OFFICE OF
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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service)
CC:DOM:FS

SUBJECT: Interest netting under I.R.C. § 6621(d)

This Field Service Advice responds to your memorandum dated December 4, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Authorized representative:

CORP X =

CORP Y =

GROUP X = CORP X and the affiliated corporations, including CORP Y, for which CORP X filed consolidated Federal income tax returns

Year 01, Year 02, etc. = Calendar years , etc.

Excise tax =

ISSUES:

1. Where CORP Y is a member of a consolidated group, does I.R.C. § 6621(d) require the Service to net CORP Y's excise tax refund against a previously assessed and paid corporate income tax deficiency of the consolidated group for interest computation purposes?

   A. Does I.R.C. § 6621(d) apply to taxes, such as an excise tax, that were repealed prior to its enactment?

   B. May a member of a consolidated group, which pays excise tax separately from the group, net the interest on such tax against the interest on income tax payable by the consolidated group?

2. Whether the petition in Tax Court improperly and prematurely raises the issue of interest netting and overpayment prior to the Court's decision becoming final.

CONCLUSIONS:

1. The interest netting procedures of I.R.C. § 6621(d) may be used for interest on any tax, regardless of whether such tax has been repealed, but the Service is limited in applying the interest netting procedures of I.R.C. § 6621(d) to interest for the same taxpayer. We will defer answering the question regarding whether a member of a consolidated group, which received a separate excise tax refund, should be treated as the same taxpayer as the consolidated group (or the group's parent) that paid a consolidated income tax liability until a proper administrative request has been filed.

2. Although the Tax Court has jurisdiction to resolve the taxpayer's claim of an interest overpayment, the taxpayer's assertion of the right to interest netting is premature. The taxpayer, however, should make an administrative request for netting of clearly identified overpayment and underpayment interest for different taxes and tax periods that coexisted over interest periods between January 1, 1987 and July 22, 1998, before December 31, 1999.

FACTS:

For all years at issue, CORP X filed consolidated income tax returns under its taxpayer identification number (TIN) for GROUP X, a consolidated group consisting of CORP X and over 100 subsidiaries. Over this same period, many of the GROUP X subsidiaries, including CORP Y, separately filed employment tax and excise tax returns using their own TINs.

In YEARS 11 and 13, CORP X, the parent for consolidated GROUP X, executed partial agreements with the Service for income tax deficiencies totaling $200M for GROUP X's YEAR 4, YEAR 5, and YEAR 6. CORP X, acting for GROUP X, paid the full amount of the agreed deficiencies in YEAR 11 and YEAR 14, and included underpayment interest on these deficiencies from the dates in YEAR 5 through YEAR 7 when the group's income taxes were initially due. In its formal refund claim, CORP X says that over 75% of the deficiencies were attributable to CORP Y and its subsidiaries, but we do not have more specific information regarding the allocation of the tax deficiencies and interest among the members of GROUP X.

In YEAR 15, CORP Y, a subsidiary of CORP X and a member of consolidated GROUP X , was determined to have overpaid its excise tax liability for tax periods from YEAR 1 through YEAR 7 by $150M. The Service refunded the payments to CORP Y in YEAR 15, together with overpayment interest computed from the various dates in YEAR 1 through YEAR 8 when the excise tax payments were initially made.

Some of the years between YEAR 1 and YEAR 13 followed the effective date of provisions within the Tax Reform Act of 1986 that first established different interest rates for overpayments and underpayment of tax under I.R.C. § 6621(c). As a result, over these post-1986 years, interest payable to the Service on underpayments accrued at a rate 1% higher than interest payable by the Service on overpayments of tax for the same interest computation periods.[1] In making the refund to CORP Y in YEAR 15, the Service denied a request from CORP X and CORP Y that it net the overpayment interest then payable to CORP Y against the underpayment interest that had already been paid by GROUP X for YEAR 4 through YEAR 6 on GROUP X's income tax deficiencies, and refund the excess underpayment to CORP X. In YEAR 15, CORP X filed a formal claim for refund of underpayment interest based upon its global netting claim. Action on this claim has been suspended.

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[1] For some periods, the rate differential may have exceeded 1% on the same amount of a tax underpayment and overpayment because of higher rate differentials between interest on "large corporate underpayments" and "large corporate overpayments."

The Service ultimately proposed additional deficiencies for GROUP X's income tax liabilities for YEAR 4 through YEAR 6 in a notice of deficiency issued in YEAR 18. The Tax Court petition that CORP X timely filed on behalf of GROUP X from that notice is still pending before the Tax Court. Within the petition, CORP X affirmatively raised the issue of whether the overpayment interest paid to CORP Y with the refund of its excise tax overpayment for the YEAR 1 through YEAR 7 could be netted against the underpayment interest paid by GROUP X on its deficiencies for YEAR 4 through YEAR 6 and against any additional underpayment interest that may be payable by GROUP X for those years as a result of the Tax Court case.

LEGAL ANALYSIS

1. Although the Service can net overpayment and underpayment interest on different types of taxes (including taxes that were repealed before July 22, 1998) if the taxpayer otherwise qualifies for the section 6621(d) netting, the Service cannot net overpayment and underpayment interest for different taxpayers.

I.R.C. § 6621(d) was enacted by § 3301(c)(2) of the Reform and Restructuring Act of 1998 (RRA), Pub. L. 105-206, to provide for netting of overpayment interest against underpayment interest when underpayments and overpayments for different tax liabilities accrue interest over the same periods. Without I.R.C. § 6621(d), interest accruing for different taxes or tax periods can only be netted, as provided in I.R.C. § 6601(f), when overpayments are credited against underpayments under I.R.C. § 6402. Northern States Power Co. v. United States, 73 F.3d 764 (8th Cir.), cert. denied,117 S.Ct. 168 (1996); see Department of Treasury Office of Tax Policy, Report to Congress on Netting of Interest on Tax Overpayments and Underpayments (April 1997).

Section 6621(d) now provides that:

> to the extent that, for any period, interest is payable under subchapter A [§§ 6601 and 6602] and allowable under subchapter B [§6611] on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title [Title 26, the Internal Revenue Code], the net rate of interest under this section on such amounts shall be zero for such period.

Section 6621(d) applies to interest for periods beginning after the effective date of the RRA. As amended by The Tax and Trade Relief Extension Act of 1998, part of Division J of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, Pub. L. 105-277, § 3301(c)(2) of the RRA provides for I.R.C. § 6621(d) to be applicable to periods beginning before July 22, 1998, if:

A. the applicable period of limitation has not expired with regard to either a tax underpayment or a tax overpayment;

B. the taxpayer reasonably identifies and establishes the periods of such tax overpayments and underpayments for which the zero rate applies; and

C. not later than December 31, 1999, the taxpayer requests the Secretary of the Treasury to apply section 6621(d) of the Internal Revenue Code of 1986, as added by subsection (a), to such periods.

Although CORP X has filed a claim to have interest on CORP Y's excise tax overpayments netted against interest on GROUP X's income tax liabilities, neither CORP X nor CORP Y has formally requested the Service to apply section 6621(d) to specific periods and taxes. In anticipation of such a request for the interest covered by CORP X's claim, we are responding to your questions about the taxes covered by section 6621(d) and the meaning of the word taxpayer in the statute.[2]

[2] We believe that the statute of limitations remains open for both the overpayment and the underpayment. CORP X could file a claim for refund of underpayment interest for up to six months after the assessment period (as extended by agreement) expires; that assessment period has been suspended and CORP X may claim an overpayment during the Tax Court case. The six year period during which CORP Y could file a suit for correct overpayment interest on the excise tax refund has not expired.

A. Section 6621(d) applies to any tax imposed under the Internal Revenue Code, including excise taxes that were imposed under provisions that expired before enactment of the RRA.

By its terms, Section 6621(d) applies to any "tax imposed by this title."[3] "This title" is Title 26 of the United States Code. Tax provisions in Title 26 that have been repealed are not currently applicable Code provisions, but remain part of Title 26 and are effective to impose the tax for dates before they were repealed. The excise taxes at issue are among the taxes that may be netted under section 6621(d).

B. Before deciding whether a member of a consolidated group, which received a separate excise tax refund, is the same taxpayer as the consolidated group, whose common parent paid consolidated income tax deficiencies of the consolidated group, we would like to review the taxpayer's request for a net interest rate of zero under section 6621(d).

One key requirement of § 6621(d) is that the underpayments and overpayments to be netted must belong to "the same taxpayer." Neither the statute nor its legislative history, however, provides guidance as to how the statutory netting is to be applied among multiple taxpayers who may be jointly or severally liable for a single tax liability when one or more of those taxpayers has a separate tax overpayment. Because the decision to expand the scope of 6621(d) from income taxes and self-employment taxes to any taxes imposed by Title 26 was made in a Senate floor amendment with only nominal debate, there is no discussion of the effect of the amendment on taxpayers with multiple liabilities in the legislative history. Senate Floor Amendment No. 2383, 144 Cong. Rec. 56, S4518; H.R. Conf. Rep. No. 105-599, 257.

The Office of Tax Policy foresaw potential problems in determining who was the taxpayer when it recommended that the netting provisions be applied to income taxes only. In concluding that netting "different kinds of taxes would be extremely difficult to administer," the Office of Tax Policy cited difficulties in dealing with employment taxes and excise taxes that "frequently present difficult questions concerning who has paid them or whether they have been passed on to other taxpayers." Department of Treasury Office of Tax Policy, Report to Congress on Netting of Interest on Tax Overpayments and Underpayments (1997), 41-42. [4]

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[3] The decision to expand the taxes covered by § 6621(d) from income taxes and self-employment taxes to any taxes imposed by Title 26 was made in a Senate floor amendment. Senate Floor Amendment No. 2383, 144 Cong. Rec. 56, S4518; H.R. Conf. Rep. No. 105-599, 257.

[4] If section 6621(d) were limited to income taxes only, some issues inherent in dealing with multiple taxpayers, such as those involving separate and joint liabilities for

Although the report did not mention problems in deciding whether or how to net a consolidated group's income tax liability against the members' separate liabilities for taxes, such as excise taxes, those problems may be common among the large corporate taxpayers who are expected to benefit from section 6621(d).

I.R.C. § 7701(a)(14) defines a taxpayer as "any person subject to internal revenue tax." In the context of a consolidated group, each member of the group is severally liable for the consolidated income tax liability of the entire group for any tax year during any part of which it is a member. Treas. Reg. § 1.1502-6(a); Turnbull, Inc. v. Commissioner, 373 F.2d 91 (5th Cir. 1967), cert. denied, 389 U.S. 842 (1967). When a tax is severally owed by two or more taxpayers, the Service has the authority to collect the full amount of unpaid tax from any of the taxpayers who are members of the group. See McCray v. United States, 910 F.2d 1289 (5th Cir. 1990). In practice, however, for each income tax period of a consolidated group, the Service maintains a single account, tracked under the TIN used by the group's parent in filing the consolidated single return, through which it assesses and collects a single liability from the members of the group, without separately tracking the payments made by each member of the group.

The members of the consolidated group, however, are separately liable as taxpayers for reporting their own liabilities for other taxes, such as employment taxes and excise taxes. See, e.g., I.R.C. § 1502 (authorizes consolidated returns only for income tax liability). These taxes are not part of the consolidated return or of the group's consolidated tax liability. Each member of the group reports its periodic liabilities for these taxes on its own return, and, under I.R.C. § 6109, is required to use its own TIN. Treas. Reg. § 301.6109-1(b)(1). The Service maintains separate accounts for each period and type of tax for each corporation under each corporation's separate TIN. [5] Only the parent of the group, which is responsible for filing the consolidated return on behalf of the group using its own TIN, uses the same TIN for its own separate returns.

Presumably, because CORP Y is a member of GROUP X, the overpayment in CORP Y's excise tax account could have been credited against any outstanding balance in GROUP X's income tax liability when the overpayment was determined.[6] Unless CORP Y requested that the Service make such a credit, however, the Service would not have matched the two accounts because they bear different

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successive years of taxpayers filing consolidated returns or using married filing joint status, would still arise. These issues, however, are not relevant to this case.

[5] Corporations must use employer identification numbers, assigned separately for each corporation that is required to file any tax return, in filing all tax returns and other documents.

[6] There was no outstanding balance.

TINs. The Service uses the TIN on an account to track other accounts of the same taxpayer.

In computing interest under I.R.C. § 6601(f) when an overpayment of tax is credited against an unpaid liability under I.R.C. § 6402, the Service has established different rules for computing interest on underpayments and overpayments depending upon whether the overpayment and the underpayment belonged to the same taxpayer. For overpayments credited to accounts of the same taxpayer, the Service applies section 6601(f), so that interest on a matching amount of an underpayment and an overpayment are computed only until the earliest date as of which both exist. IRM 31(59)3.5. If a taxpayer requests that an overpayment from its account be credited to an account of a different taxpayer, however, IRM 31(59)3.5(f) specifies that the rules under § 6601(f) for computing interest on credits applied to open accounts of the same taxpayer

> are NOT applicable where the credit is applied to an open account of a different taxpayer. When an overpayment is credited to another taxpayer's deficiency with the taxpayer's consent, the taxpayer is entitled to interest on the overpayment from the date it arose until the date it is allowed.

Thus, although the Service will, at a taxpayer's request, credit that taxpayer's overpayments against an outstanding liability of a different taxpayer, the Service will separately compute the interest on the underpayment and the overpayment through the date on which the credit is made. The key for identifying a single taxpayer is the taxpayer's TIN. Whenever an overpayment is determined, the Service's computer system is programmed to search for accounts of the same taxpayer --- one using the same TIN --- with unpaid balances against which to credit the overpayment before any balance is refunded.

In electing to file a consolidated return, each member of a consolidated group consents to use the consolidated return regulations. Treas. Reg. § 1.1502-75(a)(1). These regulations provide for the several liability of each member of the group for the consolidated income tax liability of the entire group. Treas. Reg. § 1.1502-6(a). A consolidated tax return reflects a single tax liability for the affiliated group; after each member's separate taxable income is computed, the separate incomes are aggregated and combined with consolidated items of income and deductions to reach a final consolidated income tax liability for the entire group. Treas. Reg. § 1.1502-2.

Usually, the common parent, acting as the agent for all members under Treas. Reg. § 1.1502-77(a), pays any consolidated tax liability due from the group when it files a tax return or reaches a subsequent resolution of the tax deficiency with the Service. The Service refunds any consolidated overpayments directly to and in the

name of the parent. Treas. Reg. § 1.1502-77. The parent may collect a pro rata share from each subsidiary in accordance with any agreement between them, but the Service is neither a party to nor bound by such an agreement. Although the tax liability of the consolidated group may be allocated among the members of the group for business and accounting purposes, such allocation has no net tax impact in an ongoing consolidated group because the income and losses reported by the various members of the group are combined to determine the group's consolidated tax liability. Unless the membership in a group changes or earnings and profits become an issue, there is no reason for the Service to examine the allocation of the tax liability or other tax attributes among the members of the group.

Despite their membership in the consolidated group, the members of the group retain their separate identity for tax purposes. See Moline Properties, Inc. v. Commissioner, 63 S.Ct. 1132 (1943); Kidde Industries, Inc. v. United States, 40 Fed. Cl. 42, 98-1 USTC ¶ 50,162 (Ct. Fed. Cls. 1997). A series of cases, involving a precursor to the current consolidated return provisions making the members of a consolidated group severally liable for the tax liabilities of the group, stress that the members of the consolidated group are each separate taxpayers. Dorrance v. Phillips, 85 F.2d 660 (3d Cir. 1936) (affiliated corporations do not lose their status as taxpayers or distinct corporate entities); Combined Industries, Inc. v. United States, 15 F.Supp.349 (Ct. Cl. 1936) (parent corporation that knowingly paid subsidiary's separate tax liability could not recover refund of overpayment); Hart Glass Manufacturing Co. v. United States, 48 F.2d 435, (Ct. Cl. 1931) (Although limitations period precluded refund, Service erred in crediting overpayment by one member of an affiliated group to the separate liability of another member of the group for its share of the group's income tax).

With these precedents, the application of section 6621(d) among the members of a consolidated group will be difficult to resolve. One possible resolution of the conflict may lie in the statutory definition of a taxpayer as "any person subject to internal revenue tax." The Supreme Court has ruled that a person who paid a tax to remove a Federal tax lien on property she received in a divorce settlement, even though the tax was assessed solely against her ex-husband, was nonetheless "a taxpayer" who could file a refund suit. United States v. Willliams, 115 S.Ct. 1611 (1995).

2. Because CORP X has not complied with RRA § 3301(c)(2) by requesting the net interest rate of zero for clearly identified taxes and periods, its assertion of the interest netting procedures in this Tax Court case is premature.

In the Tax Court petition filed on behalf of the affiliated group, CORP X alleges that it made income tax payments for YEAR 3 through YEAR 5 and that it received a excise tax refund, with interest, for the YEAR 1 through YEAR 7, and claims the

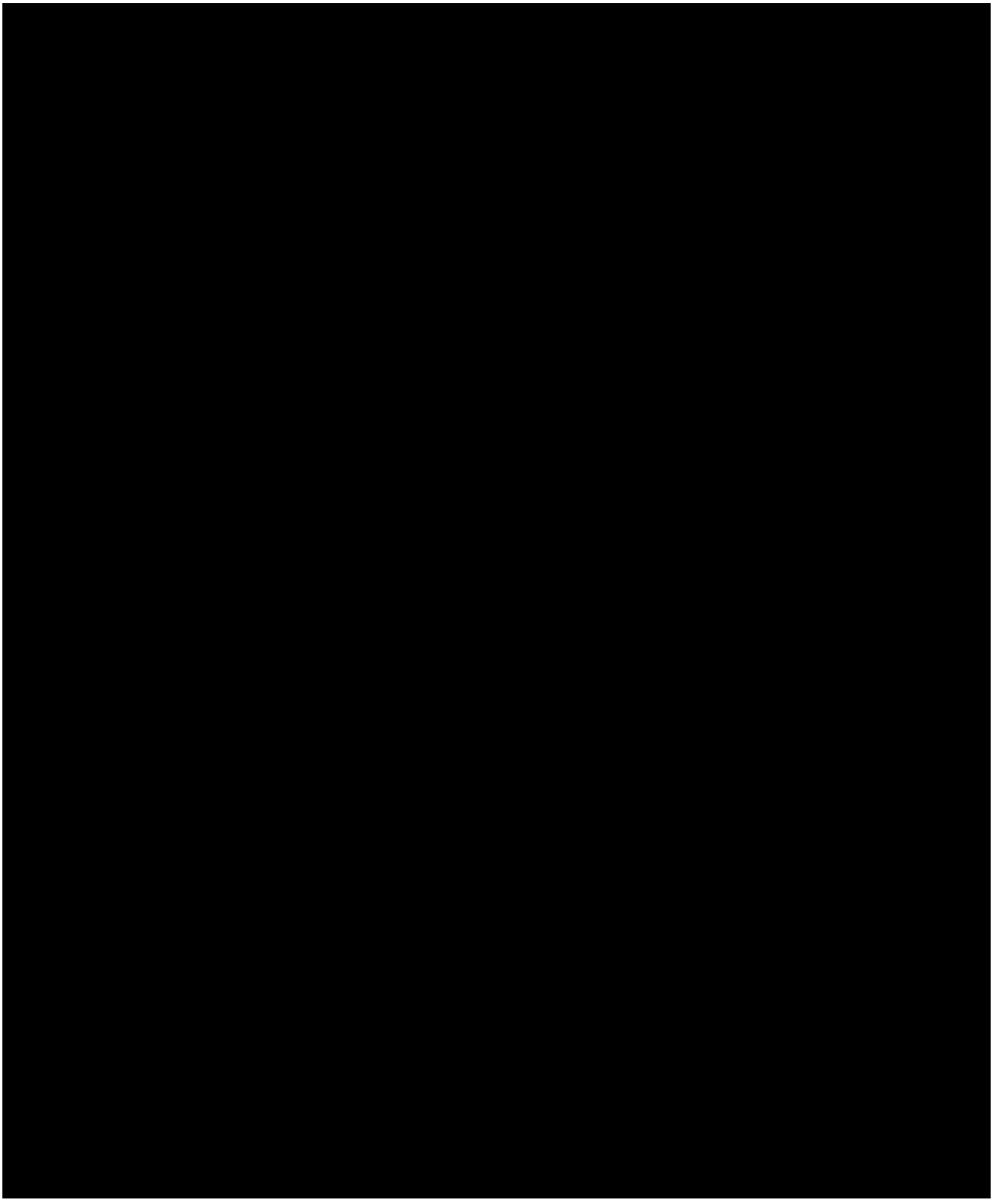
right to have the excise tax refund amounts applied against the income tax account in order to generate a reduction in interest on the income tax account. As a result, CORP X claims an overpayment of tax in YEAR 4 through YEAR 6. In view of the above discussion of CORP Y's separate liability for the excise and its separate ownership of the refunded excise tax overpayment, CORP X's claim in the petition is factually and legally erroneous.

To the extent that the Tax Court's resolution of this case may result in an overpayment, that court does have jurisdiction to consider CORP X's claim. As explained in Winn-Dixie Stores, Inc. v. Commissioner, 110 T.C. 291 (1998), the Tax Court has jurisdiction to determine overpayments of income tax. I.R.C. § 6512(b). Because I.R.C. § 6601(e)(1) provides that interest shall be treated as a tax, an overpayment of tax includes any interest that is part of such overpayment. The statutory exception in I.R.C. § 6601(a) that excludes interest as a tax for purposes of determining a deficiency under I.R.C. § 6211(a) does not apply to overpayments. As long as the Service has determined a deficiency in tax for the years at issue, the Tax Court has jurisdiction to determine an overpayment of tax, including interest, for those years. Estate of Baumgardner, 85 T.C. 445 (1986).

Although the Tax Court has jurisdiction to determine an overpayment, including an overpayment of interest for the years before it, we do not believe that CORP X can now prevail on the merits of its claim. First, as discussed above, the taxpayer must be able to demonstrate that the overpayments and underpayments for which it wants the net zero interest rate under I.R.C. § 6621(d) belongs to the same taxpayer. Second, in the absence of I.R.C. § 6621(d), Corp X's claim relies upon the use of "global netting" to offset the excise tax overpayment that was payable to CORP Y in YEAR 15 against a consolidated income tax underpayment that had already been paid in full by CORP X prior to YEAR 15. Although the Service would have had discretion to credit the overpayments against any then outstanding underpayments in YEAR 15, the Service had no legal authority to apply the overpayments against previously paid underpayments. Northern States Power Co. v. United States, 73 F.3d 764 (8th Cir.), cert. denied,117 S.Ct. 168 (1996).

Further, the retroactive application of § 6621(d) by the provisions of RRA § 3301(c)(2) is not automatic. The Service has no obligation to consider application of the net zero interest rate to periods prior to July 22, 1998, until a taxpayer files a timely request that clearly identifies the periods and taxes to be offset. The burden is on a taxpayer to make an administrative request, using the procedures outlined in Revenue Procedure 99-19 (released 3/16/99), for netting of its clearly identified overpayment and underpayment interest for different taxes and tax periods before December 31, 1999.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:



[redacted]

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