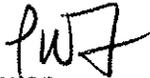


Office of Chief Counsel  
Internal Revenue Service  
**memorandum**

CC:PA:02:MAHenkel  
POSTN-117829-15

date: August 17, 2015

to: Oneida Stephens  
Office of Servicewide Interest  
SB/SE Servicewide Operations

from: Pamela Wilson Fuller   
Senior Technician Reviewer  
(Procedure & Administration)

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subject: Availability of Look-Back Interest for Netting

You have requested our advice on the following questions. Below please find our conclusions and analysis.

1. Is the look-back interest amount owed TO the government and treated as tax (it is added to the TC 150 amount when reported on a return) and the underpayment interest charged on the look-back amount eligible for interest netting (annual as well as net rate interest netting)?
2. Is the look-back interest amount owed TO the taxpayer and the interest allowed on the look-back interest amount ("add-on" interest), eligible for interest netting (annual as well as net rate interest netting)?

Conclusions

1. Underpayment interest arising from look-back interest owed to the government is eligible for interest netting because such interest is payable under subchapter A. The look-back interest itself is not eligible for netting, because it is treated as an additional tax, and is not interest on an underpayment payable under subchapter A or interest on an overpayment allowable under subchapter B such that it would be entitled to netting.
2. The answer depends on whether the taxpayer previously paid the amount of look-back interest.

If the taxpayer had not previously paid the look-back interest – Interest arising from look-back interest owed to the taxpayer is not eligible for interest netting because it is not interest on an overpayment, and this is not interest that is allowable under subchapter B. A claim for credit/refund of look-back interest that was not previously paid by the taxpayer is treated as a general, non-tax claim against the

government, and is not an overpayment because it is not an amount that was previously paid by or collected from the taxpayer. The look-back interest itself is also not eligible for interest netting, because it is not interest on an underpayment payable under subchapter A or interest on an overpayment allowable under subchapter B that would be eligible for netting.

If the taxpayer had previously paid the look-back interest – Interest arising from look-back interest owed to the taxpayer is eligible for interest netting. In this case the look-back interest would be an overpayment, and interest on this overpayment is interest allowable under subchapter B. The look-back interest itself is not eligible for netting, because it is not interest on an underpayment or an overpayment.

### Analysis

Section 460(a) requires that the taxable income from any long-term contract be determined under the percentage-of-completion method as modified in section 460(b) ("PCM"). Under section 460(b), a taxpayer using PCM to account for income from long-term contracts is required to pay or is entitled to receive interest on the amount of tax liability deferred or accelerated under that method of accounting. Ultimately, if a contract price is underestimated or a contract cost is overestimated, a taxpayer will owe interest on this deferral of liability. If the contract price is overestimated or contract costs are underestimated, the taxpayer will be entitled to receive interest as a result of the acceleration of the tax liability. This interest is referred to as "look-back interest." Under section 6621(d), interest is eligible for netting only if it is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer.

Look-back interest owed BY a taxpayer - Treated as additional tax. See section 460(b)(1) (flush language) ("For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under subparagraph (B) shall be treated as an increase in the tax imposed by this chapter for the taxable year in which the contract is completed (or, in the case of interest payable with respect to any amount properly taken into account after completion of the contract, for the taxable year in which the amount is so properly taken into account)."). Presumably, such additional tax could result in an underpayment as defined by section 6664(a). The look-back interest itself would not be eligible for netting. However, because an underpayment could result from look-back interest, any interest arising from such underpayment would be eligible for netting because it would be interest payable under subchapter A.

Look-back interest owed TO the taxpayer – Here the answer depends on whether the look-back interest was previously paid by or collected from the taxpayer.

If taxpayer made a claim for credit/refund of look-back interest (or interest payable on look-back interest) that is not attributable to an amount previously paid by or collected from the taxpayer – Treated as a general, non-tax claim against the government. Not treated as an overpayment. Treas. Reg. § 1.460-6(f)(3).

Because this amount is not treated as an overpayment, there cannot be any netting of interest that accrues on it, as such interest would not be interest that is allowable under subchapter B. As with the look-back interest owed by a taxpayer, the look-back interest itself is not eligible for netting.

If taxpayer made a claim for credit/refund of look-back interest previously paid by or collected from the taxpayer – Treated as a claim for credit or refund of an overpayment of tax and is subject to the statute of limitations in section 6511. Treas. Reg. § 1.460-6(f)(3). Here, the interest on the look-back amount will be treated as an overpayment and thus the interest on it would be allowable under subchapter B. But as with both types of look-back interest above, the look-back interest itself is not eligible for netting.