

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: R. Craig Schneider
General Attorney (Salt Lake City)
(Small Business/Self-Employed)

from: Blaise Dusenberry
Senior Technician Reviewer, Branch 1
(Procedure & Administration)

subject: Applicability of Section 6621(d) to Interest on Underpayments and Overpayments of a Parent Corporation and Two Disregarded Entities Owned by the Parent Corporation from Tax Years Prior to the Year the Entities Became Disregarded

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

LEGEND

Parent =
Entity 1 =
Entity 2 =
Date 1 =
Date 2 =
Date 3 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =

Year 8 =
Year 9 =
Year 10 =
Year 11 =
Year 12 =
Amount 1 =
Amount 2 =
Amount 3 =
EIN 1 =
EIN 2 =
EIN 3 =

ISSUES

Whether Parent, Entity 1 (a subsidiary of Parent that converted under state law to a limited liability company (the “conversion”)), and Entity 2 (a subsidiary of Parent that elected under Treas. Reg. § 301.7701-3(g)(1)(iii) to become a disregarded entity (the “election”)) are the same taxpayer under section 6621(d) and thus entitled to net interest rates on underpayments and overpayments incurred separately by each entity in tax years prior to Entity 1’s conversion and Entity 2’s election.

CONCLUSIONS

No, Parent, Entity 1, and Entity 2 are not the same taxpayer, therefore section 6621(d) is inapplicable to the extent that netting is requested between different entities.

FACTS

You submitted a request for advice on the application of section 6621(d) in order to advise the Complex Interest Unit at the Ogden Service Center on how to process Parent’s claim for refund involving interest netting. The facts below are gathered from your request for advice and from the materials submitted by Parent as part of its claim for refund.

On or about Date 3, Parent filed a claim for refund based upon a recalculation of interest due from and payable to itself using interest rate netting among itself, Entity 1, and Entity 2. The tax periods giving rise to the underpayments and overpayments for which interest netting is requested are all prior to Entity 1’s conversion and Entity 2’s election. Parent seeks a refund of Amount 1; Entity 1 seeks a refund of Amount 2; Entity 2 seeks a refund of Amount 3.

Although Entity 1 and Entity 2 were subsidiaries owned by Parent, they did not join in the filing of Parent’s consolidated income tax return for the periods at issue.¹

¹ We do not have sufficient facts to determine whether Entity 1 and Entity 2 each properly filed separate returns or should have joined in Parent’s consolidated returns for the periods at issue. If Parent filed

The tax periods at issue are as follows:

Tax Year	Type of Tax	Taxpayer	EIN
Underpayment Periods:			
Year 4	Form 1120	Parent	EIN 1
Year 6	Form 1120	Entity 1	EIN 2
Year 7	Form 1120	Entity 1	EIN 2
Year 8	Form 1120	Entity 1	EIN 2
Year 2	Form 1120	Entity 2	EIN 3
Year 4	Form 1120	Entity 2	EIN 3
Year 6	Form 1120	Entity 2	EIN 3
Year 7	Form 1120	Entity 2	EIN 3
Year 9	Form 1120	Entity 2	EIN 3
Year 10	Form 1120	Entity 2	EIN 3
Year 11	Form 1120	Entity 2	EIN 3
Overpayment Periods:			
Year 1 ²	Form 1120	Parent	EIN 1
Year 4	Form 1120	Parent	EIN 1
Year 5	Form 1120	Parent	EIN 1
Year 3	Form 1120	Entity 1	EIN 2
Year 4	Form 1120	Entity 1	EIN 2
Year 9	Form 1120	Entity 1	EIN 2
Year 2	Form 1120	Entity 2	EIN 3
Year 8	Form 1120	Entity 2	EIN 3
Year 9	Form 1120	Entity 2	EIN 3
Year 10	Form 1120	Entity 2	EIN 3

consolidated returns for the periods that Entity 1 and Entity 2 filed separate returns, Entity 1 and Entity 2 would have been required to join in Parent's consolidated returns if they were includible corporations within the meaning of section 1504(b) and the stock ownership requirements of section 1504(a)(2) were satisfied (unless they were subject to the five-year waiting period of section 1504(a)(3)). Treas. Reg. § 1.1502-76(b)(1).

² You note in your request for advice that the overpayment for Parent for Year 1 arises from refund litigation. We are unaware of any restrictions on the application of section 6621(d) to tax periods settled through court order unless the order specifically states otherwise.

State Law Conversion of Entity 1

On Date 1, Entity 1, organized under Delaware General Corporation Law, redeemed all of the stock of its minority shareholder and converted under Delaware law to a limited liability company wholly owned by Parent. Pursuant to the conversion, for federal tax purposes all of the assets and liabilities of Entity 1 were deemed distributed to Parent in complete cancellation of all of Entity 1's outstanding stock.

Election of Entity 2

On Date 2, Entity 2 elected under Treas. Reg. § 301.7701-3(g)(1)(iii) to be disregarded as an entity separate from Parent for federal tax purposes. Pursuant to this election, for federal tax purposes all the assets and liabilities of Entity 2, a wholly owned subsidiary, were deemed distributed to Parent in liquidation of Entity 2.

LAW AND ANALYSIS

Section 6601 imposes interest on any nonpayment or underpayment of a Title 26 tax running from the due date of payment to the date paid. Section 6611 authorizes the payment of interest on an overpayment of an internal revenue tax. If the overpayment is allowed and paid as a credit, interest runs from the overpayment date to the due date of the amount against which the credit is applied. I.R.C. § 6611(b)(1). If the overpayment is allowed and paid as a refund, interest runs from the overpayment date to a date determined by the Service that is no more than 30 days before the date of the refund check. I.R.C. § 6611(b)(2).

Section 6621(a)(1) establishes the interest rate for overpayments, and section 6621(a)(2) establishes the interest rate for underpayments. Section 6621(d) provides that to the extent interest is payable for any period under section 6601 and allowable under section 6611 on equivalent underpayments and overpayments by "the same taxpayer," the net rate of interest under section 6621 on the underpayment and overpayment amounts shall be zero for the overlapping period.

"Taxpayer" is defined in section 7701(a)(14) as "any person subject to any internal revenue tax." "Person" means and includes a corporation. I.R.C. § 7701(a)(1). We construe "the same taxpayer" to mean for purposes of section 6621(d) the taxpayer, whether individual or entity, that was liable for both the tax that was underpaid and the tax that was overpaid. If the entities are different, section 6621(d) does not apply and netting is not permitted by statute.

In this case, the underpayments and overpayments on which interest netting is requested involve multiple entities filing their own tax returns under separate Employer Identification Numbers (EINs). Parent requests that interest rates accruing and payable on its own underpayments and overpayments be netted against interest rates from overpayments and underpayments by Entity 1 and Entity 2 from years prior to when the

entities became disregarded and in which the entities filed separate returns. Parent suggests that the purported tax treatment of both the conversion and the election as liquidations to which section 332 applies makes Parent, Entity 1, and Entity 2 the same taxpayer.³ Unlike the situation where a target corporation merges into an acquiring corporation and goes out of existence, the fact that Entity 1 and Entity 2 were deemed liquidated into Parent under section 332 is insufficient to satisfy the “same taxpayer” requirement of section 6621(d) because Entity 1 and Entity 2 are still existing state law entities. Therefore, we must look to state conversion law and Treas. Reg. § 301.7701-2 to determine the liability of Entity 1 and Entity 2 for both the tax that was underpaid and the tax that was overpaid. For the reasons outlined below, section 6621(d) is inapplicable to the extent that interest netting is requested among the different entities.

On Date 1, Entity 1, a Delaware corporation, converted under Delaware law to a limited liability company by filing a certificate of conversion. Because the conversion took place under state law, we look to the Delaware General Corporation Act for the effects of this conversion. On the date of conversion, section 266(a) of the Act stated, “[a] corporation of this State may, upon the authorization of such conversion in accordance with this section, convert to a limited liability company....” Section 266 (d) continues, “[t]he conversion of a corporation pursuant to a certificate of conversion under this section shall not be deemed to affect any obligations or liabilities of the corporation incurred prior to such conversion.” Del. Code Ann. Title 8 § 266 (Year 12).

Under applicable state law, Entity 1 appears to be liable for its own underpayments arising in taxable years prior to the conversion. For this reason, we cannot consider Entity 1 and Parent the same taxpayer for purposes of section 6621(d).

On Date 2, pursuant to the election made under Treas. Reg. § 301.7701-3(g)(2)(iii), the assets and liabilities of Entity 2, a wholly owned subsidiary, were deemed distributed to Parent in liquidation of Entity 2. Treas. Reg. § 301.7701-2(c)(2)(iii), describing the tax liabilities of certain disregarded entities, states:

An entity that is otherwise disregarded as separate from its owner is treated as an entity separate from its owner for purposes of: (1) Federal tax liabilities of the entity with respect to any taxable period for which the entity was not disregarded. (2) Federal tax liabilities of any other entity for which the entity is liable. (3) Refunds or credits of Federal tax.

This regulation indicates that Entity 2, after electing to become a disregarded entity, is still liable for underpayments arising in taxable years before it was disregarded and is arguably entitled to overpayments from those years. Entity 2’s election under Treas. Reg. § 301.7701-3(g)(1)(iii) to be disregarded as separate from its owner, Parent, does not make these two entities the same taxpayer as required under section 6621(d).

³ We do not have sufficient facts to determine whether the conversion of Entity 1 and the election of Entity 2 properly qualify as valid deemed liquidations to which section 332 applies.

In the tax periods generating the underpayments and overpayments for which netting is requested, the three entities involved filed separate tax returns using separate EINs. The conversion by Entity 1 and the election by Entity 2 do not appear to alter this distinction. After Entity 1's conversion and Entity 2's election, these entities still exist under state law. The purported tax treatment of the conversion and the election as liquidations to which section 332 applies does not change either entity's status or liability regarding the prior tax periods. Therefore, section 6621(d) does not apply to the extent that netting is requested among different entities for interest arising from years prior to a state law conversion or check-the-box election.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The law in the area of section 6621(d) is so far largely uncharted. This office has not previously given definitive advice or guidance on the issue in this memorandum. Moreover, to our knowledge, no court has addressed it. If based on this advice, the Service denies interest netting and the taxpayer challenges the denial in litigation, there is, of course, a hazard that the government's position will not prevail. We do not, however, consider the hazards of litigation to be any greater than normal. We believe the position articulated herein is sound and fully defensible.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4910 if you have any further questions.