

## Interest Netting Study

### Notice 96-18

This Notice invites public comment in connection with the Internal Revenue Service's and Treasury's study of "interest netting." This study was initially described in Announcement 96-5, "Administrative Initiatives to Enhance Taxpayer Rights," 1996-4 I.R.B. 99 at 101 (January 22, 1996).

### BACKGROUND

The Internal Revenue Code provides that taxpayers who underpay their taxes generally must pay interest to the government for the period of the underpayment. Section 6601. The IRS has limited authority to abate the interest that is required by statute. Section 6404.

The Code likewise generally requires the government to pay interest to taxpayers with respect to any overpayment of taxes. Section 6611. There are, however, a number of limitations on the government's liability for interest, including the rule that no interest is payable with respect to a tax refund claimed for a current year if the refund is issued within 45 days of the last day prescribed for filing a return claiming the refund. Section 6611(e).

Prior to enactment of the Tax Reform Act of 1986, the same interest rate applied to underpayments and overpayments. The Tax Reform Act of 1986, however, provided for the interest rate charged on underpayments to be one percentage point higher than the interest rate paid on overpayments. See §§ 6621(a)(1) and (2). The Omnibus Budget Reconciliation Act of 1990 added that, under certain conditions, the interest rate on large corporate underpayments would be 3 percentage points higher than the interest rate on overpayments. The Uruguay Round Agreements Act, enacted in 1994, increased the differential between large corporate underpayments and certain corporate overpayments to 4.5 percentage points. See §§ 6621(a)(1) and (c).

If an overpayment is credited against an underpayment, the effect of these interest rate differences is reduced. Section 6601(f) provides:

If any portion of a tax is satisfied by credit of an overpayment, then no

interest shall be imposed ... on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

Section 6402(a) provides general authority for the IRS to credit an overpayment against an underpayment. This section states:

In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall ... refund any balance to such person.

Section 301.6402-1 of the Regulations on Procedure and Administration provides that the Commissioner may credit any overpayment of tax against any "outstanding liability" for any tax.

Congress has recognized the potential burden that the interest rate differential places on taxpayers who have both overpayments and underpayments. Thus, each time Congress has increased the interest rate differential, Congress has stated in legislative history that the Service should implement the most comprehensive procedures "consistent with sound administrative practice" to allow overpayments to be credited against underpayments. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., 1986-3 C.B. (Vol. 4) 785 (accompanying the Tax Reform Act of 1986); H.R. Conf. Rep. No. 964, 101st Cong., 2d Sess., 1991-2 C.B. 591 (accompanying the Omnibus Budget Reconciliation Act of 1990); H.R. Rep. No. 826, 103d Cong., 2d Sess., 1995-1 C.B. 254 (accompanying the Uruguay Round Agreements Act).

The Service has developed substantial crediting procedures to implement interest netting. For example:

(a) The Service will consider all increases and decreases in a taxpayer's liabilities within a single tax year before applying the statutory interest rules to that year. Rev. Proc. 94-60, 1994-2 C.B. 774, provides that a taxpayer will not be charged the differential interest rate under § 6621(a) on an underpayment that is satisfied by credit of an overpayment arising in the same taxable year. This interest netting procedure is referred to as "annual interest netting."

(b) The Service permits crediting of overpayments against underpayments for the period of time when the underpayments and overpayments are both unpaid and outstanding, even if they are from different tax years or for different types of tax. This procedure for interest netting is referred to as "offsetting."

The Service, however, generally does not net interest where a taxpayer realizes an overpayment in one tax year that overlaps with a deficiency that a taxpayer has already paid for a different tax year. Likewise, the Service generally does not net interest where an unpaid deficiency in one tax year overlaps with an overpayment that the Service has already paid for a different tax year. This kind of interest netting is referred to as "global interest netting."

The Eighth Circuit recently addressed whether the Service is required to perform global interest netting calculations. *Northern States Power Co. v. United States*, 73 F.3d 764 (8th Cir. 1996). Interpreting §§ 6402(a) and 301.6402-1, the Eighth Circuit held that where the taxpayer's liability was fully paid, there was no "outstanding liability" against which to net the taxpayer's subsequent overpayment. The court further held that the Service, in any event, has the discretion whether to credit overpayments against underpayments.

### REQUEST FOR PUBLIC COMMENT

Many taxpayers and practitioners have suggested that the Service adopt global interest netting procedures. Global interest netting, however, raises a number of legal, policy and administrative issues. Thus, Announcement 96-5 states that the Service will conduct a study of these issues and solicit public comments for the study.

#### *Legal and Policy Issues of Global Interest Netting*

As described above, global interest netting would allow the taxpayer or the Service to recalculate interest for a certain period of time whenever a taxpayer has either a new overpayment that overlaps with an underpayment that the taxpayer has already paid to the Service, or a new underpayment that overlaps with an overpayment that

the Service has already paid to the taxpayer. The Service requests comments on the following issues:

1. In view of the policy generally favoring the finality of tax determinations, should a rule concerning the finality of global interest netting computations be adopted, and, if so, what should that rule be? What effect, if any, should the statute of limitations have on global interest netting, particularly considering the language in § 6402(a) regarding the applicable period of limitations? Should the statute of limitations be kept open longer in light of global interest netting?

2. When would it be appropriate for the Service to net interest globally for a particular tax year or period? For example, would it be appropriate to net interest globally before the final decision of an appeal or court decision for a tax period overlapping with the period at issue that might affect the interest calculation for such period? Would it be appropriate to net interest globally before the final decision of an appeal or court decision for a tax period that does not overlap with the period at issue, if such decision could produce an adjustment, such as a net operating loss or credit, that might affect the interest calculation for such period?

3. What would be the effect of carrybacks and carryforwards (e.g., net operating losses, various credits, etc.) on the global interest netting calculation for a certain period? Would carrybacks and carryforwards always require a recalculation of interest for such period? Or should global interest netting calculations only be made after carryforwards and carrybacks that might affect the period at issue are finally determined? How would the analysis be affected by the restricted interest provisions of §§ 6601(d) and 6611(f)?

4. Does global interest netting present any unique implications for taxpayers filing consolidated returns?

5. How would global interest netting affect § 861 allocations or interact with other U.S. international tax provisions?

#### *Administrative Issues*

The Service's computer system does not have the data storage capacity to keep information concerning paid deficiencies and paid refunds on line. The Service thus cannot make global interest netting calculations on its computer

system but must instead retrieve the data on paid deficiencies and paid refunds from its computer storage files and then manually make the interest calculations. This procedure could entail a significant additional commitment of IRS resources, primarily because of the need to verify the accuracy and completeness of the data necessary to make a global interest netting calculation and ensure an accurate calculation. Accordingly, the Service requests the following comments:

1. To the extent that taxpayers or practitioners currently make global interest netting calculations for themselves or their clients, the Service would like to receive a detailed description of how those calculations are performed, the cost of performing those calculations, and the reasons why the method used by particular taxpayers or practitioners would be appropriate for the Service to apply to large numbers of taxpayers without requiring significant additional Service resources.

2. How should the Service fulfill its obligation to verify the accuracy and completeness of all taxpayer data relevant to make a global interest netting calculation for a particular period, given the Service's computer data storage limitations?

#### *Time and Address for Comments*

The Service and Treasury would appreciate written comments on the above issues. Comments should be submitted by June 30, 1996, to:

Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Attn: CC:DOM:CORP:T:R:IT&A  
(Branch 1) Room 5228  
Washington, DC 20044

The comments you submit will be available for public inspection and copying.

#### **DRAFTING INFORMATION**

For further information regarding this notice, contact Joel Rutstein on (202) 622-4530 (not a toll-free call).

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