

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

May 17, 2013

Third Party Communication: None  
Date of Communication: Not Applicable

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CASE-MIS No.: TAM-139384-12

Chief, Appeals Office  
Chicago

Taxpayer's Name:  
Taxpayer's Address:

Taxpayer's Identification No  
Year(s) Involved:  
Date of Conference:

LEGEND

Taxpayer:

Year 1:  
Year 2:  
Year 3:  
Year 4:  
Year 5:  
Year 6:  
Year 7:  
Year 8:  
Year 9:  
Year 10:  
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#### ISSUES:

1. Does the statute of limitations bar the Date 2 assessment of an income tax deficiency for tax year 1 in the amount of Amount 1?
2. If yes, is Taxpayer entitled to any refund of tax as a result of the barred assessment?
3. Can the Service now assess and collect any additional interest it determines to be due from Taxpayer for tax year 1, based on either the Date 1 or the Date 2 assessment? Can the Service recover any overpayment interest erroneously paid out for tax year 1?

#### CONCLUSIONS:

1. No. The Date 2 assessment of Amount 1 for tax year 1 was properly assessed within the period provided for by section 6501(h) of the Internal Revenue Code:

the deficiency assessed was attributable to an adjustment to a net operating loss carryback from Taxpayer's tax year 2, and the period of limitations on assessment was open for Year 2 pursuant to an extension under section 6501(c)(4).

2. Even if the statute of limitations barred the assessment done on Date 2, Taxpayer may not be entitled to a refund of tax for Year 1. Although the Date 2 assessment would have to be abated, any resulting refund should be offset by additional underpayment interest due for Year 1 and by any overpayment interest erroneously paid to Taxpayer.
3. No. The Service may not assess additional underpayment interest that it determines to be due based on the Date 1 assessment. Such interest may only be recovered through offset of a refund for an amount paid before the assessment statute expiration date (ASED) for the underpayment interest. On the other hand, additional underpayment interest related to the Date 2 tax assessment may be assessed and collected up through Date 3. Because the periods of limitation on filing an erroneous refund suit for tax years 1 and 2 have expired, excessive overpayment interest can only be recovered by offset against any refund due Taxpayer for the same type of tax and tax period.

#### FACTS:

Taxpayer filed a U.S. Corporation Income Tax Return (Form 1120) for its Year 1 tax year, on which it reported a tax liability of Amount 2, which was assessed and paid on Date 4. On Date 5, Taxpayer received an Amount 3 tentative refund for Year 1, which resulted from carrying back to Year 1 tentative net operating losses and credits from its Year 3 tax year. On Date 6, Taxpayer received an Amount 4 tentative refund for Year 1, this one from carrying back tentative net operating losses and credits from its Year 2 tax year.

#### Audit of Tax Year 1

The Service audited and adjusted Taxpayer's Year 2, 1, and 3 tax years. The Service completed a Form 4549-A (Income Tax Changes) reflecting the proposed examination changes to Taxpayer's tax liabilities for the tax years 2, 1, and 3 as of Date 7.<sup>1</sup> These proposed adjustments included a net deficiency in income tax due from Taxpayer for tax year 1 in the amount of Amount 5. Taxpayer and the Service entered into an agreement under section 6501(c) to extend the period for assessment of a deficiency for tax year 1 to Date 8. Before Date 8, Taxpayer executed a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment (Form 870), whereby Taxpayer agreed to waive the restrictions on assessing the Amount 5 income-tax deficiency for its Year 1 tax year.

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<sup>1</sup> The Form 4549-A is attached as Exhibit A.

This agreed deficiency of Amount 5 consisted of:

- (1) a decrease in Taxpayer's Year 1 tax liability of Amount 6, attributable to Year 1 general adjustments;
- (2) an increase in Taxpayer's Year 1 tax liability of Amount 7, attributable to the partial recapture of the Amount 3 tentative carryback allowance from Year 3; and
- (3) an increase in Taxpayer's Year 1 tax liability of 8, attributable to the partial recapture of the Amount 4 tentative carryback allowance from Year 2.

#### Computations Based on an Erroneous Form 2285

Because the agreed deficiency of Amount 5 included partial recaptures of the tentative allowances resulting from the carrybacks from Year 3 and Year 2, an interest computation under the restricted-interest provisions of the Internal Revenue Code was required. To compute this restricted interest, the revenue agent prepared a Form 2285, Concurrent Determinations of Deficiencies (Increases in Tax) and Overassessments (Decreases in Tax) in Cases Involving Restricted Interest Provisions of the Internal Code.<sup>2</sup> This form correctly reflected the Amount 5 net deficiency to be assessed for the 1993 tax year. However, and contradicting the Form 4549-A, the Form 2285 mistakenly reflected that this deficiency consisted of:

- (1) a decrease in Taxpayer's Year 1 liability of Amount 9 (rather than Amount 6) attributable to Year 1 general adjustments (Form 2285, line 11 column(a)); and
- (2) an increase in Taxpayer's Year 1 tax liability of Amount 4 (rather than Amount 8) attributable to a partial recapture of the tentative carryback allowance from Year 2 (Form 2285, line 11 column (d)).

The Form 2285 correctly reflected that this deficiency consisted of an increase in Taxpayer's Year 1 tax liability of Amount 7 attributable to a partial recapture of the tentative carryback allowance from Year 3 (Form 2285, line 11 column (c)).

The above two errors on this Form 2285 were caused when the revenue agent mistakenly included on line 5 column (a) (1993 "Current Tax Credits") an Amount 10 minimum tax credit that originated in Year 2.<sup>3</sup> This error resulted in an incorrectly stated line 5 column (a) amount of Amount 11. The line 5 column (a) amount should have included only those credits attributable to the Year 1 tax year itself, in this case, Amount 12.

Like a domino effect, this error caused another error on this Form 2285: the Year 1 tax liability *attributable to general adjustments*, instead of the correct amount of (Amount 6),

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<sup>2</sup> This Form 2285 is attached as Exhibit B.

<sup>3</sup> This Amount 10 actually resulted from the carryback of a net operating loss from Year 2 to Year 4, and further carried forward to Year 1.

was shown as (Amount 9), a difference of Amount 10. See line 11 column (a) (“Net increase (decrease) in tax”). And, again like a domino effect, this error caused another error: the Year 1 tax liability *attributable to recapture of the tentative carryback allowance from the tax year 2* was shown to be Amount 4, rather than the correct amount of Amount 8, again a difference of Amount 10. See line 11 column (d).<sup>4</sup> These entries on the Form 2285 made it seem as though the Service had recaptured Amount 10 more of the Amount 4 tentative operating loss from Year 1 that Taxpayer had carried back to Year 1 than had actually been recaptured during the audit, i.e., Amount 8.

#### Adjustments Made to the Year 1 Account, including interest

Based upon the entries on the Form 2285, both the correct and erroneous entries, the Service made the following assessments and abatements on the Taxpayer’s Year 1 account:

<u>Code</u>	<u>Date Entered</u>	<u>Effective Date</u>	<u>Amount of Assessment or (Abatement)</u>
301 <sup>5</sup>	Date 9	Date 11	(Amount 9)
308 <sup>6</sup>	Date 9	Date 12	Amount 7
308	Date 10	Date 13	Amount 4

The result of the foregoing assessments and abatement was a net assessment of Amount 5, the correct amount of the net deficiency in income tax due from Taxpayer for the tax year 1. Although the result of these adjustments was a net deficiency, the Amount 9 abatement placed Taxpayer’s account into an overpaid status as of its effective date, Date 11. Because the abatement was overstated by Amount 10, the running balance on the account was overstated by that amount -- until that overstatement was “corrected” by the Amount 4 assessment, which as outlined above was overstated by the same amount. But this correction did not occur until Date 13, the effective date of the overstated assessment. As a result, overpayment interest accrued on an erroneously high running balance for over two years, resulting in a windfall of interest to Taxpayer. To wit, the transcript reflects TC 770 allowances of credit (overpayment) interest of Amount 13 and Amount 14 on Date 14 and Date 9, respectively.<sup>7</sup> On Date 14, Taxpayer received a refund in the amount of Amount 15.

#### Audit of Tax Year 2

<sup>4</sup> The increase in the Year 1 liability attributable to the Year 3 NOL capital loss carryback was correctly reflected on the Form 2285 at line 11(c) as Amount 7, and was correctly assessed by the Service. In addition, the Year 1 net deficiency of Amount 5 remained the same: (Amount 9) + Amount 7 + Amount 4 = Amount 5. Compare : (Amount 6) + Amount 7 + Amount 8 = Amount 5.

<sup>5</sup> Transaction Code 301 is Abatement of Tax by Examination

<sup>6</sup> Transaction Code 308 is Additional Tax Assessment with interest.

<sup>7</sup> Taxpayer’s transcript for Tax Year 1 is attached as Exhibit C.

Subsequently, Taxpayer's Year 2, Year 5, and Year 6 tax years were examined. During this audit, Taxpayer and the Service executed an agreement under section 6501(c) to extend the period for assessment of a deficiency in income tax for the tax year 2 to Date 15.<sup>8</sup> Taxpayer appealed the examination findings for those tax years to Appeals, where all issues were settled. On Date 18, Taxpayer signed Form 870-AD, Offer to Waive Restrictions on Assessments and Collection of Tax Deficiency and to Accept Overassessment, reflecting that settlement.

Although there was no deficiency for Year 2, the Year 2 settlement resulted in a number of adjustments, as reflected on the Audit Statement (Form 3610)<sup>9</sup> and supporting Statement of Income Tax Changes (Form 5278)<sup>10</sup>, including:

- (1) reducing the allowable net operating loss carryback from Year 2 to Year 4 by Amount 16;
- (2) increasing the alternative tax net operating loss carryback from Year 2 to Year 4 by Amount 17; and
- (3) reducing the general business credit utilized for Year 4 by Amount 18.

As indicated in the Form 3610 Audit Statement, these adjustments resulted in a Amount 19 overpayment of income tax due to Taxpayer for the tax year 4 and the Amount 1 deficiency for Year 1 at issue herein.

#### Correction of the first Form 2285

Because the Year 1 deficiency of Amount 1 resulted from the foregoing adjustments to carrybacks from the Year 2 tax year, a Form 2285 again needed to be prepared. In preparing the new Form 2285, the Appeals Tax Computation Specialist (TCS) discovered the errors on the prior Form 2285 discussed above.

To reiterate, the revenue agent who prepared the prior Form 2285 mistakenly included, as a Year 1 general adjustment, an Amount 10 minimum tax credit that was from Year 2. The TCS sought to correct this error by preparing a new Form 2285 for Year 1, dated Date 19.<sup>11</sup> On this new form, the TCS entered the correct current tax credit general adjustment amount of Amount 12, and accounted for the Amount 10 minimum tax credit as a tax credit carryback arising in the Year 2 tax year. The shifting of this minimum tax credit to the Year 2 column where it belonged resulted in:

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<sup>8</sup> As indicated in Taxpayer's letter dated Date 16, Taxpayer initially contended that the period of limitations for assessing an income-tax deficiency for its Year 2 tax year expired on Date 17, but now agrees that the period of limitations for that year was validly extended to Date 15.

<sup>9</sup> The Form 3610 is attached as Exhibit D.

<sup>10</sup> This Form 5278 is attached as Exhibit E.

<sup>11</sup> This corrected Form 2285 is attached as Exhibit F.

- (1) an increase of Amount 10 in the Year 1 tax liability attributable to general adjustments (the first form 2285 erroneously had (Amount 9) rather than the correct amount of (Amount 6), a difference of Amount 10), and
- (2) an offsetting decrease in the Year 1 tax liability attributable to the recapture of the tentative allowance (the first Form 2285 erroneously had Amount 4 rather than the correct amount of Amount 8, again a difference of Amount 10, and
- (3) a tax deficiency of Amount 20 for Year 1.

None of these adjustments are reflected on the transcript of the Year 1 Form 1120 account. However, based upon this corrected Date 19 Form 2285, the Service made interest assessments of Amount 21 and Amount 22 for Year 1 on Date 20. Then, based on the corrected amounts in the Date 19 Form 2285, the TCS prepared another Form 2285 on Date 21 to correctly reflect the adjustments agreed to for the tax year 2.<sup>12</sup> After adjusting the Year 1 tax liability to account for the losses and credits carried back from Year 3 and Year 1, to which Taxpayer had agreed, the Date 21 Form 2285 showed that Taxpayer was liable for a net deficiency in income tax for the tax Year 1 in the amount of Amount 1.

#### Adjustments to Tax Year 1 based on the Audit of Tax Year 2

The net deficiency of Amount 1 was comprised of:

- (1) an Amount 23 decrease in Year 1 tax due to an increased carryback allowance from Year 3;
- (2) an Amount 24 increase in Year 1 tax due to the increased alternative tax net operating loss carryback from Year 3 to Year 4 (because more of the Year 2 alternative tax net operating loss was applied to Year 4, there was less alternative minimum tax in Year 4, and less alternative minimum tax credit in Year 1); and
- (3) an Amount 25 decrease in Year 1 tax due to a carryback allowance from Year 5.

The Amount 1 net deficiency for Year 1 was assessed on Date 2, within the Date 15 period of assessment under section 6501(h) for assessments of deficiencies attributable to carrybacks from Year 2, but after the period of limitations under section 6501(a) for Year 1, which had expired on Date 8. This time, the Service assessed only the net deficiency for Year 1, instead of making the three separate adjustments outlined above.

#### Further Adjustments to the Year 1 Account, including interest

Related to this Amount 1 assessment, the Service, on Date 22, abated underpayment interest of Amount 26 and credited overpayment interest of Amount 27, which, when

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<sup>12</sup> The Date 21 Form 2285 is attached as Exhibit G.

combined with the interest entries made on Date 20 to correct the earlier Form 2285, resulted in a net interest assessment of Amount 28. The Service allowed additional overpayment interest of Amount 29 on Date 23. The Service also allowed and refunded additional overpayment interest of Amount 30 on Date 24.

In Date 25, payment of this Amount 1 deficiency for the tax year 1 was satisfied in large part by transferring Amount 31 from Taxpayer's Year 4 account, which amount was originally paid by Taxpayer on Date 26. The remaining portion of the deficiency and related interest (Amount 32) was satisfied by a portion of the advance interest payment of Amount 33 that was applied to the Year 1 account from Year 6 Form 1120 account on or about Date 27.<sup>13</sup>

### The Current Controversy

On Date 16, Taxpayer filed a claim for refund of all amounts used to satisfy the Date 2 assessment of the Year 1 deficiency of Amount 1 plus interest. Specifically, Taxpayer claimed a refund of: (1) Amount 32, which is the un-refunded portion of Taxpayer's Amount 33 advance interest payment made on Date 28, and (2) the Amount 31 payment applied from Taxpayer's Year 4 account in processing cycle (approximately Date 29) with an effective date of Date 26. The claim totals Amount 39, including allowable interest. Taxpayer argues that the second assessment on Date 2 based on the Year 2 carryback could not be made because the Service had already made an assessment for that year in the full amount of the section 6411 tentative refund. To support its position, Taxpayer points to the transcript showing a TC 308 assessment of Amount 4 on Date 10, which assessment was based on the erroneous Form 2285 -- where the Year 1 tax liability attributable to recapture of the tentative carryback allowance from the tax year 2 was shown to be Amount 4, rather than the correct amount of Amount 8.

By letter to Taxpayer dated Date 30, the Service formally disallowed Taxpayer's claim for refund. Taxpayer appealed. Taxpayer and Appeals now seek technical advice regarding the issues set forth above.<sup>14</sup>

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<sup>13</sup> The advance interest payment of Amount 33 that was applied to the Year 1 account from Taxpayer's Year 6 Form 1120 account on or about Date 27 was ultimately applied as follows: (1) Amount 34 was transferred to Year 6 Form 1120 account; (2) Amount 35 was transferred to its Year 7 Form 1120 account, (3) Amount 36 was transferred to a Civil Penalty account for Year 8; and (4) Amount 37 was refunded to Taxpayer (along with Amount 38 of overpayment interest). That left Amount 32 remaining on Taxpayer's Year 1 Form 1120 account.

<sup>14</sup> Taxpayer and Appeals have timely executed successive Agreements to Extend the Time to Bring Suit (Form 907), which have extended the period of time for Taxpayer to file suit on Taxpayer's claim for refund in the amount of Amount 39 for the taxable year 1 until Date 31.

## LAW AND ANALYSIS:

1. The assessment made on Date 2 was timely because it was made within the I.R.C. § 6501(h) period of limitations for deficiencies attributable to a net operating loss carryback.

In general, the amount of any tax must be assessed within three years after the return was filed. I.R.C. § 6501(a). This three-year period may be extended by a number of circumstances, including when the Service and the taxpayer agree in writing to extend the time for assessment. I.R.C. § 6501(c)(4). Further, when a deficiency in tax is attributable to the application to the taxpayer of a net operating loss carryback or a capital loss carryback, such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the tax year of the net operating loss or net capital loss that results in such carryback may be assessed. I.R.C. § 6501(h). If a taxpayer receives a tentative refund under section 6411, the Service will be able to assess a deficiency attributable to any adjustment in the loss year, but only up to the amount of the tentative refund. I.R.C. § 6501(k). The overarching general principle to be applied when analyzing limitations periods is the principle that statutes of limitation barring the collection of taxes must be strictly construed in favor of the government. Badaracco v. Commissioner, 464 U.S. 386 (1984).

There is no definition of “attributable to” in either section 6501(h) itself or the Internal Revenue Code in general. Case law has defined the term to mean that the proposed assessment “may be traced directly to” the carryback. First Chicago Corp. v. Commissioner, 742 F.2d 1102, 1104 (7th Cir. 1984); Herman Bennett Co. v. Commissioner, 65 T.C. 506, 509 (1975). In First Chicago, the tax years at issue were 1971, 1972 and 1974. The taxpayer sustained an operating loss in 1974, which it carried back to 1971. This reduced the tax due for 1971, which in turn reduced the amount of tax carried over from 1971 to 1972, resulting in a 1972 deficiency. At the time of the 1972 assessment, the section 6501(a) period of limitations had expired for that year. However, the period of limitations for 1974 assessments remained open. The Seventh Circuit found that the 1972 assessment was timely, because “the 1972 adjustment [was] in fact an automatic mechanical adjustment due directly to the 1974 carryback.” Id. at 1107. While the statute refers only to a carryback, the court further found that a deficiency resulting from a carry-forward was still directly traceable to the 1974 carryback.

In this case, the audit of tax year 2 resulted in an increased alternative tax net operating carryback loss (ATNOL) for that year. This increased ATNOL was carried back to Year 4, where it decreased the total alternative minimum tax for that year.<sup>15</sup> Then, the reduced Year 4 alternative minimum tax resulted in a reduced minimum tax credit carryover to Year 1 and, thus, a net deficiency for that Year 1 year (Audit Statement,

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<sup>15</sup> This generated a refund for tax year 4 (Audit Statement, Schedule 2, Lines 17(a) and 24).

Schedule 2, lines 15(c) and 21). Thus, the Year 1 assessment was a mechanical automatic adjustment directly traceable to the Year 2 carryback adjustment. The present case is not distinguishable in any meaningful way from First Chicago, and the assessment made for Year 1 on Date 2 was timely.

Taxpayer asserts that the second assessment based on the Year 2 carryback could not be made because the Service had already made an assessment for that year in the full amount of the section 6411 tentative refund. In support of this argument, Taxpayer cites section 6501(k). While it is true that amounts that may be assessed “solely by reason of” section 6501(k) may not exceed the amount of a prior tentative refund, the assessment at issue in this case was not assessed under section 6501(k). When a deficiency is directly traceable to a carryback, the relevant assessment statute is section 6501(h), and not section 6501(k). See Suivski v. Commissioner, T.C. Memo. 1993-291. Section 6501(k) allows the Service to make an assessment of deficiencies that are not attributable to the carryback, and it is those types of assessments that are limited in amount. When making an assessment solely under section 6501(h), as was done in this case, there is no amount limitation. Id.; see also Jones v. Commissioner, 71 T.C. 391, 397 (explaining the difference between sections 6501(h) and 6501(m) (now 6501(k))); Treas. Reg. § 301.6501(m)-1(a)(2), example (explaining that the amount limitations apply when an assessment is made for a deficiency not attributable to the loss carryback)). Because section 6501(k) does not apply to the assessment made for tax year 1 in year 9, no amount limitation applies.

Further, the erroneous Year 7 assessment of Amount 4 did not “recapture” the Year 2 tentative allowance in full because that assessment was offset by the equally erroneous abatement of Amount 9. Again, these errors contradicted the Form 4549-A audit statement, which both parties agree is correct, and were made due to the incorrect Form 2285, which was prepared solely for purposes of making an interest computation. To that end, the only entry on the transcript that ties the assessment to Year 2 is the interest computation date of Date 13. On the other hand, the abatement had an interest computation date of Date 11, linking that adjustment to the Year 1 tax year. When these two erroneous adjustments were combined with the correct assessment of Amount 7, the result was a net deficiency of Amount 5 that matched the amount determined on the Form 4549-A. The only true error on the account was that interest was calculated incorrectly (in Taxpayer’s favor) due to the overstated abatement applied as of Date 11. This error also prevented the correct amount of underpayment interest to be computed on the net deficiency, and resulted in Taxpayer receiving overpayment interest when, in fact, it owed a deficiency. Accordingly, the assessment of the Amount 1 deficiency for the taxable year 1 was timely made on Date 2 because it was attributable to an adjustment of a net operating carryback from the taxable year 2 and was made within the section 6501(h) period of limitations for that taxable year.

2. If the assessment made on Date 2 must be abated because it was made beyond the period of limitations, any refund would be offset by additional underpayment

interest due for the 1993 tax year and by offset of overpayment interest erroneously paid to Taxpayer.

#### Abatement of the Date 2 Assessment

The term "overpayment" includes that part of the amount of the payment of any federal tax that is assessed or collected after the period of limitation expires. I.R.C. § 6401(a). In the case of an overpayment, the Service may credit the amount of such overpayment, including interest, against any liability in respect of a federal tax on the part of the person who made the overpayment and shall refund any balance to such person. I.R.C. § 6402(a). A claim for credit or refund of any overpayment of any federal tax of which the taxpayer is required to file a return shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later. I.R.C. § 6511(a).

Any tax assessed and paid after the period of limitations on assessment expires constitutes an overpayment under section 6401(a) that should be refunded under section 6402(a) if the taxpayer has filed a timely refund claim in accordance with section 6511(a). See Rev. Rul. 74-580, 1974-2 C.B. 400. Accordingly, a payment of tax that was assessed and paid after the period of limitations on assessment had expired, as provided in section 6501, can be refunded within two years after payment, if a claim for refund is filed. Id.; IRM 25.6.1.10.2.5.6.2.

Credits applied via offset with TC 700, 706, 730, or 736 have a refund statute of two years from the cycle date the credit was applied. IRM 20.2.5.2; Republic Petroleum Corp. v. United States, 613 F.2d 518, 525, n.19 (5th Cir. 1980). Here, with respect to its Year 6 Form 1120 account, Taxpayer made an Amount advance payment of interest on Date 28. On or about Date 27 (in processing cycle \_\_\_\_\_), an unrefunded portion of this advance payment, Amount 32, was offset to the Year 1 account with TC 700. With respect to its Year 4 Form 1120 account, Taxpayer made an Amount 31 payment on Date 26. In Date 30 (in processing cycle \_\_\_\_\_), this amount was offset to the Year 1 account with TC 700. Both the Date 27 and Date 30 offset payments were within two years from the date of Taxpayer's Date 32 refund claim.

Assuming the period of limitations on assessment for the taxable year 1 expired on Date 8, then the assessment made on Date 2 was barred by the statute of limitations and the payments of Amount 32 and Amount 31 made on Date 27 and Date 30, respectively, would be subject to refund because they would constitute an overpayment under section 6401(a) that is refundable under section 6402(a). See Rev. Rul. 74-580.

#### Offset of Additional Underpayment Interest

Any underpayment interest 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. I.R.C. § 6601(g). The Service can offset any additional underpayment interest against

any tax refund owed the taxpayer under section 6402(a),<sup>16</sup> even if the statute of limitations on assessment of the underpayment interest has expired, as long as the refund is for an amount paid before the ASED for the underpayment interest. Fisher v. United States, 80 F.3d 1576 (Fed. Cir. 1996); Rev. Rul. 85-67, 1085-1 C.B. 364 (even though the Service did not assess before the ASED, a payment made before the ASED does not constitute an overpayment of tax under section 6401(a)). Underpayment interest is part of a taxpayer's tax liability and is assessable in the same manner as a tax. See Fisher, 80 F.3d at 1580; I.R.C. § 6601(e) (stating that interest on tax underpayments "shall be assessed, collected, and paid in the same manner as taxes" and that any reference "to any tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax"). Thus, underpayment interest that is owed is taken into account in determining whether an overpayment exists. If an overpayment does not exist (because of the additional underpayment interest owed), the government is permitted to offset the underpayment interest against a claimed tax refund even if the statute of limitations on assessment of the interest has expired, as long as the refund claim is for an amount paid before the ASED for the underpayment interest. See Fisher, 80 F.3d at 1580; Rev. Rul. 85-67.

Because of the erroneous transcript entries made in Year 7, overpayment interest accrued on an erroneously high credit balance for over two years, resulting in a windfall of interest to Taxpayer. Similarly, this credit balance prevented underpayment interest from correctly running on the assessed tax liability. Any additional underpayment interest Taxpayer owes on the Year 7 assessments may be used to offset any refund of payments made in Year 10 and Year 9 because:

- the Year 9 assessment was satisfied by amounts paid in Date 27 and Date 25; and
- the section 6601(g) period of limitation on assessment of interest on the Year 7 assessment did not expire until Date 10.

#### Offset of Erroneously Allowed Overpayment Interest

Excessive statutory interest on overpayments under section 6611 cannot be assessed because there is no statutory authority for assessing the amount of money erroneously paid as overpayment interest. See Sunoco Inc. v. Commissioner, 663 F.3d 181, 196 (3d Cir. 2005) ("overpayment interest, i.e., interest owed to the taxpayer by the government, is not 'a part of, or even related to, a taxpayer's tax liability' and is not 'assimilated in treatment to the principal amount of a tax.'" (citations omitted)). Thus, the erroneous payment of overpayment interest may only be recovered by voluntary payment, by filing suit for an erroneous refund under section 7405, or by the common-law right of offset. See I.R.M. 20.2.4.11.2(2). The period of limitations on bringing an

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<sup>16</sup> In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person. I.R.C. § 6402(a).

erroneous refund suit is two years from the making of the refund. I.R.C. § 6532(b). The common-law right of offset, however, is not subject to any period of limitation.<sup>17</sup> See Reiter v. Cooper, 507 U.S. 258, 264 (1993) (Under the doctrine of common-law recoupment, a claim that involves “the setting off against asserted liability of a counterclaim arising out of the same transaction,” is “generally not barred by a statute of limitations so long as the main action is timely.”); Lewis v. Reynolds, 284 U.S. 281 (1932) (When considering a taxpayer’s refund claim, the Service has the right to recompute amounts owed by a taxpayer without a period of limitation, so long as the recomputation involves the same taxpayer, the same tax, and the same tax year as the refund claim); Fisher, 80 F.3d at 1579-81; Dysart v. United States, 340 F.2d 624 (Ct. Cl. 1965). The erroneous payment of overpayment interest may be offset, without a period of limitation, against any refund otherwise due the taxpayer so long as the offset involves the same taxpayer, the same type of tax, and the same tax period to which the refund is related. In this case, therefore, the Service may offset any refund of the Year 9 assessment with overpayment interest erroneously paid to Taxpayer.

3. Additional underpayment interest that the Service determines to be due from Taxpayer for the Year 1 tax year with respect to the Year 7 tax assessment can be recovered only through offset. If the assessment made on Date 2 was not barred by the statute of limitations, any additional underpayment interest that the Service determines to be due from Taxpayer for the tax year 1 with respect to that Date 2 assessment can be assessed and collected. Overpayment interest cannot be recovered, unless it is offset against any additional refund owed Taxpayer for Year 1.

As discussed in issue 2 above, any underpayment interest on any tax may be assessed and collected at any time during the period within which the tax to which such interests relates may be collected. I.R.C. § 6601(g). When the assessment of tax has been made within the period of limitations, the tax may be collected within ten years after the assessment of the tax. I.R.C. § 6502(a).

Any additional underpayment interest that the Service determines to be due from Taxpayer attributable to the deficiency assessed in Year 7 must have been assessed before Date 32, ten years after the original assessment. Because this period has expired, the Service cannot now assess any additional underpayment interest related to

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<sup>17</sup> The Federal Circuit held in Pacific Gas and Electric Co. v. United States, 417 F.3d 1375, 1381-83 (Fed. Cir. 2005), that the common-law right to offset erroneous overpayment interest against a taxpayer’s refund for the same taxable year is subject to the statute of limitation that applies to erroneous refund suits under sections 7405 and 6532(b). The Federal Circuit’s decision in Pacific Gas is erroneous. See AOD-2006-02, 2006 WL 2830795. Congress has not imposed any statute of limitations on the recovery of overpayment interest by means of offset against a taxpayer’s refund claim. See United States v. Nashville, C. & St. L. Ry. Co., 118 U.S. 120, 125 (1886) (the sovereign is “not bound by any statute of limitations unless Congress has clearly manifested its intention that they should be so bound.”)

this Year 7 assessment. As discussed above, the Service can offset any additional underpayment interest against any tax refund owed Taxpayer. I.R.C. § 6402(a).

As also discussed above, erroneous payments of overpayment interest may be recovered by voluntary repayment, by filing suit for an erroneous refund under section 7405, or by offset. Offset may be applied without regard to any period of limitation against any refund otherwise due the taxpayer, as long as the offset involves the same taxpayer, the same type of tax, and the same tax period to which the refund is related. If the erroneous payment of overpayment interest and the refund to be offset do not arise from the same type of tax and same tax period of the same taxpayer, the offset must be made within the applicable erroneous refund statute expiration date, which is two years from the date of the erroneous payment. See I.R.C. § 6532(b); IRM 20.2.4.11.2(3); IRM 21.4.5.3.1(1)(d).

The credits of overpayment interest to Taxpayer in the amounts of Amount 13, Amount 14, Amount 27, and Amount 29 on Date 14, Date 9, Date 22, and Date 23, respectively, cannot be assessed because overpayment interest is not a tax liability. Neither can these overpayment interest credits be recovered through an erroneous refund suit under section 7405 because the two-year statute of limitations for bringing suit expired in Year 11 and Year 12. Similarly, the refunds of overpayment interest to Taxpayer in the amounts of Amount 15 and Amount 30 made on Date 14 and Date 24, respectively, cannot be recovered because the two-year statute of limitations for bringing an erroneous refund suit expired in Year 11 and Year 13. These credits and refunds of overpayment interest, however, may be offset against any refund due Taxpayer, as long as the offset involves the same type of tax and tax period to which the refund is related.<sup>18</sup>

Because insufficient information has been provided, we cannot determine whether the underpayment interest abatement of Amount 26 made on Date 22, was due to clerical error or mistake of fact. Thus, until such information is provided the Service should not reverse the underpayment interest abatement of Amount 26. Instead, the Service would have to reassess before Date 3, when the statute of limitations on assessing the interest expires See sections 6601(g), 6502(a). Because the Amount 1 tax deficiency, to which the underpayment interest of Amount 26 relates, was assessed on Date 1, the statute of limitations for assessing underpayment interest on this tax assessment will expire on Date 3 – ten years from the date of the tax assessment.

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<sup>18</sup> Because the periods of limitations for recovering an erroneous refund have expired, the Service cannot recover the overpayment interest by offset against any refund owed Taxpayer that relates to a different type of tax or tax period.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to Taxpayer, but it may not be used or cited as precedent. I.R.C. § 6110(k)(3).