

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

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to: R. Craig Schneider
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(Small Business/Self-Employed)

from: Lawrence Mack
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(Procedure & Administration)

subject: Issue (1): Applicability of Zero Interest Netting Under 26 U.S.C. § 6621(d) as to
Interest Paid Through a Chapter 11 Plan Under Title 11 of the United States Code

Issue (2): Re-Designation by Taxpayer of an Overpayment Credit Elect

This Chief Counsel Advice responds to your request for assistance dated November 18, 2009. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
Company A =

Date 1 =
X =

ISSUES

Issue (1): Whether interest rates on overlapping periods of tax overpayments and underpayments may be netted to zero as provided for under 26 U.S.C. § 6621(d) where

the payment of interest of the tax underpayment is through a Chapter 11 plan under Title 11 of the United States Code.¹

Issue (2): Whether a taxpayer has a right to “re-designate” a credit election of an overpayment.

CONCLUSIONS

Issue (1): The Service should disallow a claim for zero rate interest netting where the interest paid by the taxpayer is through a Chapter 11 plan as such interest is not payable under subchapter A of Chapter 67 of Title 26 as required by 26 U.S.C. § 6621(d), but is paid in accordance with the provisions of Title 11 of the United States Code. This conclusion applies equally to bankruptcy cases filed before and after October 17, 2005, the general effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“the BAPCPA”), which added 11 U.S.C. § 511, “Rate of interest on tax claims.”

Issue (2): Once a taxpayer elects to credit an overpayment to the succeeding year’s estimated taxes, the election is irrevocable and binding on both the taxpayer and the Service. The overpayment credit elect becomes a payment in the first succeeding taxable year and is removed from the year in which it was generated. Re-designation, therefore, is impermissible.

FACTS

Issue (1): The request presents two questions relating to the availability of zero rate interest netting under 26 U.S.C. § 6621(d) where the interest paid on federal tax claims is through a Chapter 11 plan.

The first question is debtor specific. Company A seeks zero rate interest netting under 26 U.S.C. § 6621(d) as to interest paid on federal tax underpayments pursuant to Taxpayer’s Chapter 11 plan against allowable overpayment interest. Taxpayer filed its petition in bankruptcy on Date 1. The Chapter 11 Plan provides for a X rate of interest to be paid on priority tax claims.

The second issue is whether the BAPCPA’s addition of 11 U.S.C. § 511 changes our position regarding the availability of zero rate interest netting under 26 U.S.C. § 6621(d) as to interest paid on federal tax underpayments pursuant to a Chapter 11 plan against allowable overpayment interest.

Issue (2): In Year 1, the taxpayer reported an overpayment. The taxpayer elected to apply the overpayment from Year 1 as an estimated tax payment in Year 2 as a credit elect, submitting a statement as to how the credit elect was to be applied. Subsequently, the Service determined that an underpayment existed for Year 1. The

¹ Hereinafter, “Chapter 11” refers to Chapter 11 of Title 11 of the United States Code.

taxpayer requested that the Service allow it to “re-designate” the application of the overpayment credit elect.²

LAW AND ANALYSIS

Issue (1): Generally, with respect to federal tax, 26 U.S.C. § 6601(a) provides for the payment of interest on nonpayments or underpayments and 26 U.S.C. § 6611(a) provides for the allowance and payment of interest on overpayments. The rates of interest are determined under 26 U.S.C. § 6621.

With respect to interest on overlapping periods of tax overpayments and underpayments, 26 U.S.C. § 6621(d) provides:

To the extent 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.

To qualify for zero rate interest netting under 26 U.S.C. § 6621(d), interest must be payable under subchapter A and allowable under subchapter B by the same taxpayer. The interest provisions of Title 26 are embodied within Chapter 67. Subchapter A, entitled “Interest on Underpayments,” includes 26 U.S.C. § 6601. Subchapter B, entitled “Interest on Overpayments,” includes 26 U.S.C. § 6611.

We conclude that interest on an underpayment of tax paid through a Chapter 11 plan pursuant to 11 U.S.C. § 1129(a)(9)(C), whether the case was filed pre- or post- the BAPCPA, cannot be zero rate netted against allowable overpayment interest because the interest paid through the Chapter 11 plan is not interest payable under subchapter A of Chapter 67 as required by 26 U.S.C. § 6621(d).

Before a Bankruptcy Court may confirm a Chapter 11 plan, the treatment of unsecured priority tax claims must satisfy the requirements set forth in 11 U.S.C. § 1129(a)(9)(C), which contemplates the inclusion of interest on the tax indebtedness. For Chapter 11 cases filed prior to October 17, 2005, such as the case of Taxpayer, 11 U.S.C. § 1129(a)(9)(C) required that Chapter 11 plans provide the holder of priority tax claims deferred cash payments over a period not exceeding six years after the date of assessment of such claim “of a value,” as of the effective date of the plan, equal to the allowed amount of such claim. The requirement that a plan provide for postconfirmation interest on priority tax claims came from the “of a value” language.

Similarly, for Chapter 11 cases filed on or after October 17, 2005, the BAPCPA modified 11 U.S.C. § 1129(a)(9)(C) to require that the holder of priority tax claims receive regular installment payments in cash “of a total value,” as of the effective date of the plan, equal

² The factual scenario presented in the Request did not include the name of a specific taxpayer or specific tax years.

to the allowed amount of such claim, over a period ending not later than five years after the date of the order for relief and in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan. Either before or after the BAPCPA, the requirement that a Chapter 11 debtor pay interest on priority tax claims comes from 11 U.S.C. § 1129(a)(9)(C), not the Tax Code.

Before the BAPCPA, the Bankruptcy Court could set the interest rate for tax claims, as it could for interest paid to other creditors.³ The BAPCPA eliminated the Bankruptcy Court's discretion to determine the interest rate on tax claims. For bankruptcy cases filed on or after October 17, 2005, new 11 U.S.C. § 511 provides:

(a) If any provision of this title requires the payment of interest on a tax claim or an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law.

(b) In the case of taxes paid under a confirmed plan under the title, the rate of interest shall be determined as of the calendar month in which the plan is confirmed.

(emphasis added).

The interest rate set in Taxpayer's Chapter 11 plan was Bankruptcy Code interest and not Tax Code underpayment interest. There cannot be zero rate interest netting under 26 U.S.C. § 6621(d) because the interest paid through Taxpayer's Chapter 11 plan was not interest payable under subchapter A of Chapter 67 of Title 26, but interest payable at a rate proposed by Taxpayer and approved by the Bankruptcy Court by confirmation of the Chapter 11 plan — interest required to be paid under 11 U.S.C. § 1129(a)(9)(C).⁴

The above conclusion applies equally to those cases filed on or after the effective date of the BAPCPA. Section 511(a) of the Bankruptcy Code, by its terms, applies only where a provision of the Bankruptcy Code "requires" the payment of interest. When the

³ See *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). In *Till*, the Court adopted the "formula approach" for determining the applicable interest rate on deferred cash payments to secured creditors in Chapter 13 cases. The Court stated that a number of provisions of the Bankruptcy Code discount a stream of deferred payments back to their present dollar value and noted 11 U.S.C. § 1129(a)(9)(C). *Till* at 474 and *n.* 10. The Court stated, "We think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions." *Id.* at 474; see also *COLLIER ON BANKRUPTCY* § 511.01, 511-2 (16th ed. Rev. 2009).

⁴ Section 6621(d) of the Internal Revenue Code may also be inapplicable to Taxpayer's interest payments as the same taxpayer may not have both incurred the underpayment and made the overpayment. The terms "the same taxpayer" imply that the taxpayer must be liable for both the tax that was underpaid and the tax that was overpaid. We do not possess sufficient information to determine whether Taxpayer and Company A are the same taxpayer. Thus, we do not render an opinion on this issue.

payment of interest is required by the Bankruptcy Code, 11 U.S.C. § 511 directs the Bankruptcy Court to look to the Tax Code's rate effective for the month in which the plan was confirmed.⁵ Thus, postconfirmation interest on priority tax claims paid through Chapter 11 plans is Bankruptcy Code interest merely borrowing the Tax Code's rate.

Issue (2): A taxpayer may not "re-designate" the application of an overpayment credit election, as the Service will not accept a taxpayer's designation in the first instance.⁶ Once an overpayment credit elect is made by a taxpayer, the Service applies the overpayment in accordance with Rev. Rul. 99-40, 1999-2 C.B. 441. That is, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under sections 6654 or 6655 with respect to such year.

A taxpayer's election to credit an overpayment to estimated taxes is irrevocable and binding on both the taxpayer and the Service. See Martin Marietta Corp. v. United States, 216 Ct. Cl. 47 (1978); Fisher v. United States, 61 F. Supp. 2d 621 (E.D. Mich. 1999); Rev. Rul. 55-448, 1955-2 C.B. 595, amplified by Rev. Rul. 77-339, 1977-2 C.B. 475. Once the taxpayer opts to apply the overpayment as a credit elect, the overpayment is removed from the account and transferred to the succeeding year's account. The overpayment becomes a payment on account of estimated tax for the succeeding year when it is credited pursuant to section 6513(d), whether the funds are needed or not. See Fleetboston Fin. Corp. v. United States, 483 F.3d 1345 (Fed. Cir. 2007). The election by a taxpayer, therefore, has legal significance and cannot be "re-designated" at a taxpayer's request.

The taxpayer described in the Request chose to apply the Year 1 overpayment as an interest-free credit to Year 2, the succeeding year's tax. The credit is no longer in the account for the year the payments were actually made and transformed into payments for the succeeding year, whether the funds were needed or not. Once the election was made, the decision became irrevocable and the Service should have computed interest on the subsequently determined deficiency for the overpayment year in accordance with Rev. Rul. 99-40.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Issue (1): This advice is limited to underpayment interest paid through a debtor's Chapter 11 plan and does not render an opinion on whether 26 U.S.C. § 6601(a)

⁵ In the case of underpayment interest under Title 26, the rate of interest may change quarterly and is compounded daily. The interest rate fixed by 11 U.S.C. §511(b) as of a date certain is not the underpayment interest provided by 26 U.S.C § 6601(a) at the rate established under 26 U.S.C. § 6621 and, thus, is not underpayment interest payable under subchapter A of Chapter 67 of the Internal Revenue Code but interest payable at a rate fixed by the Bankruptcy Code.

⁶ As to designations after October 4, 1999. See Rev. Rul. 99-40.

underpayment interest accruing postpetition during the gap period (that period between the petition date and the date of confirmation of the Chapter 11 plan) may be zero rate netted against allowable overpayment periods under 26 U.S.C. § 6621(d).

This office has not previously given definitive advice or guidance on the issues addressed in this memorandum and, to our knowledge, no court has directly addressed the question. If the Service denies zero rate interest netting claims in reliance upon this advice and the disallowance is challenged, there is a hazard that the government's position may not prevail; nonetheless, we consider the advice articulated herein to be sound and fully defensible.⁷

Issue (2): This office has not previously given definitive advice or guidance on the specific issue addressed in this memorandum and, to our knowledge, no court has directly addressed the question.

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) 622-4940 if you have any further questions.

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