Office of Chief Counsel
Internal Revenue Service

memorandum

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date: APR 16 2001

to: William Kennedy, Manager, Group 1282, M/S 4201PHX
Attn: Mark Nutter

from: Office of Chief Counsel, Phoenix
LMSB:NR, Area 4

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subject: [redacted]
Interest income from tax refund to former parent

This memorandum responds to your request for assistance dated March 21, 2001. This memorandum should not be cited as precedent.

ISSUE

Whether the taxpayer accrues interest income from its share of a tax refund to its former parent at the time the former parent and the Service enter an agreement giving rise to such refund.

CONCLUSION

Under the specific facts of this case, the taxpayer accrues interest income at the time of the agreement.

FACTS

Prior to [redacted] the taxpayer (then called [redacted] was a subsidiary of the [redacted] subsequently changed its name to [redacted] For purposes of consistency and clarity, this memorandum will refer to the taxpayer's former parent as [redacted], regardless of its name at the time of any of the specific facts described below.

At the time [redacted] spun off the taxpayer, [redacted] and the taxpayer entered into a written "Tax Sharing Agreement" which, among other things set forth the parties' rights to any refunds which might result from returns of [redacted] for which the taxpayer was part of the consolidated group. Section [redacted] of the agreement concerned payment of refunds by [redacted] to the taxpayer. This paragraph provided that if an adjustment to any return in

which the taxpayer was included decreased the tax liability attributable to the taxpayer, or was attributable to the taxpayer and reduced the tax liability of [redacted]. "then [redacted] shall remit to [the taxpayer] any refunds received by or credited to it as a result of the adjustments attributable to" the taxpayer. This paragraph further provided that any such payments "shall be accompanied by a computation of the amount due and supporting documentation in such detail as [the taxpayer] may reasonably request to verify the amount due."

The Service examined [redacted]'s consolidated returns for [redacted] and [redacted]. [redacted] executed a Form 870-D regarding these returns on [redacted]. The Service executed this Form on [redacted]. The adjustments agreed to by the parties in the Form 870-D resulted in refunds of tax, along with interest accrued on such amounts, to [redacted]. The Service did not actually remit these refunds to [redacted] until [redacted].

On [redacted] the taxpayer's tax manager initialed a document breaking down the settlement amounts, including interest, between [redacted] and the taxpayer. This document reflected interest income to [redacted] from this settlement in the amount of $[redacted]. On [redacted] the taxpayer accrued $[redacted] of interest income on its books on account of the settlement amounts for [redacted] and [redacted]. On [redacted], [redacted] sent the taxpayer a letter stating that the Service had notified [redacted] of its acceptance of the Form 870-D. On its [redacted] return, the taxpayer did not include its share of the accrued interest in income, reversing the interest income from its books via Schedule M-1. The taxpayer subsequently reported interest income from this refund on its [redacted] return. You believe that the interest is more properly includible in income for [redacted] rather than [redacted]

DISCUSSION

It has long been established that where a refund is made after settlement and administrative closing of the case as mutually agreed by the taxpayer and the Service, the later of the date the agreement is executed by both parties or the agreed effective date is the date for accrual of interest on the overpayment as income. Rev. Rul. 62-160, 1962-2 C.B. 139. Thus, when a taxpayer enters into an agreement with the Service which results in a refund, interest on such refund is generally includible in income at the time of the agreement.

The present situation differs from the typical, however, in that the taxpayer did not enter into an agreement with the Service; the taxpayer is merely a beneficiary, through its agreement with [redacted], of [redacted]'s agreement with the Service. We

therefore believe it necessary to analyze whether this fact significantly affects the factors which would ordinarily cause such amounts to constitute income in the year of the agreement.

Our review of such factors causes us to conclude that the interest at issue was includible in the taxpayer's income in [redacted]. As you know, for accrual basis taxpayers, items are included in income when all events have occurred fixing the right of the taxpayer to receive such income. Continental Tie & Lumber Co. v. United States, 286 U.S. 290, 295 (1932); Hallmark Cards, Inc. v. Commissioner, 90 T.C. 26, 32 (1988), Treas. Reg. §§ 1.446-1(c)(1)(ii) and 1.451-(1)(a). This so-called all-events test is satisfied when all events have occurred fixing the right to receive income, and the amount is determinable with reasonable certainty. Helvering v. Enright, 312 U.S. 636, 645 (1941). It is not necessary that the exact amount of income be known, so long as the amount of the item can be determined with reasonable accuracy. Treas. Reg. § 1.446-1(c)(1)(ii); Resale Mobile Homes v. Commissioner, 965 F.2d 818, 823 (10th Cir. 1992). As explained in Flamingo Resorts, Inc. v. United States, 664 F.2d 1387, 1390 (9th Cir. 1982), any uncertainty as to the taxpayer's right to the income must be substantial, and not simply technical in nature.

In the present case, the taxpayer's book entry of [redacted] should establish not only the taxpayer's reasonable certainty as to its right to receive the interest, but also its ability to determine the amount of such income with reasonable accuracy. The combination of [redacted]'s agreement with the Service and the taxpayer's agreement with [redacted] resulted in the taxpayer obtaining an enforceable right to a portion of the refunds for [redacted] and [redacted], which it could (and did) at that point compute with reasonable accuracy.

In arriving at this conclusion, we want to specifically address two facts. First, we do not believe it significant that [redacted] did not formally advise the taxpayer of the Service's acceptance of the settlement until [redacted]. We believe that the taxpayer's book entry of [redacted] reflects the taxpayer's reasonable expectation of receipt, and that the formal notice of [redacted] did not grant the taxpayer any rights it did not already possess. The tax sharing agreement did not make such formal notice a prerequisite to the taxpayer's right to the income. Instead, the taxpayer's right arose at the point the Service executed the agreement with [redacted]. Thus, even assuming for the sake of argument that the taxpayer did not really know of its right to the interest until [redacted], this lack of knowledge of a right to income does not change the fact that the taxpayer in fact had a right to income.

Second, we do not believe that language in the tax sharing agreement setting forth when [redacted] would forward amounts to the taxpayer is significant. Again, such language does not affect the taxpayer's ultimate right to such amounts; it instead sets a deadline for [redacted]'s payment of such sums, after which the taxpayer could seek to enforce the agreement. Right to payment and timing of payment should not be confused; indeed, if timing of payment were controlling, there would be no all-events test, since by definition it deals with the question of when payments not yet received constitute taxable income. We believe that under the tax sharing agreement, the Service's acceptance of [redacted]'s Form 870-D established the taxpayer's right to the interest ultimately received. Furthermore, the taxpayer's book entry of [redacted] establishes the taxpayer's ability to determine the amount of such interest with reasonable accuracy. We therefore believe that such interest constitutes income to the taxpayer in [redacted] rather than in [redacted].

Please be advised that we consider the statements of law expressed in this memorandum to be significant large case advice. We therefore request that you refrain from acting on this memorandum for ten (10) working days to allow the Division Counsel (Large and Mid-Size Business) an opportunity to comment. If you have any questions regarding the above, please contact the undersigned at (602) 207-8052.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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Area Counsel
(Natural Resources)

By:_____
JOHN W. DUNCAN
Attorney

CC: Division Counsel (Large and Mid-Size Business)