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INTERNAL REVENUE SERVICE
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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR MARK A. O'LEARY
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FROM: John J. McGreevy
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CC:PA:APJP

SUBJECT: Interest Netting

This Chief Counsel Advice responds to your memorandum dated January 29, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer
Year 1
Year 2
Year 3
Year 4
Year 5
Year 6
Year 7
Year 8
Year 9
Year 10
Year 11
Year 12
Year 13
Year 15

Amount a
Amount b
Amount c
Amount d
Amount e
Amount f
Amount g
Amount h
Amount i

ISSUE

Whether Taxpayer would have been able to file timely claims on July 22, 1998 for underpayment interest under section 6511 of the Internal Revenue Code ("Code") for its Year 1-Year 5 taxable years?

CONCLUSION

Taxpayer would not have been able to file timely claims on July 22, 1998 for underpayment interest under section 6511 of the Code for certain of its Year 1-Year 5 underpayments.

FACTS

Year 1

Taxpayer had a deficiency for Year 1 of Amount a. Taxpayer paid the deficiency on May 29, Year 6. Taxpayer had an additional deficiency for Year 1 of Amount b. Taxpayer paid the deficiency on May 17, Year 13.

Year 2

Taxpayer had a deficiency for Year 2 of Amount c. Taxpayer paid the deficiency on May 29, Year 6.

Year 3

Taxpayer had a deficiency for Year 3 of Amount d. Taxpayer paid the deficiency on March 4, Year 8. Taxpayer had an additional deficiency for Year 3 of Amount e. Taxpayer paid the deficiency on September 1, Year 11.

Year 4

Taxpayer had a deficiency for Year 4 of Amount f. Taxpayer paid the deficiency on March 4, Year 8. Taxpayer had an additional deficiency for Year 4 of Amount g. Taxpayer paid the deficiency on May 27, Year 8. Taxpayer had another deficiency for Year 4 of Amount h. Taxpayer paid the deficiency on September 15, Year 11.

Year 5

Taxpayer had a deficiency for Year 5 of Amount i. Taxpayer paid the deficiency on September 8, Year 9.

LAW AND ANALYSIS

Section 6621(d) of the Code provides that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period.

Section 6621(d) applies to interest accruing for periods beginning before the effective date of July 22, 1998, provided, the taxpayer files a request for interest netting as required by Rev. Proc. 99-43, 1999-2 C.B. 579.

Rev. Proc. 99-43 sets forth a three-prong test for filling a timely request for interest netting. First the period of limitation for claiming a credit or refund of the underpayment interest and the period of limitation for claiming additional overpayment interest must both have been open on July 22, 1998. Second, the taxpayer must reasonably identify and establish the period for which the net rate of zero applies. Third, a valid request for interest netting must be filed with the Internal Revenue Service no later than December 31, 1999. However, the taxpayer need not take any action by December 31, 1999, if at least one of the applicable periods of limitation will be open after December 31, 1999. In that case, the taxpayer must file a claim prior to the expiration of the later period of limitation. The applicable periods of limitation can be found in section 6511 of the Code, for underpayment interest, and 28 U.S.C. sections 2401 and 2501, for overpayment interest.

Section 6511 provides, in general, that a claim for credit or refund of interest paid on an underpayment must be filed within 3 years from the time the tax return was filed or 2 years from the time the interest was paid, whichever period expires later.

Section 6511(b)(1) provides that no refund may be allowed or made after the expiration of the period of limitation for filing a claim for refund unless a claim for refund is filed by the taxpayer within such period.

CONCLUSIONS

Year 1

Taxpayer filed a Form 872, Consent to Extend the Time to Assess Tax, extending the period of assessment for Year 1 to September 30, Year 6. Taxpayer had a deficiency for Year 1 of Amount a. Taxpayer paid the deficiency on May 29, Year 6. Pursuant to section 6511, Taxpayer had two years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on May 29, Year 8. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Taxpayer had an additional deficiency for Year 1 of Amount b. Taxpayer paid the deficiency on May 17, Year 13. Pursuant to section 6511, Taxpayer had two years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on May 17, Year 15. Therefore, Taxpayer could file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Year 2

Taxpayer filed a Form 872 extending the period of assessment for Year 2 to September 15, Year 6. Taxpayer had a deficiency for Year 2 of Amount c. Taxpayer paid the deficiency on May 29, Year 6. Pursuant to section 6511, Taxpayer had two years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on May 29, Year 8. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Year 3

Taxpayer filed a Form 872 extending the period of assessment for Year 3 to September 30, Year 11. Taxpayer had a deficiency for Year 3 of Amount d. Taxpayer paid the deficiency on March 4, Year 8. Pursuant to the terms in the Form 872, Plaintiff had six months after the termination of the Form 872 agreement to file a claim for refund with the government. (See generally Form 872, paragraph (3).) Accordingly, Taxpayer's period of limitation expired on March 30, Year 12. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Taxpayer had an additional deficiency for Year 3 of Amount e. Taxpayer paid the deficiency on September 1, Year 11. Pursuant to section 6511, Taxpayer had two

years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on September 1, Year 13. Therefore, Taxpayer could file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Year 4

Taxpayer filed a Form 872 extending the period of assessment for Year 4 to September 30, Year 11. Taxpayer had a deficiency for Year 4 of Amount f. Taxpayer paid the deficiency on March 4, Year 8. Pursuant to Form 872, paragraph (3), Plaintiff had six months after the termination of the Form 872 agreement to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on March 30, Year 12. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Taxpayer had an additional deficiency for Year 4 of Amount g. Taxpayer paid the deficiency on May 27, Year 8. Pursuant to Form 872, paragraph (3), Plaintiff had six months after the termination of the Form 872 agreement to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on March 30, Year 12. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Taxpayer had another deficiency for Year 4 of Amount h. Taxpayer paid the deficiency on September 15, Year 11. Pursuant to section 6511, Taxpayer had two years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on September 15, Year 13. Therefore, Taxpayer could file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

Year 5

Taxpayer filed a Form 872 extending the period of assessment for Year 5 to February 29, Year 10. Taxpayer had a deficiency for Year 5 of Amount i. Taxpayer paid the deficiency on September 8, Year 9. Pursuant to section 6511, Taxpayer had two years from the time the interest was paid to file a claim for refund with the government. Accordingly, Taxpayer's period of limitation expired on September 8, Year 11. Therefore, Taxpayer could not file a timely claim for underpayment interest under section 6511 of the Code on July 22, 1998.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The ultimate issue in this case is whether Taxpayer's period of limitation for filing a

claim for refund on certain underpayments was open on July 22, 1998.

On November 16, 1999, Taxpayer filed a claim for refund on Form 843 ("1999 Claim"). The 1999 Claim requested that the net rate of zero provided for in section 6621(d) of the Code be applied to Taxpayer's Year 1-Year 7 tax years. Your office analyzed Taxpayer's 1999 Claim and determined that the period of limitation for filing a claim for refund on certain underpayments was closed on July 22, 1998, and, therefore, Taxpayer had not filed a valid claim for interest netting as required by Rev. Proc. 99-43.

Taxpayer contends that the period of limitation for filing a claim for refund was open on July 22, 1998, because Taxpayer had filed certain claims for its Year 1-Year 7 tax years which were still pending on July 22, 1998. Taxpayer's claims for refund requested relief based on the following theories: 1) LNG sourcing; 2) Norway creditable taxes; 3) Foreign oil and gas extraction income; 4) Commissions paid to FSC; 5) Prudhoe Bay TEFRA adjustments; 6) Capitalized indirect costs under section 263A of the Code; 7) Delay rentals; 8) Capital Loss Carrybacks; 9) Business Development Costs; 10) Asbestos Removal; 11) Egyptian Income Taxes; 12) Interest Expense Allocations under section 861 of the Code; 13) Capital loss on SIBIA stock; 14) Dues to Marine Preservation Association; 15) Section 29 credits; 16) Write-off of plugged and abandoned wells; and 17) Computational Adjustments.¹ In addition, each claim had an asterisk next to each figure. The asterisk related to the following language "or such greater amount as is legally refundable together with interest."

Rev. Proc. 99-43 requires that the period of limitation for claiming a credit or refund of the underpayment interest and the period of limitation for claiming additional overpayment interest must both have been open on July 22, 1998. The applicable periods of limitation for underpayment interest can be found in section 6511 of the Code. Section 6511 provides, in general, that a claim for credit or refund of interest paid on an underpayment must be filed within 3 years from the time the tax return was filed or 2 years from the time the interest was paid, whichever period expires later.

There are two approaches to applying Rev. Proc. 99-43's requirement that the period of limitation for filing a claim for refund of underpayment interest be open on July 22, 1998. The first approach applies the general period of limitations and determines whether the periods were open on July 22, 1998. This approach yields the result reached by your office. The second approach looks to whether the taxpayer was

¹This refers to "the right to make any adjustment in any carryover or carryback of investment credits, foreign tax credits and research credits from or to prior or subsequent taxable years and any other consequential adjustments required as a result of changes to federal income tax changes reflected in this claim."

entitled to a refund of underpayment interest as of July 22, 1998. The second approach yields the result discussed below.

Taxpayer's original claims for refund requested relief based on the above-listed issues. In addition, each claim had an asterisk next to each figure. The asterisk related to the following language "or such greater amount as is legally refundable together with interest." Section 6601(e)(1) provides that 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. In Alexander Proudfoot Co. v. United States, 454 F.2d 1379, 1382 (Ct. Cl. 1972), the Court of Claims stated that "deficiency interest has been so closely braided to principal that it has been deemed an integral part of that interest." Based on Proudfoot, the Claims Court has held that a formal claim for refund of tax implicitly includes an informal claim for any deficiency interest attributable to that tax. Deluxe Check Printers v. United States, 15 Cl. Ct. 175 (1988). Taxpayer had filed claims for its Year 1-Year 7 tax years which were still pending on July 22, 1998. Since the claims were still pending on July 22, 1998, Taxpayer was entitled to a refund of underpayment interest attributable to those underpayments on July 22, 1998.

The issue of whether a pending claim is sufficient to satisfy the requirement that the section 6511 period be open on July 22, 1998 is among the issues pending in Computervision Corporation v. United States, Fed. Cl. No. 90-284T. Thus, we cannot at this time determine the proper resolution in this case.

There are additional litigation hazards in this case. It is the Service's position that both periods of limitations must be open on July 22, 1998; however, the issue of whether both periods of limitations must be open on July 22, 1998 is currently pending in the Court of Federal Claims in Federal National Mortgage Assoc. v. United States, Fed. Cl. No. 00-369T.

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If you have any questions, please call (202) 622-4910.