

ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

**Office of Chief Counsel
Internal Revenue Service**

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memorandum

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MLGompertz

date: APR 24 1997

to: Assistant Commissioner (Examination)
Attn: Oneida Stephens

from: Associate Chief Counsel (Domestic)

subject: General Agreement on Tariffs and Trade (GATT)--Significant Advice
Request Subject to Notice N(35)000-143

This responds to your request for advice dated February 12, 1996, concerning the GATT amendment to section 6621(a)(1) of the Code, which was enacted by section 713 of the Uruguay Round Agreements Act, Pub. L. No. 103-465 (1994). The GATT amendment changed the interest rate on corporate overpayments in excess of \$10,000, effective for periods beginning after December 31, 1994. Neither the GATT amendment nor its legislative history explains how it applies with respect to an overpayment outstanding on the January 1, 1995, effective date.

On several occasions, Mr. Gompertz of this office has discussed the issues presented with Oneida Stephens of Examination and Sandy Skelton of Appeals. In accordance with those conversations, we are responding at this time to questions 1 and 2 of your memorandum. We will be pleased to respond to the other questions at a later date. The issue raised by questions 1 and 2 of your memorandum is restated below.

This memorandum provides "Significant Advice" subject to the coordination procedures of Notice N(35)000-143, dated February 10, 1997. Therefore, in accordance with these procedures, this memorandum is also being provided to the Executive Office for Service Center Operations (EOSCO).

ISSUE

Does the GATT amendment's reduction in the rate of interest applicable to the "excess portion" of a corporate overpayment (the portion in excess of \$10,000) apply only to the excess portion of an overpayment outstanding on GATT's effective date (January 1, 1995) or also to the interest that accrued on such excess portion prior to January 1, 1995?

CONCLUSION

As of the effective date of GATT, the reduced rate of interest under GATT (the GATT rate) applies not only to the

excess portion of an overpayment, but also to the interest that accrued on such excess portion under pre-GATT law.

STATUTORY PROVISIONS

Section 6611(a) provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.

Under the GATT amendment to section 6621, to the extent a corporate overpayment exceeds \$10,000, interest accrues, for periods after December 31, 1994, on the first \$10,000 if the overpayment at the federal short-term rate plus 2 percentage points (the "normal rate" of interest). Interest accrues on the excess of the overpayment over \$10,000 at the federal short-term rate plus one-half a percentage point (the "GATT rate").

Section 6622(a) provides, in part, that in computing the amount of any interest required to be paid, interest shall be compounded daily. Daily compounding means that interest is calculated at the end of each day and the resulting interest is treated as principal for the following day's interest calculation. The result of the daily compounding required in section 6622(a) is that overpayment interest is computed each day on the sum of overpayment of tax and the overpayment interest that accrued the previous day. Section 6622 was added to the Code by section 344(a) of Pub. L. No. 97-248 (1982), the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

DISCUSSION

Before discussing whether the GATT interest rate applies only to the "excess portion" of a corporate overpayment outstanding on GATT's effective date (January 1, 1995) or whether the GATT rate applies to the excess overpayment and the interest that accrued on such excess portion prior to January 1, 1995, it is important to analyze the proper application of the GATT rate without regard to the effective date of the statute.

Because section 6622 requires interest on overpayments to be compounded daily, each day when calculating interest on an overpayment, there is no distinction between the overpayment of tax (i.e., the original principal amount) and the prior accrued interest. The full debt (overpayment and accrued interest) is used to calculate the additional interest accrual. As noted frequently by the federal courts, the tax and interest are generally treated as one. E.g. Alexander Praufoot Company v. United States, 484 F.2d 1379 (Ct. Cls. 1972) ("The Code's design for...interest is to assimilate it to the tax itself...") See also I.R.C. §6601(e)(1) ("any reference in this title ...to any

tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax".

As a result of the compounding rule, for overpayments which arise after the GATT effective date (January 1, 1995), the regular overpayment rate will apply to the tax (and additions) overpaid plus all accrued interest on that overpayment. For example, an overpayment of \$12,000 would accrue interest on the first \$10,000 at the normal rate and on the excess overpayment of \$2,000 at the GATT rate until the overpayment is refunded. This must be the correct result under the statutory provisions here.

If this is not the result and §6621(a) is interpreted to mean that the \$10,000 GATT rate related only to an "overpayment of tax," and not the overpayment's accrued interest, the result would be contrary to the daily compounding requirements of section 6622. For example, one rate of interest would be applicable to the excess overpayment (\$2,000, in the example) for the accrual period of one day under I.R.C. §6622(a), and then, the interest that is calculated on that interest would be accrued under a different interest rate. This result is contrary to the section 6622 requirement of daily compounding of interest.

To interpret the GATT interest provision of section 6621 consistently with the interest compounding provision of section 6622, the result must be that the first \$10,000 of overpayment, plus all accrued interest on that overpayment continue to receive the normal overpayment interest rate, and that the reduced GATT rate applies to the excess overpayment (\$2,000 in the example) plus the accrued interest on that overpayment.

We understand, in fact, that IRS computers are programmed to calculate interest on corporate overpayments for periods after 1995 as described in the preceding paragraph. However, a different rule has been applied for interest accrued as of January 1, 1995. The question then arises whether there is legal justification for the different treatment of interest accrued before January 1, 1995 and interest accrued after that time.

We have found no legal justification for this different treatment. There is nothing in the statute or the legislative history of the GATT interest provisions that supports different treatment of interest accrued before and after the effective date of the statute. In addition, the effective date provision states only that the rates apply "for determining interest for periods after December 31, 1994." P.L.103-465, §713(a). Finally, the application is more specifically described in the legislative history.

"The provision is effective for purposes of determining interest for periods after December 31, 1994, regardless of the taxable period (if any) to which the underlying tax may relate."

H.R. Rept. No 103-826, p.178. [emphasis added]

It is clear that the effective date is tied solely to the accrual period of interest and not when the overpayment arose or the period to which the overpayment relates. It seems clear that Congress intended the GATT rate to apply in 1995 and thereafter regardless of the timing of overpayment. In this way, the GATT rate applies equally to overpayments arising before 1985 or applying to taxes arising before 1995 as it does to overpayments thereafter. This application of the rate to periods after 1994 belies an intent for it to be applied to different amounts of taxes and interest depending on whether they arose before or after January 1, 1995.

At the current time, there are no court cases that address the GATT interest issue. However, four courts of appeals have considered a similar issue: Whether section 6622's requirement that interest be compounded applies only to the underpayment outstanding on the effective date of TEFRA (January 1, 1983) or, rather, also applies to the simple interest that had accrued on such underpayment prior to the effective date. See RJR Nabisco, Inc. v. U.S., 955 F.2d 1457 (11th Cir. 1992); Purer v. U.S., 872 F.2d 277 (9th Cir. 1989); Cohn v. U.S., 872 F.2d 533 (2d Cir. 1989); and Gannet v. U.S., 877 F.2d 965, 968 (Fed. Cir. 1989).

In all four cases, the courts agreed with the Service that the requirement of compounding applies not only to the underlying underpayment, but also to the simple interest that had accrued on the underpayment prior to TEFRA's effective date, January 1, 1983. The courts concluded that nothing in the statutory language indicated that simple interest accruing prior to the effective date was "grandfathered," i.e., excepted from the requirement of compounding for the period beginning on the effective date. Similarly, we believe that nothing in the statutory language of GATT indicates that interest on an overpayment that accrued prior to GATT's effective date is excepted from the new lower rate of interest for the period beginning on the effective date.

Although there was legislative history directly on point for the section 6622 question in RJR Nabisco and the other cases, the RJR Nabisco court indicated that it might have reached the same conclusion even without the aid of the legislative history based on the logic of the compound interest requirement: i.e., under a compound interest regime, the distinction between principal and interest disappears and "[a] debt is a debt, whether the corpus consists of principal or interest or a combination thereof." 955 F.2d at 1462. Thus, in the present context, no distinction should be made between the portion of an overpayment in excess of \$10,000 and the accrued interest on such portion.

The following examples illustrate the application of GATT interest to overpayments that occurred before and after the statute's effective date of January 1, 1995.

EXAMPLE 1

On September 15, 1991, a corporation overpaid its 1990 income tax by \$9,000. The accrued interest as of January 1, 1995, was \$2,000. On March 31, 1995, the Service refunded the overpayment and paid all interest thereon to the corporation.

Although the total credit balance (\$11,000) as of January 1, 1995, exceeds the \$10,000 threshold amount, the overpayment (\$9,000) does not exceed the threshold. Thus, because accrued interest is not considered an overpayment, the GATT rate of interest is not triggered.

EXAMPLE 2

On September 15, 1991, a corporation overpaid its 1990 income tax by \$25,000. The accrued interest as of January 1, 1995, was \$5,000. On March 31, 1995, the Service refunded the overpayment and paid all interest thereon to the corporation.

As of January 1, 1995, there was a "threshold overpayment" of \$10,000 and an "excess overpayment" of \$15,000 under section 6621(a). Of the \$5,000 of accrued interest, \$2,000 was allocable to the \$10,000 threshold and \$3,000 was allocable to the \$15,000 excess overpayment. Therefore, the normal rate of interest applies to the \$10,000 threshold and the \$2,000 of interest that accrued thereon, and the GATT rate applies to the \$15,000 excess portion of the overpayment and \$3,000 of interest that accrued thereon.

EXAMPLE 3

The facts are the same as in Example 2 except that on December 31, 1994, the Service refunded the entire \$25,000 overpayment, but none of the \$5,000 of accrued interest thereon was paid to the corporation. Further, on March 31, 1995, the Service paid the \$5,000 of accrued interest and the interest that accrued thereon from January 1, 1995, to March 31, 1995.

Although the amount of accrued interest (\$5,000) is less than the \$10,000 threshold, the interest was earned on an overpayment of \$25,000, which exceeds the \$10,000 threshold. Thus, the GATT rate of interest is triggered and post-1995 interest should be computed on the pre-1995 interest in the same manner that the post-1995 interest would have been computed had

the overpayment not been refunded, as in Example 2. Therefore, as in Example 2, post-1995 interest should be computed at the normal rate on \$2,000 and at the GATT rate on \$3,000.

 /s/
JUDITH C. DUNN

cc: Executive Offices of Service Center Operations

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