with respect to a settlement or an entry of judgment are needed. The trial attorney should never assume that adjustments to interest will be proportionate to the adjustment of the tax liability of the taxpayer.

Another important point with respect to determining the principal amount for interest accrual purposes is that not all amounts tendered to the IRS are necessarily payments of tax. In particular, the law has long recognized that a remittance, in the absence of an outstanding liability, may be a "deposit in the nature of a cash bond." See Rosenman v. United States, 323 U.S. 658 (1945). The bond is not a payment of tax and, thus, does not bear interest. On the other hand, the deposit, if ultimately applied in satisfaction of a later assessment, will stop the running of interest on the amount of the deficiency so satisfied from the date the deposit was made. Further, the bond converts into a payment of tax as of the date that it is applied in satisfaction of an assessment. The IRS has issued revenue procedures over the years dealing with

deposits in the nature of cash bonds. For deposits made prior to October 3, 2004, these deposits were governed by Rev. Proc. 84-58, 1984-2 C.B. 501. Beginning October 3, 2004, deposits in the nature of cash bonds are governed by new § 6603 of the Code, enacted by § 842 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, October 22, 2004. Section 6603, in addition to providing an explicit statutory basis for making deposits in the nature of cash bonds and authorizing rulemaking with respect thereto, provides for the payment of interest, in specified circumstances, with respect to bond amounts ultimately returned to the taxpayer. The interest rate payable with respect to these amounts, however, is somewhat lower than the interest rate provided for overpayments of tax under § 6621(a)(1). § 6603(d)(4). Any deposit made pursuant to Rev. Proc. 84-58 and held by the IRS as a cash bond as of the date of enactment of § 6603 will become a deposit under § 6603 effective as of the date that the taxpayer identifies that amount as a deposit under § 6603. § 842(c), Pub. L. No. 108-357 (uncodified).

As noted above, interest is a creature of statute. With respect to underpayments of tax, interest is imposed by § 6601(a). Under the general rule, interest must be paid if "any amount of tax imposed" by Title 26 is not paid on or before the last date prescribed for payment. Thus, the principal amount of an underpayment is, generally, the excess of the amount of "tax" imposed by the statute over the amounts paid. In addition to this general rule, the determination of the principal amount of the underpayment is subject to provisions defining what constitutes "tax" for this purpose and provisions setting forth exceptions to the general rule. These provisions are set forth in § 6601 and the regulations thereunder. For example, the statute deals with how adjustments to tax based upon carrybacks are treated for purposes of determining the unpaid balance of tax. § 6601(d). Generally, reductions in tax caused by carrybacks of net operating losses, capital losses, foreign taxes[4], or business credits under § 39 are not effective,

[4] Notwithstanding the caption to § 6601(d)(2) and language in some cases, foreign tax credits are not carried back. Foreign taxes in excess of the amount creditable in the year in which they arise may be carried back and applied as if arising in the year to which the carryback is taken. It is the amount of excess foreign tax, not the foreign tax credit, that is carried back.

for purposes of § 6601, prior to the last date, determined without respect to extensions, for filing the return for the year generating the carryback. Thus, where an underpayment is reduced by a carryback that is within the scope of § 6601(d), the principal amount of the underpayment, for interest purposes, is not adjusted until the filing date of the year generating the carryback.

Section 6601(e) sets out special rules with respect to interest, penalties, and additions to tax. Prior to 1983, interest was not compounded on underpayments. Thus, accrued interest was not part of the principal amount upon which interest accrued. Interest has been added to the tax liability and accrues interest at the same rate as the underlying tax underpayment for periods of accrual beginning after December 31, 1982. § 6601(e)(1), § 6622, Treas. Reg. § 301.6601-1(f)(1), (2). Further, under § 6601(e)(2), assessable penalties and additional amounts (other than failure to file or failure to pay penalties imposed by § 6651(a)(1) and failure to pay stamp tax penalties imposed by § 6653) are not principal amounts that bear interest if paid within 21 calendar days (10 business days for amounts in excess of $100,000) of notice and demand for payment.[5] If not paid within the applicable time period, the penalty or addition to tax is added to principal for interest accrual purposes as of the date of notice and demand.

Underpayments of estimated tax liabilities and certain adjustments to employment tax liabilities also are excepted from the imposition of interest under § 6601. §§ 6205(a), 6601(h), 6601(i), 6601(k).

In the case of an erroneous refund that is recoverable under § 7405, the amount of the erroneous refund is a principal amount that bears interest at the rate applicable to underpayments of tax. Interest accrues from the date that the erroneous refund was made by the IRS. § 6602.

[5] For any notice and demand for payment that was made before January 1, 1997, only the 10 business day period was allowed for making interest-free payments, regardless of the amount due.

Interest is allowed on overpayments of tax by § 6611. As with the provisions for deficiency interest set forth in § 6601, the overpayment interest rules of § 6611 are complex and contain many exceptions and restrictions.[6] While these exceptions and restrictions are similar to the corresponding provisions of § 6601, they are not identical to those provisions. Section 6611(d) provides that estimated and advance payments of tax and withheld income taxes are deemed payments of tax, and thus added to the principal balance upon which interest may be payable, for purposes of § 6611(a) as of the last date prescribed for filing the return, determined without respect to extensions. Section 6611(f) provides special rules with respect to interest on overpayments of tax that result from various kinds of carrybacks. These provisions largely mirror the provisions with respect to underpayment interest set forth in § 6601(d) discussed above. Some differences do exist, however, between § 6601(d) and § 6611(f). Notably, the rules of § 6611(f) are coordinated with the 45-day rule of § 6611(e) (discussed in part I.F., below, regarding adjustments and restrictions). Section 6601, however, does not contain provisions corresponding to the 45-day rule. Further, for purposes of coordinating the 45-day rule with § 6611(f), if a taxpayer files a claim for refund based upon a carryback and later files an application for a tentative allowance, or "quick refund" (Form 1045 for individuals and Form 1139 for corporations), the claim for refund shall be treated as having been filed on the date that the application for tentative allowance was filed. § 6611(f)(4)(C).

C. Starting Date. With respect to deficiencies, or underpayments, interest begins to accrue as of the last date prescribed for payment. § 6601(a). The last date prescribed for payment is generally determined without regard to extensions and without regard to installment agreements entered into pursuant to § 6159.[7] § 6601(b). For taxes for which no due date is prescribed, interest begins to run as of the date the tax liability arises, but in no case later than the date that notice and demand for payment is made. § 6601(b)(5).

[6] Several of the limitations and restrictions are discussed below with respect to starting and ending dates and with respect to adjustments and restrictions.

[7] Special rules, however, apply to payments with respect to certain motor vehicle excise taxes for which an installment payment privilege has been invoked under § 6156(a). § 6601(b)(2).

Although the rules regarding the starting date for interest on underpayments appear to be relatively simple, application of those rules has been quite complicated in situations where an event after the underpayment arises affects the amount of the underpayment. A classic case involving this type of situation – and the case giving rise to the "use of money" principle – is Manning v. Seeley Tube & Box Co. of New Jersey, 338 U.S. 561 (1950). In Seeley, the Court addressed the question of whether a taxpayer remained liable for interest on a deficiency notwithstanding that the deficiency was subsequently eliminated by a net operating loss carryback.[8] The taxpayer argued that the elimination of the deficiency by the loss carryback also eliminated liability for interest on the deficiency. The Court disagreed. The Court noted that as of the due date for the tax, the required amount of tax was not paid. The deficiency, therefore, was validly assessed and the taxpayer was, in effect, in possession of funds that belonged to the Government. Therefore, the extinguishing of the deficiency by the carryback did not extinguish the liability for interest on the deficiency that accrued prior to the time that the carryback arose. "In the absence of a clear legislative expression to the contrary, the question of who properly should possess the right of use of the money owed the Government for the period it is owed must be answered in favor of the Government." 338 U.S. 561, 566. Although the precise question before the Court in Seeley is now addressed by statute, Seeley remains an important precedent establishing the "use of money" principle as an important tool for interpreting the interest provisions of the Internal Revenue Code.

The former Court of Claims addressed an issue where a subsequent event extinguished a previously assessed and paid tax liability in Brown & Williamson, Ltd. v. United States, 688 F.2d 747 (Ct. Cl. 1982). In Brown & Williamson, the taxpayer, a British corporation, timely reported and paid a certain United States corporate income tax liability. This tax liability, however, was later reduced based upon a retroactive change in law resulting from an amendment to

[8] Under current law, this question is resolved by § 6601(d)(1). Interest continues to accrue until the filing date for the year in which the loss arises.

the income tax treaty between the United States and the United Kingdom. The IRS refunded the resulting overpayment of tax, but refused to pay interest thereon. The taxpayer sued for statutory interest on the overpayment accruing from the date of the original payment of the tax. The Government contended that overpayment interest did not start to accrue until the effective date of the applicable treaty provision. The Court of Claims ruled for the taxpayer. "When a statute provides for a retroactive refund of taxes, the effect is to convert the previously paid taxes into overpayments, i.e., the amount of tax paid, although originally correct, now exceeds the correct tax liability. The date of overpayment of the refunded tax, therefore, is the date on which it originally was paid." 688 F.2d 747, 749. The Court noted that a deficiency caused by a retroactive change in law would bear interest and that the principle of symmetry is important in construing the interest provisions of the Code. The Court distinguished Seeley on the ground that Seeley involved interpretation of the loss carryback provisions of the Code. The carryback, unlike a retroactive change in law, did not affect the duty to pay the tax owed from the due date until the carryback arose. Brown & Williamson, therefore, rests on the distinction between a "general adjustment," which reduces the tax liability as originally reported, and a carryback adjustment, which reduces tax liability only as of the date the carryback became available.

Another situation that has presented complex questions regarding the starting date for interest accruals is the crediting of reported overpayments for one taxable year against the estimated tax payment liabilities for a succeeding taxable year (credit elect transfers). This problem arises especially with respect to large corporations, which frequently file their returns after the original due date pursuant to extensions of time to file. These corporate taxpayers will commonly request that the overpayment reported on their returns be applied to the estimated tax payment obligations for the subsequent taxable year (that is, the current year as of the time the return is filed). The law is clear that no interest is paid on these credit elect transfers to the subsequent taxable year.[9] Treas. Reg. § 301.6611-1(h)(2)(vii).

[9] Further, if a taxpayer, after having an overpayment applied as a credit elect against an estimated tax liability, requests permission to change the credit elect to a refund, the refund, if permitted by the IRS, is made without interest. IRM 20.2.4.8.4.

Questions have arisen, however, as to when deficiency interest begins to run under § 6601 if a deficiency is subsequently determined for the year out of which the credit elect was transferred. That is, to what extent does the originally reported overpayment that was credited against a subsequent year's estimated tax liability reduce the deficiency? This question was first addressed in Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978). In Avon, the taxpayer filed its return for 1967 on September 15, 1968. The return was timely filed pursuant to extensions. The return reported an overpayment of tax. The taxpayer elected to have the overpayment credited against its estimated tax payment for the taxable year 1968 that was due on September 15, 1968 – the day the 1967 return was filed. The IRS subsequently determined that the taxpayer had a smaller overpayment for 1967 than had been reported. Thus, the credit elect transfer resulted in a deficiency for 1967. Based upon the sequence of payments for 1967, and eliminating the amount credited to 1968, the IRS determined that the deficiency for 1967 arose, and began to accrue interest, on June 15, 1968.[10] The taxpayer argued that the deficiency for 1967 did not arise until September 15, 1967, when the installment for 1968 to which the credit elect was applied became due. The Second Circuit ruled for the taxpayer. "Reading § 6601(a) more broadly, it provides that interest shall begin running when a tax becomes both due and unpaid. Avon's 1967 taxes became due on June 15, 1968, and they were paid in full from that date until a deficiency was created on September 15. It is the latter date from which interest should run." 588 F.2d 342, 344.

In May Department Stores Co. and Subsidiaries v. United States, 36 Fed. Cl. 680 (1996), the Court of Federal Claims addressed a situation similar to that in Avon. Factually, May differed from Avon in that the taxpayer in May did not specify to which installment payment the credit elect should be applied. In the absence of directions from the taxpayer, the IRS applied the credit elect against the first installment for the year to which the credit elect was transferred. Further, the Government argued that a change in law subsequent to the decision in Avon required that once the credit elect was applied with respect to the

[10] Avon took advantage of an installment option to pay part of its tax balance due on the original due date and to pay the balance on June 15th. This option is not available under current law.

first installment of estimated tax for the subsequent year, that sum could no longer be considered in determining the amount of the deficiency for the underpayment year. The Court ruled in favor of the taxpayer. Relying heavily on the "use-of-money" principle announced in Seeley, the Court rejected the Government's argument based upon the statutory change, which was held to be inapplicable to the facts in May. The Court ruled that underpayment interest did not begin to accrue until the involved tax liability was both due and unpaid. The Court concluded that the tax liability became due and unpaid on October 15th of the subsequent year, not on the due date of the first estimated tax installment for the subsequent year. The Court's rationale is not completely clear. The October 15th date could have been chosen because that was the date that the return was filed for the year from which the credit elect was transferred or because that was the date upon which an installment of estimated tax was due that had not been previously fully paid.

The IRS acquiesced in the result in May and subsequently dealt with the issue of deficiencies and credit elect transfers in Rev. Rul. 99-40, 1999-2 C.B. 441. "When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under §§ 6654 or 6655 with respect to such year. The Service will assess interest on a subsequently determined deficiency for the overpayment year from the date that the overpayment is applied to the succeeding year's estimated taxes." Rev. Rul. 99-40. Because Rev. Rul. 99-40 sets out the rules by which the IRS applies a credit elect transfer against a succeeding year's estimated tax obligations, as of October 4, 1999, the IRS no longer accepts designations by taxpayers as to how credit elect transfers are to be applied to the subsequent year's estimated tax liabilities.

With respect to interest on overpayments of tax, the general rule is that interest starts to accrue as of the date that the overpayment arises.[11] § 6611(b)(1), (2). If a return is filed after the last date

[11] For special rules with respect to when an overpayment arises for interest purposes, see §§ 6611(d), (f), discussed in part I.B., above.

prescribed for filing (determined with regard to extensions), then interest is not payable or allowable for any period prior to the filing of the return.[12] § 6611(b)(3) (effective with respect to returns filed after October 3, 1982). Further, for purposes of § 6611(b)(3), a return is not deemed to be filed until it is in "processible form". § 6611(g). A return is not in processible form unless it is filed on a proper form and includes (i) the taxpayer's name, address, taxpayer identification number, and the required signature, and (ii) sufficient information, whether on the return or on an attachment thereto, to permit mathematical verification of the tax liability shown on the return. § 6611(g)(2).

D. Ending Date. With respect to underpayments of tax, the general rule is that interest accrues on the underpayment "to the date paid." § 6601(a). For taxes subject to the Code's deficiency procedures (see §§ 6211, 6212), which include income, estate, gift, and certain excise taxes, interest is suspended in certain circumstances if a waiver of restrictions on assessment is executed by the taxpayer. In the event that a waiver is executed and filed with the IRS, and the IRS does not issue a notice and demand for payment within 30 days of the filing, then interest is suspended from the 30th day after the filing through the date that the notice and demand is issued. Similar rules apply with respect to settlements entered into by a taxpayer with respect to partnership items. § 6601(c). Further, interest will not accrue on an underpayment after the issuance of the notice and demand for payment if prompt payment is made. For this purpose, the payment must be made within 21 calendar days, or within 10 business days if the underpayment equals or exceeds $100,000. § 6601(e)(3). In the event that an overpayment is credited against an underpayment of tax pursuant to § 6402, then interest will not accrue on the underpayment during the period during which interest would have been allowable on the overpayment, if it had not been credited against the underpayment. § 6601(f). Section 6601(f), however, does not apply to the extent that a net interest rate of zero applies pursuant to § 6621(d).

[12] With respect to the restrictions on interest being payable and allowable pursuant to the "45-day rule," see § 6611(e), discussed below.

Interest on overpayments of tax is payable pursuant to § 6611(a). The rules with respect to the ending date for interest accrual on overpayments are set out in § 6611(b) and differ significantly from the rules under § 6601(a) with respect to interest accruals on underpayments. Further, the ending date for interest accruals on overpayments differs depending upon whether the overpayment is refunded to the taxpayer or is credited against another tax liability of the taxpayer (or, with the taxpayer's consent, against a liability of a different taxpayer). If the overpayment is refunded to the taxpayer, then interest accrues through a date determined by the IRS that precedes the date of the refund check by not more than 30 days. § 6611(b)(2). This rule applies irrespective of whether the taxpayer accepts the tender of the refund check. In the case of the crediting of a refund, however, interest ceases to accrue as of "the due date of the amount against which the credit is taken." § 6611(b)(1). This rule, however, applies only if the credit is applied against a liability of the "same taxpayer" as had the overpayment. If the IRS, with the consent of the taxpayer, credits the overpayment against a tax liability of a different taxpayer, then interest on the overpayment accrues through the date on which the credit is allowed. Rev. Proc. 65-20, 1965-2 C.B. 1003, modifying Rev. Proc. 60-17, 1960-2 C.B. 942. For purposes of § 6611(b)(1), "the due date of the amount against which the credit is taken" is the due date for the payment of the tax against which the credit is applied. This is true even if the tax against which the credit is applied was fully paid as of the due date and only subsequent to that date became underpaid. Marsh & McLennan Companies, Inc. v. United States, 302 F.3d 1369 (Fed. Cir. 2002). In Marsh & McLennan, the taxpayer argued that interest on the overpayment should continue to accrue until the tax liability against which the credit was applied was both due and unpaid. The taxpayer relied on the rationales of cases such as Avon that deal with the accrual of interest on underpayments of tax and cited the principle of symmetry with respect to construing underpayment and overpayment interest provisions of the Code. The Court rejected the taxpayer's arguments. The symmetry principle did not apply here because the applicable Code provisions with respect to the ending date for interest accruals on underpayments and on overpayments do not mirror each other, but are quite different. Likewise, Avon was not applicable because it interpreted a provision of

§ 6601(a) that differed significantly from § 6611(b)(1). Further, the Court concluded that although the language of § 6611(b)(1) was not completely clear with respect to the issue before the Court, the Treasury regulation interpreting the statute was clear and reasonably construed the statute. In these circumstances, the "use-of-money" principle could not override the statute, as construed by the regulation.

E. Rate. Interest rates on overpayments and underpayments of tax are determined pursuant to § 6621.[13] For interest accruals before January 1, 1987, overpayments and underpayments accrued interest at the same rate. That rate was the adjusted prime rate, as defined by § 6621 as in effect prior to 1987. The Tax Reform Act of 1986 introduced a rate differential between overpayments and underpayments of tax. That differential became effective for interest accruals after December 31, 1986. Subsequently, effective with respect to interest accruals after December 31, 1998, the overpayment and underpayment rates were again equalized except for corporate taxpayers. An interest rate differential of at least one percentage point, and, in some circumstances, as much as 4.5 percentage points, continues to exist for corporate taxpayers.

The interest rate on overpayments of tax is the "Federal short term rate"[14] plus three percentage points, or, in the case of corporate taxpayers, plus two percentage points. § 6621(a)(1). In the case of overpayments by corporate taxpayers that exceed $10,000, interest accruals for periods beginning after December 31, 1994, are at the Federal short term rate plus 0.5 percentage point. § 6621(a)(1). This lower rate on corporate overpayments in excess of $10,000 is commonly

[13] One exception to the interest rates determined under § 6621 is set forth in § 6601(j). This exception applies to estate tax liabilities for which the time for payment has been extended under § 6166. Section 6166 allows extensions of time for payment where an interest in a closely held business constitutes a significant portion of the decedent's estate. In these circumstances, § 6601(j) replaces the otherwise applicable interest rate with a rate of 2 percent on a portion of the tax liability paid pursuant to the extension and a rate equal to 45 percent of the underpayment rate that would otherwise be applicable.

[14] The Federal short term rate is determined quarterly by the Treasury. The rate is determined with respect to the average market yield of outstanding marketable obligations of the United States with a remaining time to maturity of three years or less. § 6621(b)(3), § 1274(d).

referred to as "GATT interest" because the rate was enacted as part of the legislation implementing the Uruguay Round Agreements under the General Agreement on Tariffs and Trade (GATT).[15]

The interest rate on underpayments of tax is the Federal short term rate plus three percentage points. § 6621(a)(2). For underpayments of tax by corporations that exceed $100,000, a special "hot interest" rate equal to the Federal short term rate plus five percentage points may apply for interest accrual periods beginning after December 31, 1990. § 6621(c).[16] This hot interest rate applies beginning on the 31st day after the earlier of the date upon which either a notice of proposed deficiency or a statutory notice of deficiency is sent to the taxpayer. With respect to taxes not subject to deficiency procedures, the hot interest rate applies beginning on the 31st day after the date of a letter notifying the taxpayer of the assessment or proposing the assessment. The hot interest rate will not apply if the underpayment is paid in full within 30 days of the applicable date of notice to the taxpayer.

If a taxpayer has overlapping periods of interest accrual on an overpayment for one taxable period and on an underpayment of a different tax, or for a different taxable period for the same type of tax, then a net interest rate of zero may apply pursuant to § 6621(d). Interest netting is discussed below at part II.D.

A judgment in a tax case bears interest at the overpayment or the underpayment rate, as the case may be, established pursuant to § 6621. 28 U.S.C. §§ 1961(c), 2411(a).

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[15] Accrued interest on a corporate overpayment of more than $10,000 bears interest at the GATT rate after December 31, 1994, even if the overpayment of tax was refunded to the taxpayer prior to January 1, 1995. General Electric Company and Subsidiaries v. United States, 56 Fed. Cl. 488 (2003), aff'd, 384 F.3d 1307 (Fed. Cir. 2004).

[16] The former provision of the Code imposing an enhanced rate of interest (of 120 percent of the otherwise applicable rate) on underpayments related to tax-motivated transactions was codified as § 6621(c). Although former § 6621(c) was repealed in 1990, it remains in effect with respect to interest accruals on underpayments related to tax-motivated transactions for returns due (without regard to extensions) prior to January 1, 1990.

F. Adjustments and Restrictions. In addition to the restrictions on interest accrual discussed in parts I.B., C., and D., above, interest may be restricted, suspended, or abated in many other circumstances.

With respect to overpayments that bear interest, § 6611(e) is particularly important. Section 6611(e) sets forth the "45-day" rule. Under § 6611(e)(1), no interest is payable on an overpayment if the overpayment is refunded within 45 days of the due date for filing the return (determined with regard to extensions) or within 45 days of when the return is filed, whichever is later. Section 6611(e)(2) provides that if a taxpayer files a claim for refund or credit of an overpayment and the overpayment is refunded within 45 days of the filing of the claim, no interest is payable for the period from the time of filing the claim until the date of refund. Section 6611(e)(3) provides that where an adjustment initiated by the IRS results in an overpayment, 45 days shall be subtracted from the period during which interest accrues. Sections 6611(e)(2) and (3) are effective for claims filed and for IRS-initiated refunds paid on and after January 1, 1995.

Section 6612 sets out cross-references to various Code sections providing for adjustments or restrictions with respect to interest on overpayments. Section 6612(b) makes reference to the restrictions provided in § 6413(a). Specifically, § 6413(a)(1) provides that if more than the correct amount of tax is paid with respect to FICA (Social Security taxes), the Railroad Retirement Tax Act, or Federal income tax withholding liabilities, proper adjustments, in accordance with Treasury regulations, are to be made without interest.[17] Section 6612(c) sets out a list of various restrictions on the payment of interest on overpayments of tax. These include: § 2011(c), relating to refunds of estate tax due to the credit for State taxes;[18] § 2014(e), relating to

[17] Likewise, § 6205(a) provides that if less than the correct amount of tax is paid with respect to FICA, the Railroad Retirement Tax Act, and Federal income tax withholding, then proper adjustments are to be made without interest.

[18] With respect to the estates of decedents dying after December 31, 2004, and generation-skipping transfers made after December 31, 2004, the credit for State taxes is repealed and replaced with a deduction for State taxes paid.

refunds attributable to foreign tax credits; § 6412 relating to floor stock refunds of certain excise taxes; § 6413(d), relating to FUTA tax overpayments due to credits for State unemployment taxes; § 6416, relating to certain overpayments of retailer and manufacturers excise taxes; § 6419, relating to wagering excise tax refunds with respect to laid off wagers; § 6420, relating to payments to ultimate purchasers of gasoline that is used on farms or for farming purposes; and § 6421, relating to payments to ultimate purchasers of gasoline that is used in an off-highway business use.

Rev. Proc. 60-17, 1960-2 C.B. 942, modified by Rev. Proc. 62-27, modified in part by Rev. Proc. 65-20, modified by Rev. Proc. 83-58, and modified by Rev. Proc. 84-66, contains a list of Code provisions that restrict the payment of interest and contains discussions of how those restrictions are applied. Of course, the Code has been amended many times since Rev. Proc. 60-17 was issued, but this revenue procedure and the subsequent revenue procedures modifying it, continue to be valuable resources with respect to understanding how various interest restrictions are applied.

Pursuant to § 7508A(a), the accrual of interest may be suspended for a period of up to one year for taxpayers determined by the IRS to be affected by a Presidentially declared disaster or by a terroristic or military action. This section applies with respect to disasters and terroristic or military actions occurring on or after September 11, 2001. Prior to September 11, 2001, the statute provided relief only with respect to Presidentially declared disasters and the maximum suspension period was 120 days.

Section 6404 provides for the suspension of interest and also authorizes the IRS to abate interest in certain circumstances. If the IRS prepares a return for a taxpayer in the course of providing assistance to the taxpayer and the return contains a mathematical error that causes less than the proper amount of tax to be reported, then the IRS may abate interest on the resulting deficiency for any period ending not later than the 30th day after the date of notice and demand for payment of the deficiency. § 6404(d). The IRS may abate all or any part of the interest, for any period, on an underpayment

caused by the unreasonable error or delay by an IRS employee in performing a ministerial or managerial act, or by erroneous or dilatory performance by an IRS employee of a ministerial or managerial act, but only if no significant aspect of the error or delay is attributable to the taxpayer and the error or delay occurs after the IRS has contacted the taxpayer in writing regarding the underpayment. § 6404(e)(1). Further, the IRS must abate interest on an erroneous refund that accrues through the date of demand for repayment, unless the taxpayer (or a related party) in any way caused the erroneous refund, or the erroneous refund exceeds $50,000. § 6404(e)(2). Section 6404(f) requires the abatement of penalties and additions to tax, in certain circumstances, where the underpayment of tax is caused by erroneous written advice provided to a taxpayer in response to a taxpayer request for advice and the penalty or additional amount was not the result of a failure by the taxpayer to provide adequate or accurate information. Section 6404(f) applies with respect to requests for advice made on or after January 1, 1989. For income tax liabilities for taxable years ending after July 22, 1998, § 6404(g) requires the suspension of interest (and of certain other additions to tax) if the IRS does not provide notice to a taxpayer "specifically stating" the amount of taxpayer's liability and the basis therefore no later than 18 months after the filing date of the return, the due date of the return (giving consideration to extensions), or, if the taxpayer provides the IRS with signed documents showing an additional tax owing, the date the last of those documents is filed. The suspension runs from the end of the 18-month period through the 21st day after the date of giving of the required notice of tax due. This provision is subject to several exceptions. The suspension applies only if the return was timely filed (giving consideration to extensions). Further, the suspension does not apply with respect to any liability reported on the return and does not apply in the case of fraud. For taxable years beginning after December 31, 2003, the suspension does not apply with respect to any gross misstatement. With respect to periods of interest accrual beginning after October 3, 2004, the suspension does not apply to interest accruals with respect to any "reportable transaction" if the requirements of § 6664(d)(2)(A) have not been met or to interest with respect to any "listed transaction," as

defined by § 6707A(c).[19] If a taxpayer has made a request for abatement under § 6404 after July 30, 1996, and the request is not allowed, taxpayers who satisfy certain requirements may petition the Tax Court to determine whether denial of the abatement request was an abuse of discretion.[20]

II. Litigating Interest Issues.

A. Overview. In recent years, interest issues have become more common in tax litigation. This is especially true since the introduction of different rates for overpayments and underpayments beginning in 1987. Now, it is not unusual for suits to be filed where only interest computations are in dispute and the underlying tax liability has been resolved. In any event, the potential for the existence of interest issues often will be present in tax cases irrespective of whether such issues have been specifically raised in the pleadings. In order to handle a tax case properly, a computation file containing information and documents, such as transcripts of account, that relate to computational questions should be maintained. In analyzing computational questions, especially when addressing settlement terms or judgment computations, the attorney should always be alert for possible interest issues. In this regard, the computation specialists of the Office of Review are extremely valuable assets.

In order to spot and to analyze interest issues, the attorney must be aware of the types of interest involved in the case and the rules relating to computation of these types of interest. Most fundamentally, the attorney must understand whether interest on overpayments or underpayments (or both) is involved and whether an interest netting claim or issue exists. Unfortunately, whether a claim involves underpayment interest or overpayment interest can be far from obvious, especially in cases where a tax account has undergone numerous

[19] These exceptions for reportable transactions and listed transactions were added to the Code by § 903 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357. That Act also added §§ 6707A and 6664(d) to the Code. Pub. L. No. 108-357, §§ 811, 812.

[20] The requirements of § 6404(h) are discussed in part II.B., below.

adjustments and has been in both overpayment status and underpayment status at various times. If interest issues are raised in a taxpayer's complaint, the taxpayer's representation as to whether overpayment interest or underpayment interest is involved should not be accepted at face value. The substantive law and the procedural and jurisdiction requirements with respect to overpayment interest and underpayment interest differ significantly. A proper understanding of the type of interest involved, therefore, is essential to being able to analyze the merits of a claim and to determine what defenses may be available to the United States. Finally, the attorney will need to be alert for hidden interest issues when addressing settlement proposals and judgment computations in cases that do not necessarily appear to involve interest issues.

B. Suits for Refunds of Interest on Underpayments. A suit for a refund of interest that is alleged to have been assessed and paid in an excessive amount with respect to an underpayment of tax is generally subject to the same requirements as apply with respect to a suit for refund of the underlying tax. Alexander Proudfoot Co. v. United States, 454 F.2d 1379 (Ct. Cl. 1972). Thus, generally, a timely claim for refund must be made with respect to the interest, and a refund suit must be commenced, based upon grounds set forth in the refund claim, no later than two years after mailing of a notice of disallowance to the taxpayer. If the claim for interest is based solely upon the contention that the underlying tax itself was overpaid, then these rules are applied somewhat differently than they are in situations where a taxpayer seeks a refund of interest that is in whole, or in part, or in the alternative, based upon grounds other than whether the underlying tax was overpaid. Specifically, if the claim for refund for interest is based solely upon the contention that the underlying tax was overpaid, then no separate claim for refund need be made. The claim for refund of the tax implicitly is a claim for refund of any interest assessed and paid with respect to the tax, even if the claim does not include words such as "plus associated interest." TAM 9643001, 1996 WL 616049. Further, if the claim for interest is based solely upon the contention that the underlying tax was overpaid, and no separate substantive ground for recovery of interest is asserted, then full payment of the interest assessment is not required under the "full-payment rule" of Flora v.

United States, 362 U.S. 145 (1960). Shore v. United States, 9 F.3d 1524, 1527-28 (Fed. Cir. 1993).

If a taxpayer seeks a refund of interest on grounds other than the grounds, if any, upon which a refund of tax is requested, then the taxpayer must make a timely claim for refund of interest that specifically alleges the grounds for recovery of the interest. Alexander Proudfoot Co. v. United States, 454 F.2d 1379 (C. Cl. 1972). This claim may be included in the claim for the related tax (if plaintiff is claiming an overpayment of tax), in a separate timely claim, or in a timely amendment to a claim. If independent grounds for recovery of interest are not stated in the claim for refund, or in a timely amendment thereto, then suit for recovery of interest on those grounds will be barred by the doctrine of substantial variance. Computervision Corp. v. United States, 445 F.3d 1355, reh. denied, 467 F.3d 1322 (Fed. Cir. 2006), cert. denied, 549 U.S. 1338, 127 S. Ct. 2033 (2007); Mobil Corporation v. United States, 52 Fed. Cl. 327 (2002).

In Computervision, the taxpayer had resolved all issues with respect to its taxable year 1982 other than whether a subsidiary qualified as a domestic international sales corporation (DISC). The DISC issue was ultimately resolved by litigation in the United States Tax Court. Plaintiff filed suit to recover overpaid deficiency interest for its taxable year 1982. Plaintiff had filed a timely claim for refund of interest that had been assessed with respect to the DISC issue. That claim asserted that, due to the DISC adjustments, plaintiff should not have been charged deficiency interest from the due date of the 1982 return to the due date of the return for a subsequent year that generated a carryback. After the Tax Court resolved the DISC issue, the Government and the taxpayer reached agreement that the taxpayer was entitled to recover an overpayment of deficiency interest. A dispute developed, however, as to the amount of interest that the taxpayer could recover. An interest computation prepared by IRS Appeals and adopted by the plaintiff included adjustments based upon an "interest suspension" theory (based upon Rev. Rul. 99-40); plaintiff also claimed interest netting pursuant to § 6621(d). The Government contended that the interest suspension theory had not been raised in a timely claim for

refund and that the interest netting claim was not available under the facts of the case.

The Court agreed with the Government. A refund claim for interest must specifically state the grounds for recovery of the interest in issue. A general claim for refund of all assessed interest, without a specific statement of grounds, is insufficient to raise a claim on any basis independent of the claim that the underlying tax was not owed. In Computervision, the interest suspension claim was independent of the claim for interest based upon the DISC issue. This was clear from the fact that the taxpayer would have been entitled to recover interest based upon the interest suspension theory, if upheld on the merits, even if the taxpayer had lost the DISC issue. Because the interest suspension issue was independent of the DISC issue, and because the taxpayer had not raised the interest suspension issue in a timely claim for refund (or in a timely amendment to its claim), the doctrine of substantial variance barred the Court from exercising jurisdiction over the interest suspension claim. The Court also dismissed the interest netting claim because interest netting was not applicable under the facts of the case.

Tax Division attorneys should be alert to the possibility that interest suspensions not properly claimed by the taxpayer may slip *sub rosa* into refund computations prepared at the end of a case. This may occur, for example, because the taxpayer's accountants, or even IRS personnel, apply the principles of Rev. Rul. 99-40 without first ascertaining whether a timely claim for such treatment, if necessary, has been filed. This is very difficult to spot in the computations; therefore, it is important to have interest computations prepared or reviewed by an Office of Review computation specialist.

As discussed in part I.F., above, the IRS has authority, under § 6404, to abate underpayment interest in certain circumstances. Prior to the 1996 amendments to § 6404, a decision of the IRS not to abate interest under § 6404(e) was not reviewable by any court. See, e.g., Argabright v. United States, 35 F.3d 472 (9th Cir. 1994). In 1996, Congress amended § 6404 by modifying somewhat the language of

§ 6404(e) and by adding § 6404(h)[21], which allows limited review by the Tax Court of denials of interest abatement requests under § 6404. Pub. L. No. 104-168, § 302. If a taxpayer has made a request for abatement pursuant to § 6404 after July 30, 1996[22], the taxpayer may file an action in the Tax Court to determine whether the IRS's action was an abuse of discretion. The action must be brought no later than 180 days after the IRS mails a notice of a final determination not to abate the interest. Further, the taxpayer may not bring an action under § 6404(h) unless it satisfies the requirements of § 7430(c)(4)(A)(ii) (relating to net worth and other requirements in order to be eligible for an award of attorney's fees).

In Hinck v. United States, 550 U.S. 501, 127 S. Ct. 2011 (2007), the Supreme Court resolved a conflict among the circuits and held that the Tax Court has exclusive jurisdiction to review a denial by the IRS of a request for interest abatement under § 6404.

Finally, in any case involving a claim for refund of an overpayment of deficiency interest, the possibility exists that overpayment interest will be in issue. This is because even if no amount of tax is in dispute, the overpayment of interest – if found to exist – will be treated as an overpayment of tax for purposes of liability for overpayment interest under § 6611. § 6622(a) (applicable for periods of interest accrual beginning after December 31, 1982).

C. Suits for Statutory Interest on Overpayments. The requirements for suits seeking additional interest on an overpayment (statutory interest) are quite different from the requirements for maintaining a suit for refund of an alleged overpayment of deficiency interest. Whereas an action to recover an overassessment of deficiency interest is a refund suit and is subject to the general requirements

[21] The designation of the subsection has changed twice since its enactment in 1996. Originally, this subsection was designated § 6404(g). In 1998, it was redesignated as § 6404(i). Since 2002, it has been designated as § 6404(h).

[22] Section 6404(h) applies to requests for abatement made after July 30, 1996, irrespective of the taxable year or the period of interest accrual involved. The 1996 amendments of § 6404(e), however, apply on to interest for taxable years beginning after July 30, 1996.

applicable to refund suits, an action for recovery of statutory interest is a money claim against the United States based upon a statute. Thus, the requirements for maintaining a refund suit do not apply. No claim for refund need be filed. Rather, a complaint must be filed within six years of the accrual of the cause of action. 28 U.S.C. §§ 2401, 2501. The statute begins to run when all events have occurred that fix the Government's alleged liability. With respect to claims for statutory interest on an overpayment, the cause of action accrues on the date of allowance of the refund or credit in respect of the overpayment of tax. That date is the date upon which the scheduling of the overassessment is authorized pursuant to § 6407. General Instrument Corp. v. United States, 33 Fed. Cl. 4 (1995). The date upon which the refund check is actually issued to the taxpayer does not affect the date upon which the statute begins to run. 33 Fed. Cl. 4, 7-8. Further, the filing of a claim with the IRS for additional overassessment interest does not protect the taxpayer's rights and does not affect the running of the statute of limitations. Rev. Rul. 57-242, 1957-1 C.B. 452.

Notwithstanding some case law to the contrary, an action for statutory interest, if seeking more than $10,000, must be filed in the Court of Federal Claims. Claims for statutory interest not exceeding $10,000 may be maintained in either a district court or in the Court of Federal Claims. Because a suit for statutory interest is a suit against the United States for money based upon a statute (§ 6611), and not for the recovery of any sum assessed against or collected from the taxpayer, such suits are not within the scope of the jurisdiction of the district courts under 28 U.S.C. § 1346(a)(1). Rather, district courts have jurisdiction over such suits only to the extent provided by 28 U.S.C. § 1346(a)(2). That jurisdiction is limited to claims not exceeding $10,000. Amoco Production Co. v. United States, 61 A.F.T.R.2d 88-750, 88-1 U.S.T.C. ¶ 9272, 1988 WL 9112 (N.D. Ill. 1988). The Court of Federal Claims, on the other hand, has jurisdiction that is not limited in amount over monetary claims based upon a statute. 28 U.S.C. § 1491(a)(1). Therefore, for statutory interest claims in excess of $10,000, jurisdiction lies only with the Court of Federal Claims.[23]

[23] In a refund suit over which a district court has jurisdiction, the court also has ancillary or incidental jurisdiction to award interest on any overpayment found to exist.

Notwithstanding the requirements of the statutes, however, a few district courts have erroneously held that a statutory interest claim in excess of $10,000 may be maintained in a district court pursuant to 28 U.S.C. § 1346(a)(1). E.W. Scripps Co. v. United States, 90 A.F.T.R. 2d 2002-6835, 2002 WL 31477137 (S.D. Ohio, 2002); Trustees of the Bulkeley School v. United States, 628 F.Supp. 802 (D.Conn. 1986); and Triangle Corp. v. United States, 592 F.Supp. 1316, on reconsideration 597 F. Supp. 507 (D.Conn.1984). If a suit for statutory interest in excess of $10,000 is improperly brought in a district court in reliance on the erroneous decisions in Scripps, Bulkeley, and Triangle, the Government should seek to have the case dismissed for lack of jurisdiction (or, if the statute of limitations has expired after the filing of the complaint in the district court, to have the case transferred to the Court of Federal Claims pursuant to 28 U.S.C. § 1631).

D. Claims for Interest Netting. Claims for interest netting present special problems because they involve both an underpayment and an overpayment of tax. Ever since a higher interest rate on underpayments, compared to overpayments, was imposed, taxpayers have sought to have the differential eliminated to the extent that a taxpayer has equivalent underpayments and overpayments accruing interest simultaneously. Prior to 1998, "netting" was available only to a limited degree. To the extent that an underpayment of tax could be satisfied by crediting an overpayment against the tax liability, interest does not run on the underpayment to the extent that interest would have been allowable on the overpayment if the credit had not been made. §§ 6402(a), 6601(f). A credit under § 6402 can be made, however, only to the extent that an underpayment balance is due and payable as of the time that the overpayment credit is to be made. Once an underpayment has been satisfied, a § 6402 credit is no longer possible, even if interest had accrued on the underpayment during time periods for which interest is allowable on the overpayment. Northern States Power Co. v. United States, 73 F.3d 764 (8th Cir. 1996). Congress addressed this situation in 1998 with the enactment of § 6621(d), which provides for a net interest rate of zero with respect to equivalent overpayments and underpayments for which interest is payable and allowable for overlapping periods of interest accrual. This statute applies to periods of interest accrual beginning on and after October 1,

1998. The statute has limited applicability for periods of interest accrual beginning prior to October 1, 1998, pursuant to an uncodified effective date special rule.

Section 6621(d) provides for a net interest rate of zero on overlapping periods of underpayment and overpayment. The underpayment and the overpayment need not be of the same type of tax. Any tax imposed by the Internal Revenue Code is eligible for interest netting. Further, the tax itself may have arisen with respect to any taxable period, so long as the period of interest accrual (under the general effective date) begins on or after October 1, 1998. The overpayment and the underpayment, however, must be with respect to the same taxpayer. Thus, a corporation and a wholly owned subsidiary corporation that do not file consolidated returns are not entitled to interest netting with respect to an overpayment by one corporation and an underpayment by the other corporation, even if the two corporations are eligible to file a consolidated return and the overpayment and underpayment are transactionally related. 2002 IRS NSAR 20126 (2002 WL 32167841). Two corporations that are part of an affiliated group that filed consolidated returns for the involved periods will, however, be considered the same taxpayer. FSA 200017003, 2000 WL 1873995. Further, each overpayment and underpayment may be used only once for netting purposes. Finally, a net interest rate of zero is available only to the extent that interest is payable and allowable on the underpayment and the overpayment. Thus, if interest is not allowable on an overpayment (for example, because of application of the 45-day rule), the overpayment may not be used for netting purposes. On the other hand, if the requirements for netting are satisfied, then netting will apply even if a special high or low interest rate (such as GATT interest or hot interest) would otherwise apply.

Rev. Proc. 2000-26, 2000-1 C.B. 1257, sets forth the procedures for applying § 6621(d) with respect to periods of interest accrual beginning on and after October 1, 1998. Although the statute requires the application of a net interest rate of zero without any preconditions, the IRS is currently unable to perform netting automatically. Taxpayers, therefore, should request application of the net interest rate of zero in

accordance with Rev. Proc. 2000-26.[24] The request for a net interest rate of zero is to be made using Form 843[25], Claim for Refund and Request for Abatement. Rev. Proc. 2000-26, ¶ 5.01. The form is to be filed with the IRS office where the taxpayer filed its most recent income tax return (irrespective of the type of tax involved in the netting claim). Rev. Proc. 2000-26, ¶ 5.02. The application must be made while the statute of limitations is still open with respect to interest claims for either the underpayment taxable period or for the overpayment taxable period. Rev. Proc. 2000-26,¶ 4.01. For this purpose, the statute of limitations with respect to overpayment interest closes six years after the overpayment is allowed. See part II.C., above. With respect to claims for overpayments of deficiency interest, generally, the statute is three years from filing, or two years from payment, whichever is later. Rev. Proc. 2000-26, ¶ 4.02. If the taxpayer has requested a net interest rate of zero, in accordance with the effective date special rule, for periods beginning before October 1, 1998, and that request extends to include periods beginning on and after October 1, 1998, then no separate request need be filed under Rev. Proc. 2000-26.

Section 6621(d) does not state how the IRS is to adjust the accounts of the taxpayer in order to provide the benefit of the net interest rate of zero for the overlapping periods of underpayment and overpayment. The IRS has determined that it will implement § 6621(d) by reducing deficiency interest on the underpayment in such amount as necessary to produce a net interest rate of zero, provided that the statute of limitations is open for claiming a refund with respect to the underpayment period at the time that the netting request is made. Rev. Proc. 2000-26, ¶ 4.03(1). If, at the time the netting request is made, the statute of limitations has closed with respect to refund claims for the

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[24] Because the statute does not impose any pre-conditions, however, it is doubtful that failure to comply with Rev. Proc. 2000-26 would prevent a taxpayer from bringing an otherwise proper suit based upon § 6621(d).

[25] If one of the involved taxable periods is under examination or other consideration by an element of the IRS or if the period is in litigation, then a Form 843 is not used. Rather, the application for netting should be made by letter to the contact person at the IRS or at the Department of Justice who is responsible for the administrative action or the litigation. Rev. Proc. 2000-26,¶ 5.06.

underpayment period, but the statute is still open for suits for additional interest on the overpayment, then the IRS will increase the overpayment interest in such an amount as necessary to produce a net interest rate of zero. Rev. Proc. 2000-26, ¶ 4.03(2). The filing of the claim, however, does not protect the taxpayer's rights with respect to the claim. If the statute is about to close and the IRS has not allowed an interest netting claim, then the taxpayer must file suit in order to protect its rights to additional interest. Rev. Proc. 2000-26, ¶ 4.02(2).

Under the effective date special rule for § 6621(d), interest netting under that section will apply to interest accrual periods beginning before October 1, 1998, provided that certain requirements, in addition to the general requirements of § 6621(d), are satisfied. The procedures for requesting interest netting pursuant to the effective date special rule are set forth in Rev. Proc. 99-43, 1999-2 C.B. 579, modifying and superseding Rev. Proc. 99-19. Initially, the special rule will not apply unless the statute of limitations for interest claims (as discussed above) were open for both the overpayment period and the underpayment period on July 22, 1998. Because of awkward wording in the statute, the question was raised by taxpayers as to whether the statute had to be open as of the controlling date for both the overpayment and the underpayment periods or only needed to be open with respect to at least one of them. This question was resolved in favor of the Government's interpretation – that both periods must have been open on July 22, 1998 – in Federal National Mortgage Association v. United States, 379 F.3d 1303 (Fed. Cir. 2004). Further, interest netting will not be allowed under the special rule unless the taxpayer makes a timely request for interest netting, which request must reasonably identify the overlapping periods of interest accrual. This request must be made no later than December 31, 1999. The IRS has ruled, however, that the request may be made after December 31, 1999, provided that the statute of limitations is open with respect to claims relating to the underpayment period or the overpayment period at the time that the netting request is made. Rev. Proc. 99-43, ¶ 1.02. Otherwise, the procedural rules with respect to the effective date special rule are similar to the procedural rules applicable to § 6621(d) generally.

E. Other Issues. In handling interest issues in tax cases, as in all other tax litigation, issues such as determination of the applicable statute of limitations and availability of offsets must be considered. The applicable statutes of limitations with respect to taxpayer claims are addressed above. The statute of limitations with respect to the assessment of interest, however, may also be an issue. Further, unassessed interest may provide the basis for an offset where the interest is not otherwise collectible.

Interest on underpayments of tax is payable upon notice and demand, and is assessed, collected, and paid in the same manner as tax. § 6601(e)(1). Further, such interest bears interest, compounded daily, in the same manner as does the underlying tax. § 6622. Nonetheless, interest liabilities are not subject to deficiency procedures. § 6601(e)(1). Also, the statute of limitations for assessing and collecting interest on underpayments is not the same as the statute of limitations on assessing the underlying tax liability. Rather, interest on an underpayment may be assessed and collected at any time during the period when the related tax liability could be collected (generally, at least 10 years from the date of assessment). § 6601(g). This limitation period applies even with respect to interest imposed at the enhanced rate provided by former § 6621(c) for tax-motivated transactions, and applies to such interest imposed on underpayments based upon adjustments to partnership items pursuant to the TEFRA partnership provisions of the Code (§§ 6221-6233). Field v. United States, 381 F.3d 109 (2d Cir. 2004).

An unassessed liability for deficiency interest may provide the basis for an offset by the Government in a refund case. Fisher v. United States, 80 F.3d 1576 (Fed. Cir. 1996). In Fisher, the plaintiff, as representative of an estate, paid an asserted deficiency in estate tax that was based upon three issues. Plaintiff did not, however, pay any interest on the deficiency. The IRS failed to assess the deficiency, or any interest thereon, during the period when the tax could have been assessed. Failure to assess the tax in a timely manner likewise barred assessment of interest that had accrued on the deficiency, which had been paid while the statute was still open. The Government's answer, in addition to denying liability, asserted an offset with respect to

accrued, unassessed interest. The trial court decided two of the estate tax issues in favor of the Government and one of the issues in favor of the plaintiff. The judgment in favor of the plaintiff, based upon the one issue upon which she prevailed was not reduced by the amount of the unassessed interest that had accrued on the tax related to the two issues upon which the Government prevailed. The Government appealed the denial of the offset and the appellate court reversed. The Federal Circuit concluded that unassessed, accrued interest, the collection of which is barred by the statute of limitations, may be asserted as an offset in the same manner as statute-barred unassessed tax liabilities under Lewis v. Reynolds, 284 U.S. 281, modified on other grounds, 284 U.S. 599 (1932) and Dysart v. United States, 169 Ct. Cl. 276, 340 F.2d 624 (1965). Accordingly, the judgment for the plaintiff was reduced by the amount of the accrued interest relating to the tax liabilities upon which the Government prevailed.

The Government's right of offset interest was again considered in Pacific Gas and Electric Co. v. United States, 417 F.3d 1375 (Fed. Cl. 2005). Plaintiff sued for additional overpayment interest for 1982. The Government asserted an offset based upon an excessive payment of overpayment interest to the taxpayer for 1982 based on an earlier refund claim. That refund had been made more than two years earlier; thus, the statute of limitations in § 6532(b) barred a suit by the Government for recovery of this erroneous payment. The Federal Circuit held that the excessive payment of interest could be recouped solely by a suit for an erroneous refund and that the statute of limitations barred such an action. The court rejected the Government's position that Lewis v. Reynolds, 284 U.S. 281 (1932), which permits the Government to offset a barred underpayment of tax against a refund otherwise due the taxpayer for the same taxable period, could be applied to erroneously refunded overpayment interest the recovery of which was barred by the two-year statute of limitations. In Fisher v. United States, 80 F.3d 1576 (Fed. Cir. 1996), the court had permitted the Government to offset a barred underpayment of deficiency interest against a tax refund claimed by the plaintiff.

The Pacific Gas & Electric court distinguished these cases because they were based on the rationale that, in a tax refund suit, taxpayer

must prove an overpayment of tax for the taxable year before he or she is entitled to a refund. Tax, deficiency interest, and assessable penalties have all been considered part and parcel of the tax liability for this purpose. The court held, however, that a prior excessive refund of overpayment interest, which is not assessable as part of the tax liability, is not part and parcel of the tax for offset purposes. The court said that overpayment interest is consideration owed by the Government to the taxpayer for use of taxpayer's funds, and the taxpayer's liability to return overpayment interest excessively paid is not a tax liability, but rather an obligation imposed by the law of restitution.

Attorneys who have cases presenting this issue should bring the issue to the attention of the section chief or assistant chief. A decision can then be made as to whether to develop the issue for presentation to the court.