

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:02:MAHenkel
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to: Oneida Stephens
Office of Servicewide Interest
SB/SE Servicewide Operations

from: Adrienne Griffin 
Senior Technician Reviewer
(Procedure & Administration)

subject: Computation of Interest for Foreign Tax Credit Adjustment

You have requested our advice on the proper computation of interest when a redetermination of a taxpayer's foreign tax liability results in a decrease in the foreign tax credit and an increase in United States tax liability. Specifically, you have asked us whether interest should be computed on all transactions on the module for the tax year, or whether interest should only be computed on the underpayment resulting from the redetermination of the foreign tax credit. Below please find our conclusion and analysis.

Conclusions

When a taxpayer is subject to an adjustment to a foreign tax credit which results in an increase in U.S. tax liability, interest should be computed on the entire module for the tax year, taking into account all items for the tax year. Interest should not be computed solely on the amount of the underpayment resulting from the redetermination of the foreign tax credit.

Analysis

Under section 901(a), a taxpayer is generally entitled to a credit against his U.S. tax liability for the amount of income taxes paid to a foreign country. If a foreign tax redetermination causes an increase in U.S. tax liability (and thus a decrease in the foreign tax credit), any resulting underpayment bears interest. I.R.C. § 905(c)(5). The amount of underpayment interest is computed as the lesser of: (1) interest from the time the taxpayer receives a refund from the foreign government until the time the taxpayer pays the additional tax due to the United States, plus interest paid to the taxpayer by the foreign government, if any, or (2) the amount of interest that "otherwise would have been assessed and collected under section 6601 and the regulations under this section for that period." Treas. Reg. § 1.905-4T(e)(1).

Your question relates to the computation of interest under this second method—

specifically whether interest that otherwise would have been assessed and collected under section 6601 refers to interest on the entire module for the year, including the assessment resulting from the decrease in foreign tax credit, refunds, and any other transactions that occurred during the year or interest solely on the amount of the assessment resulting from the decrease in the foreign tax credit.

The interest computed under this second method should reflect both the decrease in the foreign tax credit and any other events that transpired during the tax year. The language of Treas. Reg. § 1.905-4T(e)(1) refers to the amount of interest that “otherwise would have been assessed and collected under section 6601 and the regulations under this section for that period.” (emphasis added). This language indicates that interest should be computed as it would have been if that portion of the foreign tax credit that was ultimately decreased was not claimed in the first place. In that event, interest would have been imposed on any underpayment resulting from all events that transpired during the tax year, not just on the amount of foreign tax credit that was not taken. The regulation does not contain any instructions that interest should be computed using a special method; rather, it requires that interest be assessed and collected as it “otherwise would have been.” We see no reason to deviate from the normal method of applying interest under section 6601. Furthermore, the fact that the regulation refers to tax for the “period” rather than something more limited, such as the tax on the amount of the tax increase resulting from the foreign tax credit adjustment, supports a reading that interest is to be imposed by looking at the entire period and all events that have occurred within it.

This amount of interest—which is the interest computed under the second method described in Treas. Reg. § 1.905-4T(e)(1)—is compared with the interest computed under the first method (interest from the time the taxpayer received a refund from the foreign government until the time the taxpayer pays the additional tax due to the United States, plus any interest paid to the taxpayer by the foreign government). The amount of interest imposed will be the lesser of these two amounts.

Please call (202) 317-6844 if you have further questions.