

Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject: Interest Netting and Collection Statute Expiration Date

This Chief Counsel Advice responds to your request for assistance dated June 12, 2007. This advice may not be used or cited as precedent.

ISSUES

1. Whether underpayment interest can be considered assessed due to a transfer of credit into an account within the 10-year CSED.
2. Does the limitations period in I.R.C. § 6532(b) for filing a suit to recover an erroneous refund apply to the reversal of a setoff?
3. May the Service reverse the setoff processed in _____ which affected tax years _____ and _____ ?

CONCLUSIONS

1. The application of a credit by the Service to a taxpayer's tax module during the 10-year CSED of an underlying tax liability does not convert an unassessed tax or interest liability into an assessed tax or interest liability. If there is no assessment on a tax or interest liability, then there is no payable liability.
2. No, the limitations period provided in I.R.C. § 6532(b) does not apply to the reversal of a setoff.

3. No, the Service has not presented facts which would support reversal of the transaction.

FACTS

Corporation X filed a claim for net rate interest netting for their tax year. Corporation X seeks a netting benefit under I.R.C. §6621(d) for the difference between the overpayment and underpayment interest for the tax year.

After numerous assessment waivers, the Service made an assessment of \$ on for the tax year. The Service only assessed the underlying tax liability of this period. Underpayment interest on the \$ was not assessed at this time. Corporation X subsequently paid the underlying tax deficiency on , but never paid any underpayment interest connected to the underlying tax deficiency.

The Collection Statute Expiration Date (CSED) for the tax year assessment expired on . Credits were applied within the 10-year CSED, but were subsequently offset to the tax year, which still had an open CSED. The credits were offset due to there being no interest liability to apply the credits against since the interest had never been assessed during the 10-year CSED of the underlying tax deficiency.

INTEREST NETTING

The Restructuring and Reform Act of 1998 (RRA) amended section 6621 by adding section 6621(d), which allowed for the elimination of interest on overlapping periods of overpayments and underpayments. 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, the net rate of interest on such amounts would be zero for such period.

The Conference Report, H. R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998) accompanying the RRA, provided that the net interest rate of zero would be applied without regard to whether the overpayment or underpayment was currently outstanding. Each overpayment or underpayment would be considered only once in determining whether equivalent amounts of overpayment and underpayment overlapped for a particular period. The report further provided that the net interest rate of zero applied even when special rules increased the rate of interest for large corporate underpayments under section 6621(c).

Section 6621(d) generally applies to interest for periods (calendar quarters) beginning after July 22, 1998 (*i.e.*, interest accruing on or after October 1, 1998). See H. R. Rep. No. 364 (Part 1), 105th Cong., 1st Sess. 64 (1998); S. Rep. No. 174, 105th Cong., 2d

Sess. 62 (1998); H. R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998). However, § 3301(c)(2) of the RRA provides that section 6621(d) applies to interest for periods beginning before July 22, 1998 (*i.e.*, interest accruing before October 1, 1998), provided certain conditions are met. First, both periods of limitation applicable to the tax underpayment and to the tax overpayment must have been open on July 22, 1998. Second, the taxpayer must:

(a) reasonably identify and establish periods of tax overpayments and underpayments for which the net interest rate of zero applies, and

(b) not later than December 31, 1999, request the Secretary of the Treasury to apply section 6621(d) to such periods.

Here, Corporation X filed Form 843, Claim for Refund and Request of Abatement, on _____, requesting a net rate of zero on accrued overpayment and underpayment interest for the _____ tax year. It has been determined that both the underpayment and the overpayment statute of limitations was open as of July 22, 1998, and Corporation X reasonably identified the periods to which the net rate of zero should apply. Corporation X, as well, requested before December 31, 1999 that the Service apply section 6621(d) to the _____ tax period. Consequently, Corporation X's claim for interest netting is procedurally acceptable. The Service must, however, determine if the underpayment interest is payable and the overpayment interest is allowable. I.R.C. § 6621(d). There is no question that the overpayment interest is allowable. The question that remains is whether the underpayment interest is payable.

1. Whether underpayment interest can be considered assessed due to a transfer of credit into an account within the 10-year CSED for the purpose of interest netting under section 6621(d).

A. Procedures for the Assessment of Underpayment Interest

The Code generally stipulates that if any amount of tax imposed by the Code is not paid on or before the last date prescribed for payment, interest on such amount must be paid for the period from such last date to the date paid at the underpayment rate established under § 6621. I.R.C. § 6601(a). Interest imposed under this section on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes. I.R.C. § 6601(e)(1).

Additionally, section 6601(g) states that interest prescribed under this section on any tax may be *assessed and collected* at any time during the period within which the tax to which such interest relates may be collected. (emphasis added).

Under section 6502, where a tax assessment has been made within the requisite period of limitations, the Service may collect the tax by levy or by a proceeding in court, but only if the levy is made or the proceeding begun within 10 years after the assessment of

the tax. This 10-year period is properly known as the Collection Statute Expiration Date, or CSED.

Thus, under section 6601(g), the Service may only *assess and collect* accrued interest within the 10-year CSED of the underlying tax. The Service must assess and collect all accrued interest within the limited time period set by the CSED on the underlying tax.

For Corporation X, the Service made a tax assessment of \$ _____ on _____ for the _____ tax year. The CSED expired on the _____ tax assessment on _____. The underpayment interest on the assessed _____ tax liability was never assessed before the expiration of the CSED on the underlying tax in _____. Thus, the Service is barred from taking any collection actions against Corporation X for the unpaid, unassessed underpayment interest for the _____ tax liability.

B. Credits

An underpayment, including underpayment interest, may be satisfied by the credit of an overpayment. Section 6402 provides that in the case of an 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 the balance to such person.

The Code does not explicitly define overpayment, however, section 6401(a) does provide that an overpayment includes payment of an Internal Revenue tax that is assessed or collected after the applicable statute of limitations has expired. Thus, a tax assessed or collected after the expiration of the applicable period of limitations is an overpayment because the tax is not rightfully due. IRS Prac. & Proc. §11.02[1]. See *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990) (“[s]ince the amounts paid in 1985 were ‘collected’ by the IRS outside of the period for assessment with no assessment having been made, they come within (the Section 6401) definition of ‘overpayment’”).

Consequently, there is nothing in the Internal Revenue Code that would transform an unassessed tax or interest liability into an assessed tax or interest liability merely because a credit was posted to a tax year module. An assessment is the formal recording of a taxpayer’s tax liability, fixing the amount payable. I.R.C. § 6203. If there is no assessment on a tax liability, then there is no payable liability.

Therefore, merely because the Service applied credits to Corporation X’s _____ tax year module during the 10-year CSED of the underlying tax liability does not mean that an accrued unassessed interest liability converts into an assessed liability. A tax assessment is distinguishable from an interest assessment. “Although the term ‘assessment’ is used when interest is posted to a taxpayer’s account, a formal summary record of assessment or 23-C Form is not prepared. The interest is simply automatically or manually posted to the account as a computer generated assessment. .

. . Interest under section 6601 is, of course, dependent upon an underlying tax obligation and accrues and is compounded on a daily basis.” *United States v. Toyota of Visalia, Inc.*, 772 F. Supp. 481 (E.D. Calif. 1991). See also I.R.M. 25.6.9.4.2. I.R.S. Prac. & Proc. § 6.02[1][a], 1999 WL 1050897.

C. Result of the Interest Netting Claim

Since the underpayment interest was never assessed in this situation within the applicable CSED, then no amount payable was ever fixed for this taxpayer on the underpayment interest. Thus, the claim for interest netting must be denied under these circumstances because, although interest may be allowable for an overpayment for the tax year, in this instance, it is not payable for the equivalent underpayment. See § 6621(d); Rev. Proc. 99-43. Corporation X never made payments nor had to make payments for the unassessed accrued interest on their tax year liability. As a result, there is nothing to net the overpayment interest against under section 6621(d).

2. Does the limitations period in I.R.C. § 6532(b) for filing a suit to recover an erroneous refund apply to the reversal of a setoff?

I.R.C. § 7405 creates a cause of action to recover an erroneous refund issued to a taxpayer. Pursuant to § 7405(d), the period of limitations during which the Service must file an erroneous refund suit is governed by § 6532(b).

I.R.C. § 6532(b) provides, in general, a 2-year period from the time a refund is made to file suit to recover such payment. A 5-year period is provided when the refund was induced by fraud or misrepresentation of a material fact.

I.R.C. § 6402(a) provides, in part, that in the case of any overpayment, the Service, within the applicable period of limitations, may credit the amount of such overpayment against any liability in respect of an internal revenue tax. When no claim for refund is submitted by the taxpayer, the Service has the discretion to apply an overpayment to a subsequent liability but is under no requirement to do so.

We could find no authority in the Internal Revenue Code or elsewhere to suggest there is a period of limitations for the reversal of a setoff. Accordingly, the reversal of a setoff is not subject to the limitations period in § 6532(b).

3. May the Service reverse the setoff processed in _____ which affected tax years and _____ ?

Neither § 6402 nor the regulations there under specifically address the Service’s authority to reverse a setoff. In general, specific statutory authority is required for the Service to reverse a completed transaction. For example, while it is within the Service’s discretion whether to make an assessment of tax, once that assessment is properly made, it can be abated only under the conditions provided in § 6404. Similarly, while

the Service may decide that it does not desire to file a tax lien against a taxpayer's property, once the lien is filed, it may be released or withdrawn only under the conditions provided in § 6323(j).

A nonstatutory "common law" exception to these prohibitions on reversing a completed transaction is referred to as the "clerical error" exception. See Bugge v. United States, 99 F.3d 740 (5th Cir. 1996); Crompton-Richmond Co. v. United States, 311 F. Supp. 1184 (S.D.N.Y. 1970). Succinctly stated, whenever an action occurs because of a mistake of fact or bookkeeping error, that mistake can be corrected so long as doing so does not prejudice the taxpayer.

The facts presented in this case indicate that the amounts at issue were setoff because the _____ account reflected an overpayment. The account reflected an overpayment because the Service did not assess underpayment interest against the taxpayer. Based on the status of the account, the setoff was appropriate; there was no clerical error. There is no authority to reverse a setoff which was not processed due to a clerical error. Therefore, the setoff should not be reversed. Even if we were to conclude that the setoff to the _____ account was caused by a clerical error, the Service may correct its mistake only if there would be no prejudice to the taxpayer. In this case, the taxpayer would likely be prejudiced because it appears that the period of limitations for assessing and collecting the underpayment interest has expired. The taxpayer currently has a windfall.

As a final matter we note that there would be other consequences if the setoff were to be reversed. The taxpayer's liability for _____ was extinguished when the funds were transferred from its _____ account to its _____ account. If the funds are now moved out of the _____ account, taxpayer will become underpaid for _____. Unless the statute of limitations on assessment is open for _____, the Service will not be able to assess and collect a newly created liability for _____. See Singleton v. United States, 128 F.3d 833 (4th Cir. 1997); Bilzerian v. United States, 86 F.3d 1067 (11th Cir. 1996), *acq. in result*, 1998-02; Clark v. United States, 63 F.3d 83 (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340 (7th Cir. 1995); United States v. Wilkes, 946 F.2d 1143, 1152 (5th Cir. 1991).

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