Interest on Federal Tax Underpayments and Overpayments

by

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FORWARD

Part of the following material is based on three articles written by the author and published in The Tax Executive in its issues for January-February, 1990,a May-June, 1990,b and November-December, 1995.c It represents an integration, adaptation, and update of those articles. It has been prepared primarily for the benefit and use of holders of the author’s TAXINT computer program, which automates the computation of interest on Federal tax underpayments and overpayments. For the convenience of users of that program, the illustrations in the article have been revised to reflect the interest factors prescribed in Rev. Proc. 95-17, 1995-1 C.B. 556, which are to apply to all computations made after 1994 (including computations for periods before 1995), notwithstanding the fact that Rev. Proc. 95-17 provides that the interest factors prescribed in Rev. Proc. 83-7, 1983-1 C.B. 583, continue to apply to all interest computations made on or before December 31, 1994. (The interest factors prescribed in Rev. Proc. 83-7 -- which may optionally be applied by the TAXINT program although the Rev. Proc. 95-17 interest factors would normally be used -- result in interest amounts that are very slightly smaller than the amounts calculated using the Rev. Proc. 95-17 interest factors.)

The author wishes to express his appreciation for the assistance of his colleague, Mary E. Monahan, for her assistance in the current revision of this article. She is knowledgeable as to interest computation matters in her own right.

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Interest on Federal Tax
Underpayments and Overpayments

by

James V. Heffernan

Like many areas of our Federal income tax laws, the computation of interest on tax underpayments and overpayments has become increasingly complex over the years. Fortunately, some of this increasing complexity has been offset by the availability of computers to help in the computations. Thus, the mechanics of making the computation, which at one time involved an arcane “month-day” method peculiar to the computation of interest on taxes and still are complicated by frequently changing rates and multiple categories of interest, can be computerized so as to do in seconds what would otherwise take hours. However, it is still necessary for the person making or verifying the interest computation to know the rules that determine the period during which interest runs and whether, on the one hand, a single period applies to all of the amount of the deficiency or overpayment or, on the other hand, the aggregate underpayment or overpayment for a given year must be fragmented into separate elements with a different interest period for each element.

1 The author is a partner in the Washington, D.C., office of Sutherland Asbill & Brennan LLP. His involvement with interest on Federal Taxes dates back as far as 1955, when he was of counsel for the taxpayer in the consideration by the United States Supreme Court of Premier Oil Co. v. United States, decided together with Koppers Co. v. United States, 348 U.S. 254 (1955), which involved the issue of interest on a “potential deficiency” in World War II excess profits taxes that was eliminated by a determination of entitlement to use a constructive average base period net income under section 722 of the Internal Revenue Code of 1939 (hereinafter referred to as the “1939 Code”).

2 The terms “underpayment” and “deficiency” are sometimes used interchangeably. However, the term “deficiency” is defined by section 6211 of the Internal Revenue Code of 1986, as amended, (hereinafter referred to as the “Code”) and applies only to taxes over which the Tax Court has jurisdiction (income, estate, gift, and certain excise taxes). Even as to such taxes, technically a deficiency can be different from an underpayment. Thus, for example, there is no deficiency if the correct tax is shown on the taxpayer’s return, even though there may be an underpayment because the full tax shown on the return has not been paid. An unpaid tax shown on a return or assessed but not paid when due is not a deficiency, but is more properly termed a delinquency.

3 The author’s TAXINT computer program, designed for stand-alone use on an IBM or compatible personal computer, will in seconds compute the interest at the various rates and in the various methods used by the Internal Revenue Service upon the simple entry of the amount on which interest is to be computed and the beginning and ending dates of the interest period.
In years past, it was not uncommon to find mathematical errors in the interest computations made by the Internal Revenue Service (hereinafter referred to as the “IRS”). Consequently it was prudent for tax practitioners to verify the correctness of such computations. Such mathematical errors are much less likely to occur today, because the IRS itself uses computers to do the mathematical part of the computations. However, it is still important to verify the interest computations done by the IRS, because they may have used the wrong starting date, the wrong ending date, or otherwise not have followed the rules prescribed by the law. This may happen not because IRS personnel want to do the computations wrong or do not care, but rather because the application of the law can be so complex in some situations.

The addition to the Code of section 6621(d), providing for interest netting in the case of overlapping periods of tax overpayments and underpayments (discussed below), has made the computation of interest involving such netting extremely complicated. Furthermore, in the case of retroactive interest netting (i.e., for interest accruing before October 1, 1998), the allowance of interest netting, when requested by the taxpayer, is conditioned on the taxpayer’s identifying and establishing the periods of such tax overpayments and underpayments.

It is the object of this paper to provide sufficient guidance that a tax practitioner (1) may readily make interest computations that will conform to the IRS’s interest computations if it is desired to pay additional taxes and interest before a bill for such interest is received from the IRS or (2) may verify computations made by the IRS. In addition, interest has become an increasingly large factor in the cost of any resolution of tax disputes, and consequently such interest should be taken into account in evaluating potential dispositions of such disputes.

**Background**

In general, interest is due to the government if there is an underpayment of taxes, and, with certain exceptions, interest is due to the taxpayer if there is an overpayment of taxes. Prior to the passage of the Tax Reform Act of 1986, interest on underpayments and interest on overpayments were computed at the same rates. As noted below, this is no longer always the case; for interest periods following December 31, 1986, the Code provided that generally interest charged on underpayments was to be 1% more than interest allowed on overpayments, and a larger differential applies for corporations in some circumstances discussed below. For interest periods after December 31, 1998, the 1% interest rate differential was eliminated for taxpayers other than corporations, but the interest rate differentials were not changed for corporations.

Changes in the rate and method of computing interest on tax underpayments and

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4 The author has experienced situations where the taxpayer was entitled to refunds of overpayments of tax and assessed interest and statutory interest thereon and where, upon checking the computations, it was found that the payments to the taxpayer were short by hundreds of thousands of dollars.

5 For example, by August 4, 1989, the interest due on a corporation’s income tax deficiency for calendar year 1982 would already have exceeded the amount of the tax deficiency; interest on a 1981 deficiency would have exceeded 100% even more quickly -- by December 6, 1987.
overpayments have grown almost geometrically. For years, such interest was simple interest at the rate of 6% per year. It was computed on the basis of a peculiar “month-day” method that was seldom, if ever, used for other purposes. But it was a method that made it relatively easy to compute such interest in the days before computers, and most tax practitioners had learned to live with it.\(^6\)

In 1975, the first change in rate or method of computation in approximately 40 years occurred when the interest rate was increased from 6% to 9%. Between that first change and the present time, we have had many other changes in either the interest rate or the method of making the computation (e.g., simple interest on a daily method, compound interest, etc.) in even the most straightforward situations. In addition, numerous other special rules have been introduced, such as charging a higher rate of interest on underpayments than is allowed on overpayments, special rules for the computation of interest on substantial underpayments attributable to tax-motivated transactions, interest on large corporate underpayments (sometimes referred to as “hot interest”), and interest on corporate overpayments of tax in excess of $10,000 (sometimes referred to as “GATT interest”).\(^7\) Is there any wonder that errors are made in such interest computations?

Where a computer program is used to assist in the interest computation, presumably these variations in rates and methods will be automatically taken into account, and the principal concern is to determine the amount on which interest is to be computed and the beginning date and ending date of the interest period. Therefore, those areas will be discussed first.

There are basically two types of interest that may be involved:

1. interest that is charged to the taxpayer in the case of an asserted underpayment, which is frequently termed “assessed interest” because it is assessed and collected as a part of the tax;\(^8\) and

2. interest that is payable to the taxpayer in the case of an overpayment of tax or an overpayment of assessed interest, which is frequently termed “statutory interest.”

The terms “assessed interest” and “statutory interest” will sometimes be used in this paper to distinguish between the two types of interest.\(^9\)

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\(^6\) This “month-day” method is of more than historical interest. It still must be used today if the interest period starts before February 1, 1980.

\(^7\) The computation of interest in these special circumstances is discussed below.

\(^8\) Section 6601(e)(1) of the Code. Such interest is sometimes termed “deficiency interest,” although such interest also applies to underpayments that are not technically deficiencies. See footnote 2, supra.

\(^9\) The term “restricted interest” is frequently used to refer to a sub-type of assessed interest, discussed below, that is computed on the portion of a deficiency that is extinguished by a loss carryback, a credit carryback, or similar retroactive adjustment. Such interest is sometimes referred to as interest on an
Assessed interest can be a part of the amount on which statutory interest is computed (i.e., where there is an overpayment of assessed interest). When there has been an overpayment which is refunded, typically the government will send the taxpayer a single check that may contain three elements: (1) a refund of the overpayment of tax, (2) a refund of the overpayment of assessed interest, and (3) statutory interest on the overpayment of both tax and assessed interest. Unfortunately, there is often no indication of what portion of the single check is attributable to each of these elements, notwithstanding that each element has different tax consequences.

In the discussion that follows, the amount on which interest is to be computed will be termed the “base amount.” In simple situations, the base amount may be the entire amount of the tax underpayment or overpayment. In other situations, where interest runs on a part of the entire underpayment or overpayment for a period that is different from the period applicable to another part of the underpayment or overpayment, the base amount may be only a portion of the entire tax underpayment or overpayment; that is to say, particularly prior to the time when compound interest was required, the applicable interest period or periods would typically dictate or affect the determination of the base amount, because separate interest computations would be made for each part of the entire tax underpayment or overpayment subject to a different interest period. This will be illustrated more fully below.

After the advent of compound interest in 1983 (discussed below), in many instances previously accrued but unpaid interest may be included in the base amount for computation purposes, but the tax and interest elements in the base amount have differing characteristics and therefore must be subject to separate identification.

“extinguished deficiency” or a “potential deficiency.” An early use of the term “restricted interest” may be found in Rev. Proc. 60-17, 1960-2 C.B. 942, where interest on a deficiency extinguished by a carryback was discussed along with interest in other situations where the term “restricted interest” was applied to refer to interest that was limited or restricted by some statutory prohibition of interest. In a sense, interest on a deficiency extinguished by a carryback is “restricted” in that interest on the initial deficiency ceases to run at some point (discussed in the text below) because of the entitlement to the carryback deduction.

Interest similar to restricted interest may also arise where, after an underpayment of tax has become due, an additional tax payment is made which eliminates the underpayment and may even created an overpayment of tax. In that event, even though, at the time interest is to be calculated, there may be no underpayment because of such payment, there will be underpayment interest on the underpayment of tax prior to such payment.

Normally, the tax refund is not taxable income. The refund of the overpayment of assessed interest is taxable income only to the extent that the payment of the assessed interest was deducted in a prior taxable period with a tax benefit from such deduction. Section 111 of the Code; see Eboli v. Commissioner, 93 T.C. 123 (1989). (This could also be the case with the tax refund if the tax were a type of tax that could be claimed as a deduction.) The amount of the statutory interest is always taxable income. In addition, the crediting of an overpayment to satisfy an assessed interest liability for another period can result in an interest expense deduction under section 163(a) of the Code. Eboli v. Commissioner, supra.
**Base Amount**

Where a single interest period applies to a tax underpayment on which interest is due, the base amount is the excess of the correct tax over the amount paid. Similarly, where a single interest period applies to a tax overpayment on which interest is due, the base amount is the excess of the aggregate tax paid over the correct tax.

Where different interest periods apply to different parts of the aggregate underpayment or overpayment on which interest is due, prior to 1983 (when the requirement to use compound interest took effect) the administrative practice of the IRS had rather uniformly been to make a separate interest computation for each part of the underpayment or overpayment for which a different interest period applied. If one were to think in terms of a diagram with the interest period represented by the horizontal axis and the amount of the underpayment or overpayment represented by the vertical axis, where different interest periods apply, the interest computation would be made by fragmenting the amount of underpayment or overpayment “horizontally” and making a separate interest computation for each element of the underpayment or overpayment having a different interest period. See Diagram 1.

**Diagram 1**

Interest was computed like this

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Element 1

Element 2

Element 3

Thus, the IRS’s practice was not to make interest computations by fragmenting the interest periods “vertically” and making a separate interest computation for each element of the interest period having a different amount of underpayment or overpayment. See Diagram 2.
Although the ultimate amount of interest would be the same under either of such calculations, before the advent of compound interest on tax underpayments and overpayments, taxpayers were well advised to follow the “horizontal” practice used by the IRS so that any discrepancies in the computations could more readily be identified.

With the advent of compound interest in 1983, as more fully described below, it was necessary to aggregate all amounts owed (both tax and interest) on December 31, 1982, and to start over with compound interest on the aggregate amount from that point forward. That step is, in effect, the application of a “vertical” approach at least in that limited circumstance. Thereafter, one could use either the “horizontal” or the “vertical” approach for any subsequent changes in the amount on which interest is to be computed (e.g., by reason of partial payments that would reduce the amount on which interest would be owed). However, the prevailing practice for interest computations for periods after 1982 has evolved to the use of a “vertical” approach, so that, at each point at which there is a payment or other event which changes the amount of “base amount” on which interest is to be computed, interest on the prior “base amount” is terminated and interest on a new “base amount,” including previously accrued interest, is commenced.

Under either approach, after first determining the ultimate amount of a tax underpayment or overpayment on which interest is due, before making any interest computation, it is necessary to determine whether a single interest period applies to the entire underpayment or overpayment. If it does, the entire amount of the underpayment or overpayment is the base amount for a single interest computation. If it does not, because -- using the “horizontal” approach -- one interest period applies to one part of the underpayment or overpayment and another interest period
applies to another part, the aggregate amount of the underpayment or overpayment must be fragmented into each element that has an interest period that is different from the other, and each such element becomes a base amount for a separate interest computation. Alternatively -- if the “vertical” approach is to be used -- the overall interest period must be fragmented and separate interest computations must be made for different “base amounts” for each interest period. Under either approach, the total of the amounts of interest computed in such separate interest computations is the total amount of interest on the underpayment or overpayment.

As noted above, statutory interest is payable on an overpayment of assessed interest just as in the case of an overpayment of the tax. It may be necessary to make a computation of the correct amount of assessed interest to determine the amount of the overpayment of assessed interest. Thus, the excess of the assessed interest that was paid over the correct amount of the assessed interest is the overpayment of assessed interest. That overpayment then is the “base amount” for a separate computation of the statutory interest due thereon (under the “horizontal” approach) or it becomes an increase in the “base amount” for a separate computation of statutory interest for the next interest period (under the “vertical” approach).

Interest may also be due on additions to the tax and tax penalties after such amounts have been assessed, in which case the amount of the addition to the tax or the penalty is the “base amount” for a separate interest computation (under the “horizontal” approach) or it becomes an increase in the “base amount” for a separate computation of interest for the next interest period (under the “vertical” approach).

**Interest Period**

The interest period is the period between the time when interest starts to run and the time when interest ceases to run. The time when interest starts to run and when it ceases to run depends on the character of the base amount. If the base amount is an underpayment of tax, generally the interest starts to run on the payment due date; if it is an overpayment, generally the interest starts to run on the date the overpayment is made or first arises. The time when the interest ceases to run depends on a number of factors discussed below.

In general, the period for interest on an underpayment of tax is prescribed by section 6601, and the period for interest on an overpayment of tax is prescribed by section 6611. However, it should be recognized that, with the advent of compound interest (discussed below), under section 6622(a) both underpayment interest and overpayment interest must be compounded daily, as a result of which unpaid interest of either type will continue to compound until it is fully paid even though the period prescribed under section 6601 or section 6611 for interest on the tax underpayment or overpayment may have expired.

1. **Underpayments**
   a. **Normal underpayment interest starting date**

   Section 6601(a) of the Code provides that if any amount of tax is not paid by the last date prescribed for payment, interest runs from such last date to the date paid. Thus, for a corporation
using a calendar year for income tax purposes, interest on an underpayment of such tax generally starts to run on March 15 of the year following the year for which such tax is due.\textsuperscript{11} In the case of an individual using the calendar year for income tax purposes, interest on an underpayment of income tax generally starts on April 15 of the year following the year for which the tax is due.\textsuperscript{12} Estate tax returns and the tax thereunder are currently due nine months after the decedent’s death,\textsuperscript{13} and gift tax returns and the tax thereunder are currently due April 15 following the close of the calendar year in which the gift is made,\textsuperscript{14} and those respective dates are the start of the underpayment interest period. Certain exceptions to these starting dates will be discussed below.

b. Normal underpayment interest ending date

Notwithstanding that section 6601(a) indicates that the interest period runs until the date the tax is paid, the interest on underpayments often ends before the date of payment. Section 6601(c) provides that, in the case of a deficiency as defined in section 6211 (relating to income, estate, gift, and certain excise taxes), if a waiver of restrictions under section 6213(d) on the assessment of such deficiency\textsuperscript{15} has been filed, and if notice and demand for payment of such tax is not made within 30 days after the filing of such waiver, interest is not imposed for the period beginning immediately after such 30th day and ending with the date of notice and demand.\textsuperscript{16} In

\textsuperscript{11} Corporations reporting on a calendar year basis are generally required by section 6072(b) of the Code to file income tax returns by March 15 following the close of the calendar year. If a fiscal year is used, the return is required by the 15th day of the third month following the close of the fiscal year. As prescribed by section 6151 of the Code, generally the tax is due on the date prescribed for filing the return (determined without regard to any extension of time to file the return). For taxable years beginning before 1983, corporations could elect to make installment payments of income tax, and that could affect the start of the interest period, as discussed below.

\textsuperscript{12} Except as otherwise prescribed, the income tax return of an individual, a trust, or an estate using the calendar year is required by section 6072(a) of the Code to be filed by the 15th day of April following the close of the calendar year, and, if a fiscal year is used, the return must be filed by the 15th day of the fourth month following the close of the fiscal year. Section 6151 of the Code requires that the tax be paid by such filing date (determined without regard to any extension of time for filing).

\textsuperscript{13} Section 6075(a) and section 6151 of the Code. For decedents dying before 1971, the estate tax return was due 15 months after the decedent’s death.

\textsuperscript{14} Section 6075(b) and section 6151 of the Code. Quarterly gift tax returns have sometimes been required by section 6075.

\textsuperscript{15} The waiver of restrictions to which section 6601(c) refers is the Form 870 or the Form 870-AD, each of which waives the restriction under section 6213(a) on the assessment and collection of the tax, thereby giving up the right of the taxpayer to file a petition to the Tax Court for a redetermination of the deficiency. Such a waiver is provided for in section 6213(d). A Form 870 is deemed filed when it is delivered to the IRS; a Form 870-AD, however, is not deemed filed until it has been accepted by the IRS, which may be a substantial time after it is delivered to the Service.

\textsuperscript{16} Form 3552, captioned Statement of Tax Due on Federal Tax Return, is typically used as the notice and
addition, section 6601(e)(3) provides that if notice and demand is made for payment of any amount, and if such amount is paid within 21 calendar days after the date of such notice and demand (10 business days if the amount for which such notice and demand is made equals or exceeds $100,000), interest on the amount so paid is not imposed after the date of notice and demand. The effect of section 6601(c) and section 6601(e)(3), taken together, is that if a Form 870 waiver is filed and the tax is thereafter paid within the prescribed period (i.e., 21 calendar days or 10 business days, as the case may be) after the date of the notice and demand, the interest period will end 30 days after the waiver is filed (unless the tax is theretofore paid).

Special rules for the end of the interest period for a tax underpayment apply in the case of so-called “restricted interest.” Those rules are discussed below under the heading “Restricted Interest.” See also the discussion below concerning the ending date for underpayment interest where the underpayment is satisfied by crediting the amount of an overpayment for another period and where the overpayment occurred after the underpayment was due.

The “American Jobs Creation Act of 2004,” P.L. 108-357, created a new section 6603 of the Internal Revenue Code which can be used to stop the running of interest on an underpayment while preserving the right to contest the underpayment in the Tax Court, where jurisdiction depends on the issuance of a statutory notice of deficiency pursuant to section 6212 (a “90-day letter”) for an asserted underpayment of tax. Section 6603 provides that a taxpayer may make a cash deposit with the IRS that may subsequently be used to pay an underpayment of income, gift, estate, generation skipping, or certain excise taxes. Interest will not be charged on the portion of the underpayment that is deposited and subsequently applied for such tax payment for the period that the amount was on deposit. Generally, deposited amounts that have not been used to pay a tax may be withdrawn at any time if the taxpayer so requests in writing. The withdrawn amounts will earn interest at the applicable Federal rate (i.e., three percentage points below the non-corporate overpayment rate) to the extent that they are attributable to a “disputable tax” as prescribed in section 6603(d)(2) and (3). Because such a deposit is not a payment of tax, it does not preclude the taxpayer from litigating a disputed tax in the Tax Court, even if the deposit is made before the issuance of a statutory notice of deficiency (“90-day letter”) in an amount equal to or greater than the asserted underpayment. The new provision applies to deposits made after October 22, 2004, the date of enactment of P.L. 108-357.

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17 In the case of a notice and demand issued prior to 1997, the interest-free period was 10 calendar days.

18 Similarly, if a Form 870-AD is used, the interest period will end 30 days after the Form 870-AD is accepted on behalf of the IRS (unless the tax is theretofore paid).
The new procedure under section 6603 presumably substantially replaces the use of deposits in the nature of a cash bond described in Rev. Proc. 84-58.19 Amounts already on deposit under that Rev. Proc. as of the date of enactment of section 6603 can be treated as deposited in accordance with section 6603 on the date the taxpayer identifies the amount as a deposit thereunder.

If a taxpayer intends to make a payment of tax (and/or interest) rather than a deposit under section 6603 or a deposit in the nature of a cash bond (for example, to be entitled to full overpayment interest on a refund of the amount so paid), it is important to make it clear that a payment of tax (and/or interest) is being made so that an assessment of the amount of such payment may be made pursuant to section 6213(b)(4). If such payment is made in response to a liability proposed as a result of an audit, an assessment will normally be made of the amount paid, but, if the payment is not in response to such a proposed liability, an amended return (e.g., Form 1040X or Form 1120X) should be filed with a statement of a waiver of the restriction on assessment and collection. To the extent that such a payment exceeds the assessed liability, including any interest and penalty, the excess may be treated as a deposit in the nature of a cash bond. Guidelines for the payment of tax and interest in cases involving entity-level examination of partnerships and S corporations were provided in Announcement 86-114.20


c. Some variations in the underpayment interest starting dates

For taxable years beginning before 1983, corporations could elect to make installment payments of income tax.21 That election could affect the start of the interest period for underpayments.22

Interest on a liability for the accumulated earnings tax under section 531 of the Code23 is another instance where the start of the interest period varies depending on the year for which the tax was due. In the case of an accumulated earnings tax in respect of a year for which the tax

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19 1984-2 C.B. 501. If a deposit in the nature of a cash bond is subsequently applied to satisfy a tax underpayment, interest on the underpayment equal to the amount so applied stops as of the date of the deposit. However a deposit in the nature of a cash bond is not a payment of tax and if returned to the taxpayer does not bear interest. Because it is not a payment of tax, it also does not preclude the issuance of a “90-day letter” that is a prerequisite to the taxpayer’s right to litigate a disputed tax in the Tax Court.

20 1986-47 I.R.B. 46 (10/23/86). That Announcement was not reproduced in the Cumulative Bulletin, but it was reproduced in 1986 CCH ¶ 6693.

21 Section 6152 (a) and (b) of the Code prior to amendment by P.L. 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 (hereinafter referred to as “TEFRA”).


23 The accumulated earnings tax under section 531 of the Code is imposed to prevent corporations from accumulating (rather than distributing) income with the intent of reducing or avoiding taxes.
return was due (without regard to extensions) before 1986, interest is charged only from the date that the IRS demanded payment of the tax, rather than the date the return was originally due to be filed.\(^{24}\) Section 1512 of the Tax Reform Act of 1986\(^{25}\) enacted section 6601(b)(4) of the Code to provide, in effect, that interest is imposed on underpayments of the accumulated earnings tax from the due date of the income tax return for the year for which the tax is imposed. The changed interest starting date applies to returns the due date for which (determined without regard to extensions) is after December 31, 1985.\(^ {26}\)

d. **Underpayment interest variations attributable to erroneously claimed overpayments**

In many instances, a taxpayer will have made estimated income tax payments that exceed the tax liability reported in the taxpayer’s income tax return. The taxpayer may direct that the claimed overpayment be either refunded or applied as a payment of estimated tax for the next taxable year (or partly refunded and partly so-applied). A subsequent audit, however may find that the tax liability was greater than that shown on the taxpayer’s return (i.e., the claimed overpayment was erroneous), with the result that the refund received or the credit applied to the next taxable year created or increased a tax deficiency.

The agonizing changing positions of the IRS as to the computation of underpayment interest in such situations have been reflected in a series of Revenue Rulings.\(^ {27}\) The current-day position was developed largely in response to court decisions that were adverse to the IRS,\(^ {28}\) but


\(^{25}\) P.L. 99-514.

\(^{26}\) Section 1512(b) of P.L. 99-514, the Tax Reform Act of 1986.


\(^{28}\) The principal court decisions that triggered those changes are: Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1987), and May Department Stores v. United States, 36 Fed. Cl. 680 (1966), Acq., 1997-2 C.B. 1, in which the Court of Federal Claims held that Rev. Rul. 88-98 was invalid to the extent that it would require the payment of underpayment interest on the amount of a deficiency created by crediting a reported (but incorrect) overpayment to the first installment of estimated tax for the subsequent year for the period between the filing date of the return reporting such presumed overpayment.
also in response to legislative directions in the Deficit Reduction Act of 1984. The current IRS position applies a “use of money” principle originally enunciated in Manning v. Seeley Tube & Box Co., 338 U.S. 561 (1950). Thus it appears that the current position of the IRS as to the computation of underpayment interest in the four situations described below is as follows:

1. **Erroneous Overpayment Refunded Without Interest**

Where a claimed (but erroneous) overpayment is refunded to the taxpayer without overpayment interest (because of the “45-day rule” of section 6611(e)), underpayment interest on the portion of a deficiency created by such refund starts on the date on which the IRS refunded the overpayment. See “Situation 3” and “Situation 4” in Rev. Rul. 99-40, supra. The ruling reasons that until the date of the refund the IRS had the use of the money without owing interest thereon and therefore the tax did not become “underpaid” until the date of the refund.

2. **Erroneous Overpayment Refunded With Interest**

Although Rev. Rul. 99-40 does not specifically address the situation where the claimed (but erroneous) overpayment is refunded with overpayment interest (because it was not made within the 45 day period prescribed in section 6611 (e)), presumably in that case underpayment interest would start on the unextended due date of the tax return on which the erroneous overpayment was claimed (i.e., the date from which the overpayment interest on the erroneous overpayment would have been calculated). However, interest on the portion of the underpayment created by the refund of the erroneously claimed overpayment should qualify for interest netting under section 6621(d) for the period for which overpayment interest was paid on the erroneous refund. That is, the underpayment interest on that part of the deficiency should be computed at the overpayment interest rate rather than the underpayment interest rate. See Rev. Proc. 99-43, 1999-2 C.B. 579.

3. **Erroneous Overpayment Credited to Estimated Tax and Necessary to Avoid a Penalty**

Where a claimed (but erroneous) overpayment is credited to the estimated tax for the succeeding taxable year, the underpayment interest on the portion of the deficiency created by the crediting of the claimed overpayment starts on the date the claimed overpayment is applied to the succeeding year’s estimated tax, meaning when it is needed to avoid the liability for a penalty (an addition to tax under section 6654 or section 6655) for failure to pay estimated tax. See “Situation 1” and “Situation 2” in Rev. Rul. 99-40. As to when the credit is needed to avoid the penalty, Rev. Rul. 99-40 states that “the estimated tax rules in effect for the tax year for which the election to credit a return and the due date for such first installment.

overpayment is effective are used to determine when the overpayment is applied to that year’s estimated taxes, and, thus, for determining when interest begins to run on the subsequently determined deficiency.” Form 2210 (in the case of the estimated tax owed by an individual, estate or trust) or Form 2220 (in the case of an estimated tax owed by a corporation), as in effect for the year to which the credit is applied, can be used to make the computation of when an additional payment of estimated tax was needed to avoid a penalty and thus when interest on that part of the prior year deficiency should start.

4. Erroneous Overpayment Credited to Estimated Tax and Not Necessary to Avoid a Penalty

In an instance when no amount of the claimed overpayment is needed to avoid the penalty for underpayment of estimated tax (because no payment of estimated tax was required or because a sufficient amount of estimated tax was paid to avoid any penalty without resort to any credit of a claimed overpayment from the preceding year), underpayment interest on the prior-year deficiency created by the credit starts on the unextended due date of the tax return for the year to which the credit is made.30

5. Taxpayer May Need to Calculate Underpayment Interest

The IRS reportedly does not (and perhaps cannot, without input from the taxpayer) sua sponte calculate underpayment interest as required by Rev. Rul. 99-40. The IRS does not normally have the data needed to make the calculations required by Form 2210 or Form 2220 to determine the minimum amount of additional estimated tax payment to avoid the underpayment penalty. It would seem, therefore, that it is incumbent on a taxpayer faced with a deficiency created by such a credit of a claimed (but erroneous) overpayment to the estimated tax for the next tax year to make the calculation, using the appropriate form, of the amount of such credit needed on each installment date to avoid the underpayment penalty.

e. Effect on underpayment interest of crediting an actual overpayment to an underpayment

If any portion of a tax underpayment is satisfied by a credit of an overpayment for another period, then no interest is imposed on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.31 The interest computation with respect to such overpayment will be

30 See Field Service Advice 200049001, Doc 2000-31661, 2000 TNT 238-57, dated November 15, 1999 and released December 14, 2000. The ruling reasons that, under section 6513(d), the amount credited is considered as a payment of tax for the succeeding taxable year on the unextended due date of the tax return for that year.

31 Section 6601(f) of the Code.
discussed below. The effect of this provision generally is that if the tax that was underpaid was due before the date of the overpayment, interest on the underpayment satisfied by the crediting of the overpayment stops on the date of the overpayment of the amount so credited; if the tax that was underpaid was due after the date of the overpayment, no interest is due on the portion of the underpayment satisfied by the crediting of the overpayment.

f. Underpayment interest on penalties, etc.

In the case of any assessable penalty, additional amount, or addition to the tax, generally interest is due only if such assessable penalty, additional amount, or addition to the tax is not paid within 21 calendar days from the date of notice and demand therefor (10 business days if the amount for which notice and demand is made equals or exceed $100,000), and in such case interest is imposed only for the period from the date of notice and demand to the date of payment. Exceptions to this rule are provided in the case of certain additions to the tax that have to do with the filing or contents of the tax return, where the interest period begins on the due date of the return (taking account of any extension of time to file the return) and ends on the date of payment of such addition to tax.

g. Suspension of interest

Under section 6404(g) of the Code, as added by the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, interest (and certain penalties) on an underpayment by an individual who filed a timely return is suspended (except in certain cases involving fraud, etc.) if the Internal Revenue Service fails to send a notice to the taxpayer.

32 Where the overpayment is reflected in the tax return for a subsequent year, interest on the underpayment satisfied by the crediting of such subsequent overpayment runs to the due date of the return for the subsequent year (determined without regard to any extension), if that return is filed timely or filed during an extension period, and to the actual date of filing, if that return is delinquent. Rev. Rul. 88-97, 1988-2 C.B. 355.

33 With the advent of an interest rate differential between the rate charged on underpayments and the rate credited on overpayments, discussed below, the effect of satisfying an underpayment by crediting an overpayment for another period could be material. See footnote 37 and “Interest Netting” below.

34 Section 6601(e)(2)(A) of the Code. The excise tax under section 4975 of the Code for prohibited transactions has been held to be a tax, not a penalty, so interest thereon starts with the tax return due date, not on the date of notice and demand following assessment. Latterman v. United States, 872 F.2d 564 (3d Cir 1989). This decision is in conflict with several prior decisions, including the Court of Appeals for the Eighth Circuit in Rockefeller v. United States, 718 F.2d 290 (8th Cir 1983), aff'g 572 F. Supp 9 (E.D. Ark 1982).

35 Section 6601(e)(2)(B). This applies in the case of additions to the tax under section 6651(a)(1) (late filing of the return), section 6653 (failure to pay stamp tax), and sections 6662 through 6664 (accuracy-related and fraud penalties).
specifically stating the taxpayer’s liability and the basis for the liability (e.g., a Revenue Agent’s Report) before the close of the 1-year period (18 month period in the case of taxable years beginning before January 1, 2004) beginning on the later of (i) the date on which the return was filed, or (ii) the due date of the return without regard to extensions. Interest resumes 21 days after the IRS sends such a notice to the taxpayer. This provision applies to taxable years ending after July 22, 1998 (the date of enactment of P.L. 105-206). The suspension does not apply to self-assessed amounts (e.g., amounts shown on the return but not paid).

2. **Overpayments**

a. **General Rule**

Section 6611(b) of the Code provides the general rules for the period for interest on overpayments.\(^{36}\) In the case of an overpayment which is applied as a credit to satisfy another liability, the interest period runs from the date of the overpayment to the due date of the amount against which the credit is taken.\(^{37}\) In the case of an overpayment which is refunded, the interest

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\(^{36}\) A deposit under section 6603 or a payment which is a deposit in the nature of a cash bond made to stop the running of interest on an asserted underpayment of tax is not a payment of tax, so such a payment is not an “overpayment” for this purpose even if in an amount greater than the asserted tax underpayment, and, except as provided in section 6603, the return of any such deposit does not bear interest. See the discussion of such deposits above. There has been some divergence of opinion as to whether a remittance made to the IRS with a Form 4868 automatic extension request is a tax payment or a deposit. See, Ott v. United States, 141 F.3d 1306 (9th Cir. 1998). That question typically has risen when the issue is the statute of limitations, but it could also affect the allowability of overpayment interest.

\(^{37}\) Section 6611(b)(1). In accordance with Treas. Reg. § 301.6611-1(h)(2), for an overpayment credited against an income tax underpayment, such “due date” is the last day for the payment of the tax (determined without regard to any extension of time), namely the unextended due date for the tax return for the taxable year to which the amount is credited. This is the result even though the underpayment is attributable to an erroneous “credit elect overpayment” credited (without interest) against estimated taxes for the succeeding year. Marsh & McLennan Companies, Inc. v. U.S., 302 F.3d 1369 (Fed. Cir. 2002). Cf. AT&T Corporation and Subsidiaries v. U.S., 2004 WL 2367337 (Fed. Cl. 10/18/04), where (unlike in Marsh & McLennan) the tax underpayment against which an overpayment was credited did not arise as of the due date of the return for that year but rather later when an erroneous refund attributable to a tentative carryback under section 6411 (presumably without interest) was made after the overpayment at issue arose.

Terminating overpayment interest on the due date of the underpayment amount against which the credit is taken coordinates with section 6601(f), discussed above, dealing with interest on underpayments satisfied by a credit. If the tax that was underpaid was due before the date of the overpayment, interest on the underpayment satisfied by the crediting of such overpayment stops on the date of the overpayment so credited, and no interest is payable on the overpayment that is credited to satisfy such underpayment. If the tax that was underpaid was due after the date of the overpayment, interest on the overpayment credited to satisfy such underpayment stops on the due date of the underpayment, and no interest is due on the underpayment so satisfied. For years before 1987 (when a 1% differential between interest on underpayments and interest on overpayments came into effect), the reduction under section 6601(f) of the
period runs from the date of overpayment to a date (to be determined by the IRS) preceding the date of the refund check by not more than 30 days.\footnote{38}

Pursuant to section 6611(d), which incorporates section 6513, payment of any portion of the tax before the last day prescribed for payment of the tax is considered as made on such last day. As noted above,\footnote{39} generally the tax is due on the date prescribed for filing the return, and section 6513(a) states that the last day prescribed for filing the return or paying the tax is to be determined without regard to any extension of time granted to the taxpayer and without regard to any election to pay the tax in installments. Thus, any overpayment shown on the return attributable, for example, to estimated tax payments in excess of the tax due, is deemed an overpayment on the due date for the return, regardless of the fact that such estimated tax payments will have been made before such due date. In addition, section 6513(d) provides that if any overpayment of income tax is claimed as a credit against estimated tax for the succeeding taxable year, such amount is considered a payment of the succeeding taxable year, and not as an overpayment for the taxable year in which the overpayment arose.

\footnote{38} Section 6611(b) (2). The purpose of the 30-day leeway is to provide administrative convenience, so that the IRS can first compute the interest and then process and deliver the refund check without incurring additional interest for the period after the date used in making the interest computation.

A taxpayer who receives a refund check which he believes does not include enough statutory interest should nevertheless accept and deposit the check, because, even if the interest is wrong, no additional interest will be payable on the amount of the refund covered by the check. Furthermore, section 6611(b)(2) expressly states that the acceptance of the check does not deprive the taxpayer of the right to claim any additional overpayment and interest thereon.

Query whether any 30-day or other leeway would apply to the obligation to pay additional compound interest under section 6622 where the full amount of the overpayment of tax and any overpayment of assessed interest was refunded but there was insufficient statutory interest paid because of an error in computing the amount of such statutory interest. The amount of such additional statutory interest owed to the taxpayer would be neither an overpayment nor a tax and therefore would not be a “refund” within the meaning of the 30-day leeway under section 6611(b)(2). It could therefore be argued that any unpaid statutory interest would continue to compound under section 6622 until the very moment the last amount of interest was paid.

\footnote{39} See footnotes 11 and 12 above.
Furthermore, section 6611(b)(3) provides that, in the case of a late return (i.e., a return filed after the last day prescribed for filing such return, determined with regard to extensions), no interest is allowed for any period before the date on which such return is filed.  

b. “Forty-five day” rule exceptions

Section 6611(e) provides several “45-day” rules for the disallowance of interest on overpayments. Thus, Section 6611(e)(1) provides that no interest is allowed on an overpayment of income tax if such overpayment is refunded within 45 days after the date prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or is refunded within 45 days after the return is filed where the return is filed after such last date. Section 6611(e)(2) provides that, if a claim for credit or refund of an overpayment is filed and such overpayment is refunded within 45 days after such claim is filed, no interest is allowed on such overpayment from the date the claim is filed until the day the refund is made. In the case where an adjustment initiated by the IRS results in a credit or refund, under section 6611(e)(3) interest on such overpayment is computed by subtracting 45 days from the number of days interest would otherwise be allowed with respect to such overpayment. This rule applies to refunds paid after 1994 regardless of the tax period to which they relate. There is no indication of which 45 days to subtract (which could make a difference, since interest rates vary from time to time), but presumably they would be days at the end of the normal interest period.

c. Overpayment resulting from payment of an asserted deficiency

In many cases, a taxpayer’s claim that there has been an overpayment arises because there has been an audit by the IRS as a result of which a deficiency has been asserted and the taxpayer has paid the asserted deficiency and assessed interest thereon. The overpayment does not arise until the taxpayer has paid an amount in excess of the amount due. Thus, for example,

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40 Where the entity claiming a refund is exempt from tax, the provisions of section 6611(b)(3) have been held not to be applicable, because the claimant could not have filed a late return where no return was required. In MNOPF Trustees, Ltd v. United States, 123 F.3d 1460 (Fed. Cir. 1997), the government argued that interest should run from the date the refund claim was filed notwithstanding earlier withholding of tax from amounts payable to claimant, and in State of Michigan v. United States, 141 F.3d 662 (6th Cir. 1998), the government argued that interest should run from the date a tax return would have been due if the claimant were not exempt from taxation notwithstanding earlier actual payments of estimated tax. In both instances the court held that overpayment interest runs from an earlier date when the overpayment was deemed paid — in the former case when the banks, acting as withholding agents, reported the withholding to the Treasury, and in the latter case from the date of actual payment of installments of estimated tax.

41 Thus, for example, if a corporate income tax return for a calendar year is filed on March 15 of the following year and any overpayment shown on such return is refunded by April 29, no interest is allowed on such overpayment. However, if the time to file such return is extended to September 15 and the return is actually filed on September 1, no interest is allowed on such overpayment if the overpayment is refunded by October 15.
if the taxpayer makes an interim payment of the amount due in respect of adjustments not disputed and subsequently makes an additional payment of tax in respect of other adjustments (some of which are no longer in dispute and others of which are disputed and are subsequently resolved in the taxpayer’s favor), the overpayment of tax arises (and thus the interest period begins) only when the subsequent payment is made.

In such a situation, the base amount is the amount by which the aggregate amount of tax paid exceeds the tax ultimately determined to be due. Assuming that assessed interest was paid with the payments of taxes, there would also be an overpayment of assessed interest in the amount by which the assessed interest paid exceeded the amount of assessed interest actually due (i.e., calculated on the correct amount of underpayment of tax). The interest period for the overpayment of such assessed interest would begin on the date the overpayment of assessed interest was made.\(^{42}\)

However, if the taxpayer referred to in the preceding two paragraphs thereafter establishes that there was another favorable adjustment that causes the tax actually due to be less than that shown on the return (as a result of which there would have been no deficiency owing at the time subsequent payments were made), there would be three interest periods for three different tax base amounts:

1. the interim payment of the asserted deficiency computed in respect of adjustments not disputed would be one base amount with an interest period beginning when such interim payment was made;
2. the subsequent payment of the asserted deficiency would be another base amount with an interest period beginning when such subsequent payment was made; and
3. the amount by which the tax shown on the return exceeded the tax actually due would be a third base amount with an interest period beginning on the due date of the return (determined without regard to any extension of time to file such return).

In addition, the entire amount of assessed interest paid would be an overpayment representing a base amount with an interest period beginning on the date such assessed interest was paid. The aggregate statutory interest due would be the total of these separately calculated amounts.

\(^{42}\) Where an asserted underpayment of tax is satisfied by the crediting of an overpayment of tax for another period, the reduction under section 6601(f) of the Code (discussed above) in the amount of interest that would otherwise be payable by the taxpayer (in the absence of the crediting of the overpayment) is not treated as a payment of assessed interest which would constitute an overpayment of interest if it were subsequently held that there was not an underpayment of tax. Consequently, there would not be statutory interest on the amount by which the interest on the asserted underpayment was reduced. Texas Eastern Corp. v. United States, 907 F.2d 138 (Fed. Cir. 1990). Instead there would be more statutory interest due on the overpayment of tax erroneously credited to the asserted underpayment, but there would be no interest on interest until 1983, when compound interest came into effect.
d. **Overpayment attributable to a carryback**

If an overpayment of income tax results from a carryback of a net operating loss or a net capital loss in a later year, interest on the overpayment resulting from such carryback starts at a date later than for an overpayment that existed when the return for the overpayment year was filed. Section 6611(f)(1) currently provides that interest on an overpayment resulting from such a carryback does not start to run until the “filing date” for the tax year in which the net operating loss or net capital loss arose. For this purpose, the term “filing date” means the last day prescribed for filing the return for the loss year (determined without regard to any extension). For interest accruing prior to October 4, 1982, a slightly different rule applies: interest on the overpayment attributable to such a carryback starts to run at the end of the carryback year, rather than on the “filing date” for such year.

A similar rule applies for interest on an overpayment attributable to foreign tax credit carrybacks and certain other credit carrybacks. That is, interest for any such overpayment does not start to run until the “filing date” for the tax year that gives rise to the carried-back credit (or until the end of such tax year in the case of interest accruing before October 4, 1982).

Furthermore, in the case of a net operating loss carryback, a capital loss carryback, or one of the credit carrybacks discussed in the preceding paragraph, a variation of the 45-day rule under section 6611(e), discussed above, applies. The overpayment is treated as an overpayment for the carryback year, and, for purposes of the 45-day rule, the return for that year is treated as not filed before the claim for refund of the resulting overpayment if filed. Consequently, if the overpayment resulting from a carryback is refunded within 45 days after the claim for refund of such overpayment is filed, no interest is payable on the overpayment. Also, if a taxpayer first files a claim for refund of such an overpayment and subsequently files an application for a tentative refund under section 6411(a) (i.e., a “quickie refund”) with respect to such overpayment, the 45 day period starts to run when the application under section 6411(a) was filed.

43 Section 6611(f)(4)(A).


45 Section 6611(f)(2).

46 Section 6611(f)(3).

47 Section 6611(f)(4)(B)(i)(I) and (II). See also TAM 20001727, 2000 TNT 11-20.

48 Section 6611(f)(4)C).
Rates and Methods for Computing Interest

If a computer program to compute interest on Federal taxes is not available, a separate interest computation must be made for each portion of the overall interest period that had a different interest rate or different computations method, and the interest for the aggregate interest period is the sum of such separate interest computations. If the interest period extends over a long period, this can involve many separate interest computations.

Rev. Proc. 95-17\(^{49}\) provides a fairly comprehensive description of the interest rates and computation methods in effect prior to 1983 and for the first six months of 1983, when compound interest first went into effect. Thereafter interest rates changed, and the frequency with which they changed increased, but the computation method has stayed the same. Rev. Proc. 95-17 also provides tables and factors for computing interest both under the simple interest rates and procedures in effect prior to 1983 and under the daily compounding rules effective for interest accruing after 1982. Therefore, for anyone desiring to understand the intricacies of the computation of interest on Federal taxes, Rev. Proc. 95-17 is required reading. It is also the source of the interest factors that must be used manually for all computations made after 1994 if a computer program to make the interest computations is not to be used.

1. **Interest rates and methods in effect before 1983**

For interest prior to July 1, 1975, simple interest at 6% per year was prescribed by the Code.\(^{50}\) The “month-day” method described below was employed to compute such interest. The “month-day” method continued to be the prescribed method for interest through January 31, 1980, although varying interest rates were in effect. From February 1, 1980 through December 31, 1982, the IRS used a daily rate to compute simple interest at the prescribed rate. TEFRA enacted section 6622 of the Code to require the daily compounding of interest on all amounts accruing after December 31, 1982.

The “month-day” method of computing interest was well suited to the computation of interest when the interest rate was 6% simple interest and when computers were not available to assist in the computation. The interest period was stated in terms of the number of years, months, and days, and an interest factor was assigned to each number: 6% for each year, 0.5% for each month (regardless of the number of days in the month), and a factor from a simple 30-factor table for the number of days.\(^{51}\) The three interest factors (for years, months, and days)


\(^{50}\) Section 6601(a) and section 6611(a) of the Code prior to the amendments enacted by P.L. 93-625.

\(^{51}\) The factors in the table were derived simply by dividing .06 by 365 (the number of days in a year) and multiplying the result by the number of days the factor represents. The same daily factors were used for leap years and for non-leap years. However, leap years were taken into account for other purposes as described below.
were added up to obtain a total interest factor for the interest period, and the base amount was multiplied by such total interest factor.

To obtain the number of years, months, and days, the date of the end of the interest period was set up in terms of the year, the month of the year, and the day of the month. The date of the beginning of the interest period was similarly set up and subtracted from the end of the interest period as follows:

End of interest period:  # year / # month / # day
Beginning of period:    # year / # month / # day
Period:                 # years / # months / # days

If the number for the day of the month at the end of the interest period were smaller than the number for the day of the month at the beginning of the interest period, the number of days in the month preceding the month in which the interest period ends would be “borrowed” and added to the day number, and the number for the month at the end of the interest period would be reduced by one.

Thus, the number of days that may be “borrowed” depended on the month in which the interest period ends, and leap years must be taken into account if the interest period ends in March (because the “borrowing” would be from February, which may be 28 or 29 days). Similarly, if the number for the month of the year at the end of the interest period (reduced for any “borrowing” required for days) were smaller than the number for the month of the year at the beginning of the interest period, 12 months would be “borrowed” from the year figure, and the number for the year at the end of the interest period would be reduced by one.

For example, if the end of the interest period were July 10, 1974, and the beginning of the interest period were December 17, 1970, the beginning and ending dates would be set up as follows:

End of interest period:  74 / 7/10
Beginning of period:    70/12/17

After “borrowing” 30 days from June (the month before July) to add to the day number at the end of the interest period, and “borrowing” twelve months to add to the month number (reduced by one for the “borrowing” to increase the day number) at the end of the interest period, the interest period would be calculated as follows:

End of interest period:  73/18/40
Beginning of period:    70/12/17
Period:                 3/  6/23

Thus the interest period would be three years, six months, and 23 days, and the interest factor would be:
For years: 3 x .06 = .18
For months: 6 x .005 = .030
For days: from table: .003780820
Total: .213780820

The base amount would then be multiplied by this factor to compute the interest for the period.

Section 6621(a) of the Code, as added by P.L. 93-625, provided that the interest rate would be 9% unless a different rate was established under section 6621(b). Accordingly the interest rate was 9% for the period from July 1, 1975 through January 31, 1976, when the interest rate was established as 7%. The 7% rate was in effect through January 31, 1978, when a new rate of 6% went into effect through January 31, 1980. Throughout this period, the “month-day” method of computation described above was used. Rev. Proc 95-17, supra, and Rev. Proc. 83-7, supra, include the year, month, and day interest factors to be used for such computations.

Starting with February 1, 1980, the IRS shifted to the computation of interest using a daily rate. At that point in time, the interest rate was established as 12%, and the interest was to be computed by simply multiplying the number of days in the interest period by a daily interest factor of .000328767 (which is .12 divided by 365). The 12% rate continued in effect

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52 Section 7(a)(1) of P.L. 93-625.
53 As originally enacted, section 6621(b) provided that an adjustment thereunder could not be made prior the expiration of 23 months following the date of any preceding adjustment. The interest rate was to be set at a rate equal to 90% of the prime rate charged by commercial lenders. Section 6621(c).
55 See IR-1897, dated October 14, 1977.
56 One somewhat peculiar result of the “month-day” method is that the seven-month period from July 1, 1975 through January 31, 1976 (the period over which the interest rate was 9%) is counted as seven months and one day (because June has 30 days, whereas January has 31 days). As a consequence, the interest factor used by the IRS for 9% simple interest for that period is .0527465753, not simply .0525, which would be the interest factor for seven months at 9%.
57 When the 9% rate was in effect, the yearly interest factor was .09, the monthly interest factor was .0075, and the daily interest factor, which was provided in a table, was computed as .09 divided by 365 and multiplied by the day number. Similarly, when the 7% rate was in effect, the yearly interest factor was .07, the monthly interest factor was .00583333 (which is .07 divided by 12), and the daily interest factor provided in a table was computed as .07 divided by 365 and multiplied by the day number.
59 Under the IRS’s practice, the extra day in a leap year is not taken into account to determine the simple interest daily interest factors. One peculiar result of this is that the interest factor the IRS uses for 12%
through January 31, 1982, after which the interest rate was established as 20% and stayed at that level through December 31, 1982. During the 20% period, the daily interest factor was .000547945 (which is .20 divided by 365).

2. **Compound interest starting in 1983**

Under section 6622(a) of the Code, as added by TEFRA, interest computed using daily compounding rules was required for interest accruing after December 31, 1982. Rev. Proc. 83-7, supra, (subsequently replaced by Rev. Proc. 95-17, supra) was designed to provide comprehensive instructions as to how to convert from simple interest to compound interest. Interest under the old methods and rates was to be computed through December 31, 1982, and then all tax, assessed penalty or addition to the tax, and all interest (whether or not assessed) was to be added together to determine the amount to be carried over on which daily interest would be charged under the compounding rules.

The legislative history of section 6622 states that: “In a case in which the principal portion of an obligation is satisfied, and interest remains outstanding, such interest will, of course, be compounded.” H. Conf. Rep. No. 760, 97th Cong., 2d Sess. 596 (1983). Accordingly, it is clear that interest on previously accrued interest continues to compound under section 6622 until all interest has been paid, whether or not the underlying tax underpayment or overpayment has been paid.

Under both Rev. Proc. 83-7 and Rev. Proc. 95-17, tables of daily compound interest factors were provided for interest rates from 1% through 24% for both non-leap years and for leap years. When the compound interest requirement went into effect on January 1, 1983, the simple interest for the two-year period from February 1, 1980 through January 31, 1982, inclusive, is .2403287671, not simply .24. This is because the daily interest factor is derived by dividing .12 by 365 regardless of whether the interest period includes a leap year, but the period from February 1, 1980 through January 31, 1982, inclusive, is 731 days, not 730 days, because it includes February 29, 1980.

Rev. Rul. 81-260, 1981-2 C.B. 244. The Economic Recovery Tax Act of 1981, P.L. 97-34, amended section 6621 of the Code, applicable to adjustments made after August 13, 1981, to provide for annual adjustments to the interest rate and to set the rate at 100% of the prime rate, rounded to the nearest whole percent.

Section 344(a) of TEFRA, P.L. 97-248.

The formula for the computation of the daily compound interest factors for a non-leap year is:

\[(1 + r/365)^d - 1\]

where \(r\) is the annual rate and \(d\) is the number of days in the compound interest period. For a leap year the number 366 would be substituted for the number 365.

Compound interest factors computed pursuant to this formula are minimally larger than the Rev. Proc. 83-7 table factors, apparently because of inaccuracies in the Rev. Proc. 83-7 factors that were corrected in
interest rate was established at 16%. Interest rates were to be established semi-annually based on
the adjusted prime rate charged by banks.

Prior to the further revision of the interest rules enacted by the Tax Reform Act of 1986, interest rates went from 16% in the first half of 1983, to 11% for the last half of 1983 and all of
1984 (although 1984 required the use of different tables because it was a leap year), to 13% for
the first half of 1985, back to 11% for the second half of 1985, to 10% for the first half of 1986,
and to 9% for the second half of 1986.

3. Interest rate differentials starting in 1987

For interest after December 31, 1986, the Tax Reform Act of 1986 shifted to quarterly
revisions of the interest rate and provided for a 1% differential between the rate charged for
underpayments and the rate credited for overpayments. Initially, for the first three quarters of
1987, the rate was 9% for underpayments and 8% for overpayments, and there have been
numerous rate changes since then. See the schedule showing interest rates and methods in
Appendix A hereto.

The introduction of the concept of having an interest rate differential between interest on
underpayments and interest on overpayments produced the potential for inequity and further
complexities. One may question whether there is a sound conceptual basis in the first instance
for having a differential between the rate for underpayment interest and the rate for overpayment
interest. If the purpose of such interest is solely to compensate a party for the use of funds, why
should the compensation to the taxpayer be less than the compensation to the government? The
U.S. Treasury is not a banking operation designed to make a profit on the difference between the
interest it pays for borrowed funds and the interest it charges on loans. The question becomes
more critical where simultaneous reciprocal obligations exist, i.e., there is both an underpayment
and an overpayment for the same interest period. The problem is greatly exacerbated by the
increasing of the interest rate differential for corporations discussed below.

The inequity of having interest rate differentials has been materially mitigated by two
provisions added to the Code by the Internal Revenue Service Restructuring and Reform Act of
1998, P.L. 105-206. Pursuant to amendments to the Code by one of those provisions, section

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Rev. Proc. 95-17. The Rev. Proc. 95-17 table factors appear to be the same as the interest factors
computed by the foregoing formula, rounded to the ninth decimal place.

The author’s TAXINT computer program computes interest factors under the foregoing formula which
are then rounded to the ninth decimal place to conform to the Rev. Proc. 95-17 table factors, thereby
avoiding anomalous rounding discrepancies that might appear if unrounded factors were used.

63 P.L. 99-514, §§ 1511 and 1512.

64 See section 6621(a) and (b) of the Code, as added by section 1511 of P.L. 99-514, the Tax Reform Act
of 1986.
6621(a)(1)(B) of the Code eliminates the interest rate differential, except for corporations, by making the overpayment rate the same as the underpayment rate for interest periods beginning after December 31, 1998. There is, of course, still an interest rate differential for corporations, and for interest periods after 1998 there are two different normal overpayment rates, one for corporations and another for non-corporations.

The second mitigating provision added by P.L. 105-206 is section 6621(d) of the Code, which is discussed at some length below in connection with interest netting.

4. **Interest on Large Corporate Underpayments – “Hot Interest”**

Section 7721(b) of the Revenue Reconciliation Act of 1990, P.L. 101-508, added section 6621(c) to the Code, which called for a higher rate of interest on certain “large corporate underpayments.” The interest rate was 2 percent higher than the normal underpayment rate (and thus 3 percent higher than the normal overpayment rate). Thus, where applicable, the newly prescribed interest (sometimes termed “hot interest”) reflected a 3 percent interest rate differential rather than the previous 1 percent differential.

The provisions for the higher rate of interest on large corporate underpayments took effect on January 1, 1991. The definition of a “large corporate underpayment” is contained in section 6621(c)(3) of the Code -- it is any underpayment of tax by a C corporation for any taxable period (e.g., a taxable year) if the amount of such underpayment exceeds $100,000. The higher rate of interest applies to periods after the “applicable date,” which is defined by section 6621(c)(2) of the Code. Generally the applicable date is the 30th day after the earlier of --

(i) the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals is sent (e.g., the date of a “30 day letter”), or

(ii) the date on which the deficiency notice under section 6212 is sent (e.g., the date of a “90 day letter”).

Where a “30 day letter” or “90 day letter” was sent to the taxpayer more than 30 days before January 1, 1991 and the tax shown thereon has not been paid before that date, the higher rate of interest starts on January 1, 1991. A special rule applies where the deficiency provisions do not apply, and the higher rate of interest does not come into effect if, during the 30 day period after the letter or notice was sent, the taxpayer makes a payment equal to the amount shown as due in

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65 In the case of an underpayment of tax to which the deficiency procedures do not apply, the applicable date is determined by reference to any letter or notice which notifies the taxpayer of the assessment or proposed assessment of the tax. See section 6621(c)(2)(B)(i) of the Code.
such letter or notice. Furthermore, the higher rate of interest is not triggered by a letter or notice which is subsequently withdrawn by the IRS.

5. **Interest on Corporate overpayments of tax in excess of $10,000 – “GATT Interest”**

The next expansion of the interest rate differential came with the enactment of the Uruguay Round Agreement Act, P.L. 103-465, which was passed in connection with the General Agreement on Tariffs and Trade (“GATT”). That law included, as a revenue raiser, an amendment to section 6621(a)(1) of the Code that provided for a reduced rate of interest on certain overpayments of tax by a corporation (sometimes termed “GATT interest”). As if the computation of interest on tax underpayments and overpayments were not complicated enough already, that amendment not only has materially increased the mechanical complications of computing interest on the overpayments to which it applies, but also it has led to controversies as to its proper application.

As amended, section 6621(a)(1) provides that, to the extent that an overpayment of tax by a corporation for any taxable period (as defined by section 6621(c)(3) -- meaning, in the case of an overpayment of income tax, a taxable year) exceeds $10,000, the interest rate payable on such amount is 1.5 percentage points below the normal overpayment rate for interest periods after December 31, 1994. Thus, for periods after 1994, the interest rate differential between the rate payable on normal corporate underpayments and the rate payable on overpayments to which the new GATT interest provision applies is 2.5% (instead of the normal 1%) and the interest rate differential between the rate payable on “large corporate underpayments” and such GATT interest overpayments is 4.5%.

The legislative history of the GATT interest amendment is rather sparse, and the wording of the law itself leaves room for some uncertainties. For example, the law refers to an “overpayment of tax” in excess of $10,000, but it is not clear what is meant by a “tax.” It would seem clear that the word “tax” would include underpayment interest, since section 6601(e)(1) provides that (with specified exceptions not relevant for this purpose) any reference to a tax imposed by the Code shall be deemed also to refer to underpayment interest on such tax. Does it also include additions to the tax, additional amounts, and assessable penalties prescribed by Chapter 68, sections 6651 through 6724? In instructions to the field in February 1995, the National Office of the Internal Revenue Service stated that, when a refund is being issued as a result of abating tax, penalty, and/or interest that was previously paid by the taxpayer, the “principal” amount, for purposes of determining the $10,000 “threshold” triggering the application of the lower GATT interest rates, consists of the entire abatement amount which the taxpayer paid. Thus, for example, assume, in the case of a corporate taxpayer, that a $9,000 deficiency was assessed consisting of tax and penalty along with $1,500 in underpayment

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66 Section 6621(c)(2)(B)(ii) of the Code.

67 Section 6621(c)(2) as amended by Section 1702(c)(6) of the Small Business Job Protection Act of 1996, P.L. 104-188.
interest, that such amounts were paid by the taxpayer on 1/15/95, and that the taxpayer files a claim for refund of such amounts which is allowed. The IRS would apply the GATT interest rate to $500 of the refund.\(^{68}\)

A more controversial matter has been the treatment of overpayment interest accruing through December 31, 1994. A recent decision by the Court of Appeals for the Federal Circuit\(^ {69}\) addresses that issue in favor of the government as described below, but the background leading up to that case is both interesting and relevant.

The February, 1995, National Office instructions to the field referred to above specifically took the position that overpayment interest accrued through December 31, 1994, on any part of an overpayment in excess of $10,000 would not be subject to the GATT interest rates after 1994, but rather the amount of such interest as of December 31, 1994, would continue to compound at the normal overpayment interest rates. However, in a Service Center Advice designated SCA 1998-014, dated April 24, 1997, reportedly released 6/28/98 (although released in such a way that it did not attract public attention), the Service reversed its position on that subject. Thus, in SCA 1998-014 the Service took the position that, where an overpayment occurred before January 1, 1995 (the effective date of the GATT interest amendment), the lower GATT interest rate of interest applies after December 31, 1994, not only to the overpayment of tax in excess of $10,000 but also to the amount of overpayment interest that accrued thereon prior to January 1, 1995. The Service acknowledged that this was a reversal of its prior position that would require re-programming of the Service’s computers, and reportedly the Service has not applied its revised position to GATT interest computations made before January 1, 1999, even in the case of a revision of such a pre-1999 computation to correct errors.\(^ {70}\)

Several cases contesting the propriety of the Service’s change in position were lodged in the United States Court of Federal Claims.\(^ {71}\) One such case, the case recently decided by the

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\(^{68}\) As to the underpayment interest, the IRS interpretation derives support from section 6601(e)(1), referred to above; as to the penalty, section 6724(b) states that penalties shall be paid in the same manner as a tax, but unlike section 6601(e)(1) it contains no provision that a reference in the Code to a tax shall be deemed also to refer to a penalty.

\(^{69}\) General Electric Company and Subsidiaries v. United States, ___ F.3d ___, 2004 TNT 188-22 (Fed. Cir. 2004).

\(^{70}\) On July 30, 1999, the author of this article filed with the Service an objection to the Service’s changed position, on the ground that the changed position would violate the clear terms of section 6621(a)(1), which provides that, effective 1/1/95, the lower GATT overpayment interest rate is applicable only to the extent that an “overpayment of tax” by a corporation exceeds $10,000, and the overpayment interest accrued through December 31, 1994, is neither an “overpayment” nor a “tax.” See Doc 1999-25859 (7 original pages); 1999 TNT 151-46. On October 8, 1999 the Service rejected that objection, stating that it believes that “beginning on the GATT effective date, the GATT rate will apply to a large corporate overpayment arising before the GATT effective date, as well as to the accrued interest thereon.”

\(^{71}\) In most instances, litigation on this issue must be brought in the United States Court of Federal Claims,
Court of Appeals, involved General Electric Company and Subsidiaries. That case became the lead case on the issue, although it is somewhat unique in that, as of the effective date of the GATT interest amendment, there was no tax overpayment owed to the taxpayer but only additional overpayment interest. The government argued, and the court apparently agreed, that the GATT interest rate applies to all principal and interest “stemming from” the portions of an overpayment that exceeds $10,000 to the extend any such amount (principal or interest) was still owing to the taxpayer on January 1, 1995, the effective date of the GATT interest provision. The Court of Appeals seems to have agreed with its description of the trial court’s view that an “overpayment” is “intended to denote the difference between the tax owed and the tax paid by the taxpayer for the taxable year in question, without reference to any credits, refunds, or accrued interest that may have altered the amount of the obligation stemming from that overpaid sum” and that the term “overpayment” is “a fixed amount that is not reduced as the overpayment is retired."

The issue involved in the pending GATT interest cases properly arises only in “transitional” cases, where the overpayment arises before January 1, 1995, and the interest period continues after that date. As to such situations, the National office’s 1995 instructions to the field addressed a number of circumstances that might arise in such transition cases with examples that are not consistent with the IRS’s changed position. Therefore, the detailed which has been given jurisdiction for such a suit by 28 U.S.C. §1491. Under 28 U.S.C §1346, District Courts have been given concurrent jurisdiction with the United States Court of Federal Claims for civil actions against the United States for tax refunds, etc. without limitation as to amount or for other civil actions against the United States not exceeding $10,000 in amount. Since a suit for additional overpayment interest is not a refund suit, it may be arguable that such a suit in a District Court is subject to the $10,000 limit. But see Trustees of Bulkeley School v. United States, 628 F. Supp. 802 (D.Conn 1986), holding that the $10,000 limitation does not apply

In instances where a deficiency is asserted by the Service followed by litigation in the Tax Court where the Tax Court, pursuant to section 6512(b), determines that, instead of a deficiency, there was actually an overpayment of tax in excess of $10,000, a dispute as to the computation of interest on the overpayment can alternatively be adjudicated by the Tax Court pursuant to section 7481(c). Appellate review of the decision by the Tax Court would be by the Court of Appeals specified by section 7482, whereas review of a decision by the United States Court of Federal Claims in a suit under 28 U.S.C. §1491 would be by the Court of Appeals for the Federal Circuit. The difference in the appellate forum might be a significant consideration.

The statute of limitations for a suit under 28 U.S.C §1491 expires six years from the date the overpayment is allowed. See Rev. Rul. 56-506 and Rev. Rul. 56-574, both at 1956-2 C.B. 959, and Rev. Rul. 57-242, 1957-1 C.B. 452. On the other hand, a Tax Court proceeding under section 7481(c) must be instituted within 1 year after the date the decision of the Tax Court becomes final.

72 However see Appendix D hereto, describing a concept termed “Super-GATT.”

73 Those examples presumably no longer represent the IRS’s position, because they applied the GATT interest rate only to the “tax” (which the IRS says includes assessed interest and penalties), but not to overpayment interest accrued before 1995.
discussion of those examples which were previously included in the body of this article has been moved to an appendix hereto. However, some of the principles involved in those examples might still be present in the IRS’s revised position. Thus, two of the examples indicated that the post-1994 $10,000 GATT initial threshold amount would be reduced by any pre-1995 refund of tax for the taxable period involved. As noted below, one may question the propriety of that conclusion. In any event, however, that question could not have a tremendous economic impact, however, because it could not reduce the initial 1995 normal overpayment interest base (and increase the GATT interest base) by more than $10,000.

Nevertheless, a new complexity is created by the need under SCA 1998-014 to make two overpayment interest computations for pre-1995 overpayments, one for pre-1995 interest on the portion of the pre-1995 overpayment equal to the GATT threshold amount (which will become part of the post-1994 normal overpayment interest base) and the second for pre-1995 interest on the balance of the pre-1995 overpayment (which, according to SCA 1998-014, will become part of the GATT interest base).

The GATT interest computations are complex even in non-transitional cases. Thus, in any circumstance where the GATT interest provision comes into play, there will always be at least two elements to the computation of the interest on the refund which must be aggregated to determine the total interest payable. For example, assume that on 1/15/95 a payment of tax in the amount of $25,000 was made and that it was subsequently determined that the payment constituted an overpayment of tax that should be refunded. The refund is made together with interest through 11/15/95, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overpayment of tax on 1/15/95</td>
<td>$25,000.00</td>
</tr>
<tr>
<td>Normal overpayment interest on first $10,000</td>
<td></td>
</tr>
<tr>
<td>1/15/95 - 11/15/95</td>
<td>$715.59</td>
</tr>
<tr>
<td>GATT interest on $15,000 excess</td>
<td>873.87</td>
</tr>
<tr>
<td>1/15/95 - 11/15/95</td>
<td></td>
</tr>
<tr>
<td>Total overpayment interest payable</td>
<td>1,589.46</td>
</tr>
<tr>
<td>Total amount payable</td>
<td>$26,589.46</td>
</tr>
</tbody>
</table>

If the normal overpayment interest rate applied to the entire overpayment, the interest payable for the period would have been $1,789.00 (computed as a single element), rather than $1,589.46. On the other hand, if the GATT interest rates applied to the entire overpayment, the interest payable would be only $1,456.46.

Other, relatively minor, GATT interest computational issues exist which may or may not ultimately have to be addressed in litigation or otherwise. Thus, it is not clear whether, after
there has been a tax overpayment in excess of $10,000, a refund of tax in an amount less than the aggregate overpayment first reduces the GATT interest tax base or the normal interest tax base or both. In the absence of other guidance, it would intuitively seem that, if an aggregate tax overpayment in excess of the $10,000 threshold amount is reduced by a tax refund, the result would be that thereafter the amount of the tax overpayment in excess of $10,000 (to which the GATT interest rate applies) would be less. That is to say, where the amount of the overpayment increases and decreases over time, the GATT interest base (the amount over the $10,000 threshold) is the last to come and the first to go – last in, first out. Also, where there is an overpayment less than the $10,000 threshold amount which is refunded before the time when there arose an additional tax payment or other occurrence resulting, at that point in time, in an overpayment also less than $10,000 for the same taxable year, whether the two non-overlapping overpayment amounts would be aggregated to determine whether during any interest period there would be deemed to be a tax overpayment in excess of the threshold amount, resulting in GATT interest on the deemed excess amount. In the absence of other guidance, it would seem that the lower GATT interest rates would be applicable to compute current interest on tax overpayments in excess of the $10,000 threshold amount only for interest periods during which such an excess amount actually exists.

It is unfortunate that the enactment of the GATT interest provision was done in such a way that it introduced so many new complexities to a field that was already overly complex. The Service’s change of position in SCA 1998-014 only added to the areas of potential controversy that will have to be resolved over a period of time.

**Interest Netting**

From the very outset, Congress recognized that the creation of interest rate differentials by the Tax Reform Act of 1986 necessitated some liberal interest netting rules.\(^{74}\) However,

\[^{74}\] When the interest rate differential was first prescribed, section 1511(b) of the Tax Reform Act of 1986 provided that the Secretary of the Treasury may issue regulations to “coordinate” section 6621 [which prescribes the interest rates] with section 6601(f) [which provides for the computation of interest where a tax is satisfied by credit of an overpayment] for the period ending 3 years after the date of enactment of the Act. The Senate Report on the bill states that, by the latter date, “the committee expects that the IRS will have implemented computerized netting procedures,” and the Conference Report states that, by that date, “the IRS should have implemented the most comprehensive netting procedures that are consistent with sound administrative practice.” S. Rep. 99-313, p 185; H. Conf. Rep. 99-841, p. II-785.

When section 6621(c) (providing for “hot interest”) was added to the Code by the Omnibus Budget Reconciliation Act of 1990, the Conference Report on the bill stated that the Secretary “should implement the most comprehensive crediting procedures ... that are consistent with sound administrative practice.” H. Conf. Rep. 101-964, p. 1101.

Then, when the “GATT interest” was prescribed in the flush material at the end of section 6621(a)(1) by section 713(a) of the Omnibus Budget Reconciliation Act of 1993, Congress again instructed the Secretary of the Treasury to implement such regulations, adding that the IRS “should do so as rapidly as is practicable.” H. Rep. 103-826, p. 178.
Global interest netting has proved highly elusive. Prior to the enactment of a provision specifically authorizing interest netting, if the timing of the determination of an overpayment could be managed to match the determination of an underpayment, and if the IRS is willing to cooperate by applying the overpayment in satisfaction of the underpayment, a form of interest netting could be achieved. In the case of such netting, the result is the same as though the higher underpayment rate were applied to the overpayment that is used to satisfy the underpayment liability. With an interest rate differential as high as 4.5 percent, a substantial interest saving may be effected.\(^ {75} \)

However, prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, it was critical that neither the overpayment nor the underpayment be satisfied by payment rather than by crediting. Thus, in Northern States Power Co. et al v. United States, 73 F.3d 764 (8th Cir. 1996), it was held that a prior payment of an underpayment (with interest) -- thereby extinguishing the liability for the underpayment -- precluded the application of an overpayment in satisfaction of the liability that had been extinguished by such payment. Consequently, the court held that it was not possible to apply a credit under section 6601(f) to obtain the benefit of netting. If netting were possible, the court said that the taxpayer would have been entitled to an additional $460,000.

Global interest netting that is not so restricted was provided by the enactment of section 6621(d), by P.L. 105-206, which provides, in effect, that to the extent that, for any period, interest is payable on an underpayment in respect of any internal revenue tax and is allowable on an overpayment in respect of such a tax, on equivalent underpayments and overpayments of such taxes by the same taxpayer, the net rate of interest on such amounts is zero for such period. Thus, where such offsetting obligations exist, there should be “interest netting” that will eliminate the interest rate differential between the interest rate otherwise payable on underpayments of tax and the lower interest rate otherwise allowable on overpayments of tax. Nevertheless, there are many complex facets to this seemingly simple provision.

The general effective date for the new interest netting provision is for interest periods beginning after July 22, 1998, the date of enactment of P.L. 105-206. Thus, in general, the provision is prospective only in its effect. However, the effective date provision contains a “special rule” that provides for retroactive application of the new interest netting rules under specified limited circumstances. Because qualification for such retroactive application of the interest netting might provide a substantial benefit, it is essential that care be taken to avoid the possible loss of such an opportunity.

After amendment by section 4002(d) of the Tax and Trade Relief Extension Act of 1998, P.L. 105-277, the “special rule” provides that, subject to any applicable statute of limitations not

\(^ {75} \) In an instance in which the author was involved, an interest saving amounting to a number of million dollars was effected by arranging to have an overpayment resulting from a settlement of a suit for refund credited to a deficiency which was agreed to administratively.
having expired with regard to either a tax underpayment or a tax overpayment, the new interest netting rules may apply to interest for periods beginning before July 22, 1998, if the taxpayer --

(A) reasonably identifies and establishes the periods of such tax overpayments and underpayments for which the zero rate applies, and

(B) not later than December 31, 1999, requests the Secretary of the Treasury to apply section 6621(d), as enacted by P.L. 105-206, to such periods.

Thus, taxpayers which have overlapping underpayments and overpayments of tax for the same interest periods may be entitled to have the retroactive application of the benefits of interest netting, subject to certain conditions.


The Internal Revenue Service has firmly taken the position that, for retroactive interest netting to be available, the relevant statutes of limitations for both the underpayment year and the overpayment year must have been open on July 22, 1998, the date of enactment of the legislation adding section 6621(d) to the Code. The applicable statute of limitations for the underpayment year is that for the refund of underpayment interest that is provided in section 6511, relating to the refund of an overpayment of tax (which section 6601(e) makes applicable to a refund of an overpayment of underpayment interest). In general, that period of limitations is 3 years from the time the relevant tax return was filed or 2 years from the time the tax was paid, whichever of such periods expires later, subject to extension in accordance with section 6511(d) in the case of an agreement to extend the limitations period for assessment of a tax (under which the refund period expires 6 months after the expiration of the period within which and assessment may be made pursuant to such agreement). The applicable statute of limitations for the overpayment year is that for the filing of a suit for additional overpayment interest provided in 28 U.S.C sections 2401 and 2501. That period of limitations is 6 years from the time the claim for such additional overpayment interest first accrues, which has been interpreted to be the date on which the Commissioner or his delegate signs the schedule on which the overpayment is listed.76

76 See Rev. Rul. 56-506, 1956-2 C.B. 959; Rev. Rul. 56-574, 1956-2 C.B. 959; Rev. Rul. 57-242, 1957-2 C.B. 452; and General Instrument Corp. v. United States, 33 Fed. Cl. 4 (1995). It has been said that the filing of a claim for additional overpayment interest does not stop the running of the 6 year period and that the only method in which a taxpayer can fully protect its rights to such additional overpayment interest is by filing a civil suit against the United States prior to the termination of such 6 year period. Rev. Rul. 57-242, supra. There is no indication that such 6-year period can be extended by mutual agreement.
Thus, Rev. Proc. 99-43 reiterates the IRS’s position that, for retroactive interest netting to be available, both such statutes of limitations must not have expired on July 22, 1998 (the date the statute was enacted), but it for the first time also attaches significance to what statute of limitations, if any, expired before the request for retroactive interest netting is filed.77

Although the public law enacting section 6621(d) provides for retroactive application of that provision where, among other things, not later than December 31, 1999, the taxpayer requests the application of that provision, Rev. Proc. 99-43 qualifies that condition by providing that a taxpayer must file such a request by December 31, 1999, only if both the applicable statutes of limitations (i.e., for additional interest on the relevant overpayment and for a refund of the interest paid on the relevant underpayment) -- which must have been open on July 22, 1998 for the taxpayer to be entitled to retroactive interest netting -- will have expired on or before December 31, 1999.

If both of the applicable statutes of limitations had not expired on July 22, 1998, but both such statutes will have expired on or before December 31, 1999, then the request for retroactive interest netting must be filed by December 31, 1999. If the request is not filed by December 31, 1999, in such a case, the right to retroactive interest netting will have been lost.

On the other hand, if both applicable statute of limitations were open on July 22, 1998 and at least one of the applicable statutes of limitations will remain open after December 31, 1999, the Rev. Proc. states that the taxpayer need not take any action on or before December 31, 1999, to be able to qualify for retroactive interest netting. In such a situation, the taxpayer must file the request for retroactive interest netting before the date on which the last applicable statute of limitations closes. However, (for the reason discussed below) it may nevertheless be advisable for the taxpayer to file the request for retroactive interest netting on or before the later of December 31, 1999, or the last day before the date on which the applicable statute of limitations for a refund of interest on the relevant underpayment expires.

A different (and possibly less advantageous) interest netting computation under the terms of the Rev. Proc. may result if the netting request is filed at a time when the only open statute of limitations is the overpayment statute. The Rev. Proc. provides that interest netting will be accomplished in one of two ways, depending on which statute of limitations is open at the time the request for netting is filed. If either (a) both applicable statutes of limitations are open at the time the request for netting is filed or (b) both statutes of limitations were open on July 22, 1998, and the request for netting was filed either on or before December 31, 1999, or before the statute

77 In Federal National Mortgage Association v. United States, ___ F.3d ___ (Fed. Cir. 8/12/04), the Court of Appeals, reversing a decision by the United States Court of Federal Claims, upheld the requirement of Rev. Proc. 99-43 that both statutes of limitations must not have expired on July 22, 1998 for there to be retroactive interest netting. The court acknowledged that the statute and the legislative history was ambiguous on the point, but it held for the government on the ground that permitting interest netting involved a waiver of sovereign immunity (authorizing claims against the government to recover interest paid) which must be strictly construed and that the waiver had not been “unambiguously expressed.”

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of limitations for refunding underpayment interest expired then the Service will achieve the required net rate of zero by decreasing the underpayment interest owed by the taxpayer. On the other hand, if the request for netting is filed after December 31, 1999, and, although both applicable statutes of limitations were open on July 22, 1998, at the time the request for netting is filed the statute of limitations for refunding underpayment interest is closed but the statute of limitations for payment of additional overpayment interest is open, then the Service will achieve the required net rate of zero by increasing the overpayment interest owed to the taxpayer. The result in the two situations may be different.

Whether interest netting is accomplished by the mechanism of reducing the underpayment interest owed by the taxpayer (the Service’s general rule) or by increasing the overpayment interest owed to the taxpayer (the Service’s secondary rule) -- or by netting the offsetting liabilities, thereby reducing both interest rates to zero, a mechanism not mentioned in the Rev. Proc. -- will have a bearing on the computation of interest for periods after the overlap period. If there continues to be an underpayment after the overlap period and if, as a result of the interest netting, underpayment interest is reduced during the overlap period, compound underpayment interest (interest on interest) computed for periods after the overlap period will also be reduced. That post-overlap compound underpayment interest may include “hot interest,” which the taxpayer would like to keep to a minimum.

On the other hand, if as a result of the interest netting, overpayment interest is increased during the overlap period, there may be a question whether the additional overpayment interest for the overlap period can be treated as earning additional post-overlap interest (interest on the additional interest) or whether any such post-overlap interest could be secondarily netted against any post-overlap underpayment interest to eliminate any post-overlap period interest rate differential. First, there may be a question as to whether there is any provision for post-overlap interest on the additional overpayment interest for the overlap period resulting from the netting. Both section 6611 of the Code and 28 U.S.C. §2411 (providing for interest in connection with a court judgment in respect of any internal-revenue tax) speak in terms of an “overpayment” and a “refund.” However, literally any additional overpayment interest owed to the taxpayer as a result of interest netting does not appear to constitute an “overpayment” and payment of the additional overpayment interest would not appear to constitute a “refund.” Furthermore, even if there can be some post-overlap interest on the additional overpayment interest for the overlap period resulting from netting, there may be a problem in achieving secondary netting of such post-overlap interest against any post-overlap underpayment interest, because section 6621(d) speaks of netting where interest is allowable on an overpayment of a “tax,” and the additional overpayment interest for the overlap period may not be deemed a “tax” for this purpose. Thus, where interest netting is achieved by increasing the overpayment interest for the overlap period, there might be an un-nettable interest rate differential between the unchanged post-overlap underpayment interest and any post-overlap interest on the additional overpayment interest for the overlap period resulting from the interest netting.

78 Such post-overlap interest could be justified on the ground that section 6622 requires that such overpayment interest must continue until the interest is fully paid. See p. 7, supra.
To avoid having to address such questions, a taxpayer for whom both applicable statutes of limitations were open on July 22, 1998, may be well advised to file the request for retroactive interest netting on or before the later of (1) December 31, 1999, or (2) the last day before the date the statute of limitations for a refund of underpayment interest would expire. In that circumstance, Rev. Proc. 99-43 would call for the netting to be accomplished by reducing the underpayment interest (not increasing the overpayment interest). Where the unnetted underpayment interest has previously been paid, such a reduction will result in an overpayment of the underpayment interest. Because section 6601(e)(1) provides that (with an exception not applicable here) any reference in the Code to any tax imposed by the Code shall be deemed also to refer to any underpayment interest on such tax, it is clear that an overpayment of underpayment interest resulting from the decrease in such underpayment interest, both during the overlap period and thereafter, due to the netting process is equivalent to an overpayment of tax that must be refunded or credited, and that the taxpayer will be entitled to interest on such overpayment pursuant to section 6611 for the period starting with the date the excessive underpayment interest was paid by the taxpayer.

This leads to a problem with the example found in Section 6 of Rev. Proc. 99-43. Examples 1 and 2 are substantially the same as the examples in Rev. Proc. 99-19. Examples 3 and 4 are new, but they both have the same problem as does Example 1, namely that they do not take account of the effect of netting for the overlap period on the amount of interest for any post-overlap interest period. Examples 1, 3, and 4 all seem to suggest that the amount to be paid to the taxpayer as a result of the netting is simply the difference between the amount of interest originally computed for the overlap period on the offsetting amount and the amount of interest for the overlap period on the offsetting amount using the alternative rate of interest for that period. This ignores the fact that there was interest originally computed for post-overlap interest periods, including interest on interest for the overlap period, that must be changed as a result of the change of interest for the overlap period.

In conversations with IRS representatives, it has been suggested that the main point intended to be illustrated by the examples in Rev. Proc. 99-43 is the effect of the running of the statute of limitations on the entitlement to, and netting mechanism to be used for, retroactive interest netting, and that such examples were not intended to specify the amount to be paid to the taxpayer in the circumstances described in the examples. For instance, in Example 1 the interest paid by the taxpayer on May 12, 1998, for the period from July 29, 1997 (the end of the overlap period) to May 3, 1998 (the end of the underpayment interest period) included compounded interest on the unnetted interest amount that accrued during the overlap period. If the interest netting mechanism results in a decrease of underpayment interest owed by the taxpayer for the overlap period, the interest owed by the taxpayer for the post-overlap period should also decrease. Therefore, in such circumstances the amount to be refunded to the taxpayer should be greater than the amount specified in the example (an amount equal to the difference between the underpayment interest paid by the taxpayer on the $30,000 offsetting amount for the overlap period and the overpayment interest computed and paid by the IRS on that amount for the overlap period), and the amount paid by the taxpayer on May 12, 1998 would result in an

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overpayment of underpayment interest that bears overpayment interest under section 6611 from the date of such payment. It is unfortunate that the examples do not address this point, because the language in the examples may be taken literally by IRS personnel making retroactive interest netting computations or verifying a taxpayer’s calculations.

Rev. Proc. 2000-26, 2000-1 C.B. 1257, provides guidance for applying section 6621(d) to interest accruing on or after October 1, 1998. Undoubtedly there will be questions that will arise in such prospective as well as the retroactive implementation of the new netting procedures. Of course, where a taxpayer has a contemporaneous overpayment and underpayment, the netting amount for any given interest period will be the smaller of the amount of the overpayment or the amount of the underpayment during that period. There will almost inevitably be something left over (either an underpayment or an overpayment) after the netting. For example, if a corporation, for the same interest period, has both an amount of underpayment and a smaller amount of overpayment (so there will be some underpayment left over after the netting), and if the overpayment (prior to netting) is subject in part to the lower GATT overpayment interest rates and in part to the normal interest rates, it would seem appropriate that, where the underpayment interest rate is to be reduced to the overpayment rate, the underpayment interest rate should first be reduced to the GATT interest rate for an underpayment amount equal to the GATT overpayment interest base and thereafter the underpayment interest rate should be reduced the normal overpayment interest rate for an underpayment amount equal to the normal overpayment interest base. In such a situation, for the offset period the pre-netting underpayment interest rate (either the normal underpayment interest rate or the “hot interest” rate, as the case may be) would be applicable only to the balance of the underpayment. Thus, as many as three different interest rates could be applicable to a given interest period. Furthermore, the netting should first be applied where the interest rate differential is greatest.

Similarly, it would seem appropriate that if, for the same interest period, a corporation had both an underpayment subject to normal underpayment interest rates and (for another taxable year) an underpayment subject to “hot interest” rates, and an overpayment smaller than the two underpayment amounts, the overpayment interest rate should be used to replace the “hot interest” rate first to the extent of the base to which the “hot interest” was applicable and should be used to replace the normal underpayment interest rate only to the extent the overpayment interest base exceeded the “hot interest” base. Again, this would be a case where the netting should first be applied where the interest rate differential is greatest.

Finally, there is the question whether netting may be applied for an interest period when there is underpayment interest for an underpayment of tax and, for the same period, there is an overpayment of tax for which no interest is allowed because of a “45-day” rule exception under

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79 For example, the final determination of the existence of both the underpayment and the overpayment may occur at different times, as a result of which interest computations previously done on one may have to be re-done after the determination of the other. It may be necessary to take steps to keep a statute of limitations open until both determinations are final.
The IRS has stated that Rev. Proc. 2000-26, supra, “does not apply” in such circumstances (presumably meaning that netting under such circumstances would not be permitted). However, such a result would seem to run counter to the “use of the money” principle originally enunciated in Manning v. Seeley Tube & Box Co., supra, and applied in May Department Stores, supra, which provided the basis for the IRS’s change of position in Rev. Rul. 99-40, supra.

Restricted Interest

When an underpayment of income tax that otherwise would be due is reduced or eliminated because of a carryback of a loss or a credit, special interest computation rules come into play. The underpayment that is eliminated by the carryback is sometimes referred to as an “extinguished deficiency” or a “potential deficiency.” Notwithstanding that the tax underpayment extinguished by the carryback does not have to be paid, interest is payable on the extinguished deficiency. Such interest is sometimes referred to as “restricted interest.”

The concept of interest on a “potential deficiency” originated before the Code expressly provided for such interest, as it now does. It came about because the Code did provide that interest on an overpayment resulting from a carryback did not start to run until the taxpayer became entitled to the carryback at the end of the carryback year, and it seemed equitable to charge a taxpayer who had underpaid his tax with interest on the underpayment extinguished by the carryback if another taxpayer who had not underpaid his tax could not get interest on a refund attributable to a carryback prior to the end of the carryback year. The Supreme Court so held in Manning v. Seeley Tube & Box Co.

80 See p. 17, supra.

81 Rev. Proc. 2000-26, Sec. 3.02(3).

82 See pp. 11-12, supra.

83 As noted above, such restricted interest is a sub-type of assessed interest. The term “restricted interest” has also been applied to any interest, both interest on underpayments and interest on overpayments, as to which there are special provisions in law which limit or prohibit such interest. See Rev. Rul. 60-17, 1960-2 C.B. 942, 943. In this article, however, the term “restricted interest” is limited to interest payable on a deficiency extinguished by a carryback.

To facilitate the computation of restricted interest, the IRS typically prepares a Form 2285 for each taxable year involving such interest. As completed, the form shows the amount of the original underpayment and the amount at each stage when the amount of such underpayment changes.

84 338 U.S. 561 (1950). The same concept was applied in Koppers Co. v. United States, 348 U.S. 254 (1955), involving a “potential deficiency” in World War II excess profits taxes that was eliminated by a determination that the taxpayer was entitled to use a constructive average base period net income under section 722 of the 1939 Code to determine what was the amount of “excess profits” subject to the tax. Unlike a carryback that arises only as a result of events in a subsequent period, the section 722 determination related to the tax period in which the deficiency arose. But the Supreme Court concluded that interest should be paid on the “potential deficiency” because a refund of an overpayment resulting
This concept that interest should be paid on such an “extinguished deficiency” was substantially codified by the enactment of section 6601(e) (subsequently redesignated section 6601(d) by P.L. 93-625) as part of the original Internal Revenue Code of 1954.

Until the enactment of TEFRA, interest on such an “extinguished deficiency” ran to the end of the taxable year in which the carryback arose.\textsuperscript{85} Currently, and for interest accruing after October 3, 1982, the interest generally runs to the filing date (determined without regard to extensions) for the return for the taxable year in which the carryback arose.\textsuperscript{86} Thus, for example, a calendar year corporation that filed its 1984 income tax return showing less tax than was actually owed, and which subsequently had a loss in 1987 that was carried back to 1984, thereby extinguishing the previously-existing 1984 deficiency, would owe restricted interest on the extinguished deficiency from March 15, 1985 to March 15, 1988.

At one point it appeared that, contrary to the general rule currently applicable to the computation of restricted interest on a deficiency extinguished by a carryback, interest on a deficiency extinguished by a carryback of a foreign tax credit arising in taxable years beginning before August 6, 1997, might be governed by the pre-TEFRA rule. Thus, the Court of Appeals for the Federal Circuit, after reversing the United States Court of Federal Claims on the basic question in issue -- whether a foreign tax credit carryback that eliminates a tax underpayment also eliminates interest on the underpayment -- held that the accrual of interest should stop as of the end of the taxable year in which the foreign tax credit became available, not the filing date for the return for such year.\textsuperscript{87} On the other hand, the Tax Court and subsequently the Court of Appeals for the Fifth Circuit reached the opposite conclusion, holding that underpayment interest runs to the filing date of the return.\textsuperscript{88} Section 1055 of the Taxpayer Relief Act of 1997, P.L. 105-34, amended section 6601(d) of the Code to provide that the interest period runs to the filing date for the carryback year (corresponding to the rule applicable to a net operating loss or a capital loss carryback), but that amendment applies only to foreign tax credit carrybacks arising in a taxable year beginning after the effective date of the Act (i.e., August 5, 1997).

\textsuperscript{85} Section 6601(d)(1) of the Code prior to its amendment by TEFRA.

\textsuperscript{86} Section 6601(d) of the Code.


\textsuperscript{88} \textit{Intel Corporation v. Commissioner}, 111 T.C. 90 (1998); \textit{Dresser Industries, Inc. v. United States}, 238 F.3d 603 (5th Cir. 2001). In \textit{Hallmark Cards, Inc. v. Commissioner}, 111 T.C. 266 (1998), the Tax Court denied taxpayer’s effort to withdraw a pre-\textit{Intel} decision motion to redetermine interest in a case involving a foreign tax credit carryback and reasserted the position it had taken in the \textit{Intel} case that underpayment interest runs to the filing date of the return. See also, \textit{Guardian Industries Corp. v. United States}, 2001-1 USTC ¶ 50,123 (E.D. Mich. 1999).
A unique situation arises with respect to restricted interest for a period before December 31, 1982, for a taxable year for which there is also an overpayment before that date. Prior to 1983, the Code provided that interest was not to be charged on interest. Consequently, there was no interest on restricted interest prior to 1983. After compound interest was required for periods after 1982, Rev. Proc. 83-7, supra, prescribed that all tax, assessed penalty or addition to tax, and interest (whether or not assessed) was to be added together to determine the amount to be carried over on which daily interest would be charged under the compounding rules. It would seem clear that any pre-1983 payment of assessed interest would be an overpayment of assessed interest only to the extent such payment exceeded the assessed interest owed, including the restricted interest. Similarly, if there were not an overpayment of assessed interest, any restricted interest due in excess of the assessed interest paid should be offset against the overpayment of tax, and compound interest on the net overpayment (i.e., the overpayment reduced by the restricted interest due) would be computed for the period after 1982. If there were such a net overpayment, there would be no interest on the restricted interest for the period after 1982.

Other Special Circumstances

1. Interest at Reduced Underpayment Rates

In lieu of the underpayment interest rates set in section 6621, section 6601(j) currently provides for reduced rates of interest of 2 percent rate in some instances or a rate that is 45 percent of the normal underpayment rates in other instances on specified portions of an estate tax extended as provided in section 6166. The current provision applies to estates of decedents

89 Such an overpayment could arise in various ways, such as (1) the carryback was sufficiently large that it not only extinguished the initial deficiency, but also created an overpayment or (2) the carryback was not large enough to extinguish the initial deficiency, but thereafter (and before 1983) tax and assessed interest was paid in an amount ultimately determined to be more than was due.

90 Section 6601(e)(2) prior to the enactment of TEFRA, applicable to interest accruing after December 31, 1982. The prohibition of interest on interest came with the enactment of the 1954 Code; under the 1939 Code, if assessed interest were not paid within 10 days of notice and demand, interest was charged on such assessed interest from the date of notice and demand. Section 294(b) of the 1939 Code.

91 Rev. Proc. 83-7, supra, Sec. 3.02-2.

92 Of course, if the restricted interest due on December 31, 1982 exceeded the overpayment of tax plus statutory interest thereon to that date, such excess would be a net underpayment subject to compound interest after 1982, and there would be no statutory interest on the overpayment after 1982.

93 Section 6601(j) as amended by Sec. 501(e) and Sec. 503 of the Taxpayer Relief Act of 1997, P.L. 105-34. Sec. 503(b) of that law amended other Code provisions so that no deduction is allowed for estate or income tax purposes for interest payable under section 6601(j) as so amended.
dying after 1997. Under prior law, section 6601(j) provided for a different reduced underpayment rate of interest (4 percent) applicable to certain estate tax amounts payable pursuant to such extensions of time for payment and to certain extensions of time in the case of tax attributable to recoveries of certain expropriation losses.

2. **Estimated Tax Penalties**

   Section 6622(b) provides that the requirement for the daily compounding of interest after December 31, 1982 does not apply for purposes of computing the penalty under section 6654 or section 6655 for underpayment of estimated tax. Simple interest computations are required for these purposes. The “period of underpayment” under section 6654 or section 6655 (i.e., the penalty period) runs from the due date for the installment of estimated tax to the earlier of (1) the date of payment or (2) the 15th day of the fourth month (for individuals) or the 15th day of the third month (for corporations) following the close of the taxable year. Thus, the penalty period can never exceed one year.

   Section 6621(b)(2)(B) provides that, for purposes of computing the penalty under section 6654 for individuals (but not the penalty under section 6655 for corporations), the rate in effect for the third month after the end of the taxable year will be applied for the first 15 days of the fourth month (i.e., the final 15 days of the period for which the penalty can apply). For most individuals -- those using a calendar taxable year -- this means that the rate in effect for March will be applicable for the first 15 days of April.

3. **Interest on Substantial Underpayments Attributable to Tax Motivated Transactions**

   Section 6621(c) of the Code, as applicable to returns the due date for which (determined without regard to extensions) is before January 1, 1990, provides for interest at 120% of the normally applicable rate in the case of interest accruing after December 31, 1984 on a “substantial underpayment” attributable to a “tax motivated transaction” as defined by section 6621(c)(3)(A). A “substantial underpayment” for this purpose is an underpayment which exceeds $1,000. Under applicable law for this purpose, a “tax motivated transaction” meant --

   A. any valuation overstatement (within the meaning of then section 6659(c)),

   B. any loss disallowed by reason of then section 456(a) (limiting certain losses to the amount “at risk”) and any credit disallowed under then section 46(c)(8) (limiting the investment credit in the case of “nonqualified nonrecourse financing”).

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94 Section 6621(c) of the Code was repealed by section 7721(b) of the Omnibus Budget Reconciliation Act of 1989, P.L. 101-239, but, because section 7721(d) provides that the repeal applies only with respect to returns the due date for which is after December 31, 1989, the provisions discussed below continue to apply after 1989 with respect to returns due before 1990.
C. any “straddle” (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

D. any use of an accounting method specified in Treasury regulations as a use which may result in a substantial distortion of income,

E. any sham or fraudulent transaction, and

F. other types of transactions which may be specified in the Treasury regulations as “tax motivated” for purposes of this provision, with a later specified effective date.

Neither Rev. Proc. 95-17 nor Rev. Proc 83-7 provides tables of compound interest factors for interest at 120% of the normally applicable rates, so some sort of computer program to compute such interest is essential.\(^{95}\)

4. **Special Interest Provisions Outside the Code**

Special provisions relating to the computation of interest may be outside the Internal Revenue Code. For example, Rev. Proc. 60-17\(^{96}\) identifies a number of provisions where a public law enacting a provision added to the Code will specify a limitation on interest related to such provision and where such limitation does not become a part of the Code.\(^{97}\) In such situations, therefore, it is important to be aware of the special interest provisions that do not appear in the Code.

**Illustrative Examples**

The following examples may be helpful in illustrating the rules and concepts discussed above:\(^{98}\)

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\(^{95}\) The formula referred to in footnote 63, *supra*, can be used to compute the appropriate interest factor, using 120% of the normal underpayment rate for the \(r\) factor and the number of days in the interest period for the \(d\) factor (the exponent in the formula). However, the thought of manually (i.e., without a computer) making a computation using an exponent consisting of the number of days in an extended interest period is daunting.

\(^{96}\) 1960-2 C.B. 942.

\(^{97}\) An illustration of this is section 3(i) of P.L. 86-69, the Life Insurance Company Income Tax Act of 1959, which provided that all payments made prior to September 15, 1959, with respect to 1958 income tax liabilities shall be deemed to be payments on that date, as a result of which no interest was payable on any underpayment or overpayment of 1958 income tax liabilities prior to that date.

\(^{98}\) For the convenience of users of the author’s TAXINT program, the illustrations here use the interest factors prescribed in Rev. Proc. 95-17, 1995-1 C.B. 556, which are to apply to all computations made after 1994 (including computations for periods before 1995). The very slightly different interest factors prescribed in Rev. Proc. 83-7, 1983-1 C.B. 583, continue to apply to all interest computations made on or
1. **Simple underpayment**

A calendar-year corporation reported and paid tax of $1,546,378 for 1978. On audit, the correct tax liability was determined to be $1,637,321. A Form 870 was filed on April 19, 1983. Notice and demand was issued August 5, 1983, showing a tax due of $90,943 and assessed interest due of $51,717.58; the tax and assessed interest was paid on August 12, 1983. The assessed interest was correctly computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base amount (tax deficiency)</td>
<td>$90,943.00</td>
</tr>
<tr>
<td>Interest period:</td>
<td>3/15/79 - 5/19/83</td>
</tr>
<tr>
<td>Assessed interest due</td>
<td>$51,717.56$^{99}$</td>
</tr>
</tbody>
</table>

2. **Relatively simple overpayment**

A calendar-year corporation paid an estimated tax of $2 million for taxable year 1982; the tax return filed on March 10, 1983, reported a tax liability of $1,937,678, and a refund of the overpayment was requested. A refund of $62,322 was paid on April 28, 1983, without interest. A claim for refund was filed on May 23, 1985; the correct tax liability was determined to be $1,875,798. A check dated September 23, 1985, in the amount of $83,125.63 is delivered to taxpayer.

Verification determines that the check is in the appropriate range, representing a tax refund of $61,880 and statutory interest of $21,245.63. Statutory interest was computed to August 30, 1985, which is within 30 days of the date of the refund check, as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base amount (tax overpayment)</td>
<td>$61,880.00</td>
</tr>
<tr>
<td>Interest period:</td>
<td>3/15/83 - 8/30/85</td>
</tr>
<tr>
<td>Total payment</td>
<td>$83,125.63</td>
</tr>
</tbody>
</table>

3. **Payment of disputed deficiency and subsequent refund**

A calendar-year corporation reported and paid tax of $3,678,945 for 1978. On audit, a deficiency of $2,037,678 was asserted and a Form 870 for that amount was filed on before December 31, 1994.

$^{99}$ The interest period is from the due date of the return to the date 30 days after the Form 870 was filed. Appendix B hereto is a replication of the computer-generated backup made by the TAXINT program, showing the computation of the assessed interest for this illustration. The period for this illustration was picked so the backup would show the computation of simple interest on the month-day method, daily simple interest, and daily compound interest after 1982. The total of the amounts computed under each of those methods is the aggregate assessed interest due in Illustration 1. Similar computations would have to be made for each of the interest periods in the illustrations that follow.
August 24, 1983. The amount of the asserted deficiency was shown on a notice and demand dated October 6, 1983, together with assessed interest erroneously computed as $1,368,397.58 (it should have been computed as $1,302,638.76), and those amounts were paid on October 12, 1983. A claim for refund was filed on January 15, 1984. The correct tax liability was determined to be $4,327,739. A check dated March 22, 1986 in the amount of $3,073,287.56 is delivered to the taxpayer.

Verification determines that the amount of the check was correctly computed, as follows:

Tax overpayment on 10/12/83:
- Tax paid with return: $3,678,945.00
- Asserted deficiency: $2,037,678.00
- Total tax paid: $5,716,623.00
- Correct tax liability: $4,327,739.00
- Overpayment of tax: $1,388,884.00

Assessed interest overpayment on 10/12/83:
- Correct tax liability: $4,327,739.00
- Tax paid with return: $3,678,945.00
- Correct deficiency: $648,794.00
  (Base amount for computation of assessed interest)
- Interest period: 3/15/79 - 9/23/83
- Correct assessed interest: $414,758.47
- Assessed interest paid: $1,368,397.58
- Overpayment of assessed interest: $953,639.11

Statutory interest on overpayment:
- Tax overpayment: $1,388,884.00
- Assessed int. overpayment: $953,639.11
- Total (Base amount): $2,342,523.11
- Interest period: 10/12/83 - 3/5/86
- Statutory interest: $730,764.45

Refund check:
- Refund of tax: $1,388,884.00
- Refund of assessed int.: $953,639.11
- Statutory interest: $730,764.45
- Total: $3,073,287.56

The statutory interest was computed to a date within 30 days of the date of the refund check.
4. **Deficiency with restricted interest**

A calendar-year corporation reported and paid a tax of $2,573,728 for 1983. In 1986, it had a net operating loss shown on a timely-filed return that is carried back to 1983. On audit of the 1983 tax return, it was determined that there was a tax deficiency for 1983 of $543,276 taking account of the 1986 loss carryback to 1983, and that the deficiency would have been $728,716 if it were not for the 1986 loss carryback. A Form 870 for the $543,276 deficiency was filed on July 24, 1987, and the notice and demand was thereafter issued on September 30, 1987. The notice and demand should be for the tax deficiency of $543,276 and assessed interest of $308,503.86, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base amount for restricted interest:</td>
<td></td>
</tr>
<tr>
<td>Deficiency without carryback</td>
<td>$728,716.00</td>
</tr>
<tr>
<td>Deficiency after carryback</td>
<td>$543,276.00</td>
</tr>
<tr>
<td>Extinguished deficiency</td>
<td>$185,440.00</td>
</tr>
<tr>
<td>Total</td>
<td>$1,457,432.00</td>
</tr>
<tr>
<td>Interest period:</td>
<td>3/15/84 - 3/15/87</td>
</tr>
<tr>
<td>Restricted interest</td>
<td>$70,071.16</td>
</tr>
<tr>
<td>Interest on restricted interest</td>
<td>$2,837.33</td>
</tr>
<tr>
<td>Base amount for regular interest (tax deficiency)</td>
<td>$543,276.00</td>
</tr>
<tr>
<td>Interest period:</td>
<td>3/15/84 - 8/23/87</td>
</tr>
<tr>
<td>Regular assessed interest</td>
<td>$235,595.37</td>
</tr>
<tr>
<td>Total assessed interest</td>
<td>$308,503.86</td>
</tr>
</tbody>
</table>

5. **More complex situation -- combination of restricted interest on extinguished deficiency and successive overpayments prior to 1983**

A calendar-year corporation reported and paid a tax of $2,508,630 for 1973. In 1976, it had a net operating loss shown on a timely-filed return that is carried back to 1973. On audit of the 1973 return, a deficiency was asserted for 1973 in the amount of $273,528 (without regard to the loss carry-back from 1976, which had not yet been audited). That deficiency and assessed interest in the amount of $59,423.65 was paid on April 28, 1977 simultaneous with the filing of a Form 870 with respect to such payment. A claim for refund for 1973 was filed, and it was subsequently determined that the correct 1973 tax
liability, before the 1976 loss carryback, was $2,683,720 and that the correct tax after giving effect to the loss carryback was $2,467,926. The statutory interest on the refund was computed to August 24, 1988 with a view to issuance of the check within 30 days thereafter.

Although it is not certain how the interest on such a combination of circumstances would be computed, it would seem that the aggregate amount of the payment could be $992,434.69, computed as follows:

Base amount for restricted interest:
  Correct liability before Carryback $2,683,720.00
  Tax paid with return 2,508,630.00
  Initial deficiency $175,090.00
    (Base amount)
  Interest period: 3/15/74 - 12/31/76
    (to end of carryback year, rather than to filing date, because before 10/4/82)
  Restricted interest $34,033.82

Base amount for first overpayment:
  (attributable to entitlement to the loss carryback on 1/1/77)
  Tax paid with return $2,508,630.00
  Correct tax after carryback 2,467,926.00
  Overpayment (Base amount) $40,704.00
  Interest period: 1/1/77 - 12/31/82
    (to end of simple interest period)
  Statutory interest $25,199.68

Base amount for subsequent overpayment:
  Deficiency paid $273,528.00
  Assessed interest paid $59,423.65
  Less restricted
    Interest 34,033.82
  Overpayment of assessed interest 25,389.83
  Total (Base amount) $298,917.83
  Interest period: 4/28/77 - 12/31/82
    (to end of simple interest period)
  Statutory interest $178,279.88

Base amount for net overpayment on 1/1/83:
First overpayment – tax $ 40,704.00
Statutory int. to 12/31/82 25,199.68
Second overpayment – tax 273,528.00
Overpayment of assessed int. 25,389.83
Statutory int. to 12/31/82 178,279.88
Net overpayment on 12/31/82 $ 543,101.39
(Base amount)
Interest period: 12/31/82 - 8/24/88
Statutory interest $ 449,333.30

Aggregate payment:
Refund of tax:
($40,704 + $273,528) $ 314,232.00
Refund of assessed interest 25,389.83
Statutory interest:
($25,199.68 + $178,279.88 + $449,333.30) 652,812.86
Total $ 992,434.69

6. Illustration of effect of netting by crediting an overpayment against an underpayment.

A calendar year corporation files a suit for refund of Federal income taxes and assessed interest previously paid on December 5, 1983, as a result of an audit and asserted deficiencies for 1977 and 1978. In mid-December, 1994, pursuant to a settlement of that litigation, the following amounts become payable to the taxpayer, together with statutory interest from the date of overpayment:

<table>
<thead>
<tr>
<th></th>
<th>1977</th>
<th>1978</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax overpayment</td>
<td>$1,675,333</td>
<td>$1,847,950</td>
</tr>
<tr>
<td>Assessed interest overpayment</td>
<td>1,732,280</td>
<td>1,633,563</td>
</tr>
<tr>
<td>Total overpayment</td>
<td>$3,407,613</td>
<td>$3,481,513</td>
</tr>
</tbody>
</table>

Relatively contemporaneously with the agreement to settle that litigation, the taxpayer agrees to pay a tax deficiency asserted by the Service for 1983 in the amount of $8,683,927. It would be possible for taxpayer to take a refund of the agreed overpayment for 1977 and 1978, together with statutory interest thereon and to pay the asserted deficiency, together with assessed interest. Instead, taxpayer arranged with the Service to have the 1983 deficiency satisfied in part by a credit of the overpayments and interest thereon, in accordance with section 6402 of the Code, and to pay only the balance of the 1983 deficiency in cash, together with the appropriate assessed interest. That
arrangement saved taxpayer $1,552,896 as compared to the cost if both the overpayment and the underpayment were paid in cash on December 15, 1994, computed as follows:

**Result if paid in cash:**

Base amount for overpayments:
- 1977 overpayment $3,407,613.00
- 1978 overpayment $3,481,513.00
- Total (Base amount) $6,889,126.00

Interest period: 12/5/83 - 12/15/94
- Statutory interest if rec’d in cash $11,867,633.14
- Total of tax and interest due taxpayer $18,756,759.14

Base amount for underpayment: $8,683,927.00

Interest period: 3/15/84 - 12/15/94
- Assessed interest if paid in cash $16,151,074.24
- Total of tax and interest due IRS $24,835,001.24

Net amount payable to IRS
- ($24,835,001.24 minus $18,756,759.14) $6,078,242.10

**Result if netted by crediting:**

Base amount for overpayments:
- 1977 overpayment $3,407,613.00
- 1978 overpayment $3,481,513.00
- Total (Base amount) $6,889,126.00

Interest period: 12/5/83 - 3/15/84 (Section 6611(b)(1) of the Code)
- Statutory interest if credited $212,446.65
- Total tax and interest credited $7,101,572.65

Base amount for underpayment:
- Total underpayment $8,683,927.00
- Amount satisfied by credit $7,101,572.65
- Balance payable (Base amount) $1,582,345.35

Interest period: 3/15/84 - 12/15/94
- Assessed interest on balance $2,942,991.43
- Total of tax and interest $4,525,345.78
- (Total amount payable to IRS)

Saving effected by netting
- ($6,078,242.10 minus $4,525,345.78) $1,552,896.32
It can be seen that the saving is the difference between interest at the underpayment rate and interest at the overpayment rate on the amount credited from the due date of the underpayment (except for a 3 cent difference probably due to rounding), as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overpayment amt. credited (Base amount)</td>
<td>$7,101,572.65</td>
</tr>
<tr>
<td>Interest period: 3/15/84 - 12/15/94</td>
<td></td>
</tr>
<tr>
<td>Interest at underpayment rate</td>
<td>13,208,082.84</td>
</tr>
<tr>
<td>Interest at overpayment rate</td>
<td>11,655,186.49</td>
</tr>
<tr>
<td>Difference</td>
<td>$1,552,896.35</td>
</tr>
</tbody>
</table>

That is, the result of netting is as though interest at the underpayment rate (rather than the lower overpayment rate) were paid on the overpayment (including statutory interest to the due date of the underpayment on the overpayment of tax and assessed interest) for the period after the due date of the underpayment.

**Conclusion**

The history of the various methods for computing interest on tax deficiencies and overpayments provides a striking illustration of how the advent of computers has been both a blessing and a curse. It is a blessing in that it enables us to make computations quickly, easily, and accurately that would otherwise be very difficult. On the other hand, it is a curse because the ability to make such computations with computers has encouraged the introduction of complexities into the procedures. Society would simply not tolerate such complexities if computers were not available to do the “grunt work.” Sometimes it seems that the curse outweighs the blessing.

J.V.H.
## Appendix A
### Resumé of interest rates and methods

The prescribed interest rates and methods for interest periods through September 30, 2004, are as follows:

<table>
<thead>
<tr>
<th>Period and Method</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest thru 6/30/75:</td>
<td>6%</td>
</tr>
<tr>
<td>Simple interest - “month-day” method</td>
<td></td>
</tr>
<tr>
<td>Interest from 7/1/75 thru 1/31/76:</td>
<td>9%</td>
</tr>
<tr>
<td>Simple interest - “month-day” method</td>
<td></td>
</tr>
<tr>
<td>Interest from 2/1/76 thru 1/31/78:</td>
<td>7%</td>
</tr>
<tr>
<td>Simple interest - “month-day” method</td>
<td></td>
</tr>
<tr>
<td>Interest from 2/1/78 thru 1/31/80:</td>
<td>6%</td>
</tr>
<tr>
<td>Simple interest - “month-day” method</td>
<td></td>
</tr>
<tr>
<td>Interest from 2/1/80 thru 1/31/82:</td>
<td>12%</td>
</tr>
<tr>
<td>Simple interest - daily method</td>
<td></td>
</tr>
<tr>
<td>Interest from 2/1/82 thru 12/31/82:</td>
<td>20%</td>
</tr>
<tr>
<td>Simple interest - daily method</td>
<td></td>
</tr>
<tr>
<td>Interest from 1/1/83 thru 6/30/83:</td>
<td>16%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
<tr>
<td>Interest from 7/1/83 thru 12/31/83:</td>
<td>11%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
<tr>
<td>Interest from 1/1/84 thru 12/31/84:</td>
<td>11%</td>
</tr>
<tr>
<td>Compound interest (leap year)</td>
<td></td>
</tr>
<tr>
<td>Interest from 1/1/85 thru 6/30/85:</td>
<td>13%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
<tr>
<td>Interest from 7/1/85 thru 12/31/85:</td>
<td>11%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
<tr>
<td>Interest from 1/1/86 thru 6/30/86:</td>
<td>10%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
<tr>
<td>Interest from 7/1/86 thru 12/31/86:</td>
<td>9%</td>
</tr>
<tr>
<td>Compound interest</td>
<td></td>
</tr>
</tbody>
</table>
Normal Interest after 12/31/86 (first differential rates):

<table>
<thead>
<tr>
<th>Compound interest</th>
<th>Underpayment Rate</th>
<th>Overpayment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 1/1/87 thru 9/30/87:</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 10/1/87 thru 12/31/87:</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>From 1/1/88 thru 3/31/88 (leap year):</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>From 4/1/88 thru 9/30/88 (leap year):</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>From 10/1/88 thru 12/31/88 (leap year):</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>From 1/1/89 thru 3/31/89 (non-leap year):</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>From 4/1/89 thru 9/30/89:</td>
<td>12%</td>
<td>11%</td>
</tr>
<tr>
<td>From 10/1/89 thru 3/31/91:</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>From 4/1/91 thru 12/31/91:</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>From 1/1/92 thru 3/31/92 (leap year):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 4/1/92 thru 9/30/92 (leap year):</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 10/1/92 thru 12/31/92 (leap year):</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>From 1/1/93 thru 6/30/94: (non-leap year):</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>From 7/1/94 thru 9/30/94:</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 10/1/94 thru 3/31/95:</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 4/1/95 thru 6/30/95:</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>From 7/1/95 thru 12/31/95:</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 1/1/96 thru 3/31/96 (leap year):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 4/1/96 thru 6/30/96 (leap year):</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 7/1/96 thru 12/31/96 (leap year):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 1/1/97 thru 3/31/98 (non-leap years):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 4/1/98 thru 12/31/98:</td>
<td>8%</td>
<td>7%</td>
</tr>
</tbody>
</table>
Elimination of non-corporate rate differential:

<table>
<thead>
<tr>
<th>Compound interest</th>
<th>Underpayment and Non-Corporate Overpayment Rate</th>
<th>Corporate Overpayment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 1/1/99 thru 3/31/99:</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>From 4/1/99 thru 12/31/99:</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 1/1/2000 thru 3/31/2000 (leap year):</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 4/1/2000 thru 12/31/2000 (leap year):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 1/1/2001 thru 3/31/2001 (non-leap year):</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>From 4/1/2001 thru 6/30/2001:</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>From 7/1/2001 thru 12/31/2001:</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>From 1/1/2002 thru 12/31/2002:</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>From 1/1/2003 thru 9/30/2003:</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>From 10/1/2003 thru 12/31/2003:</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>From 1/1/2004 thru 3/31/2004 (leap year):</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>From 4/1/2004 thru 6/30/2004 (leap year):</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>From 7/1/2004 thru 9/30/2004 (leap year):</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>From 10/1/2004 thru 12/31/2004 (leap year):</td>
<td>5%</td>
<td>4%</td>
</tr>
</tbody>
</table>
Large corporate underpayments (“hot interest”) after 12/31/90 and corporate overpayments of tax in excess of $10,000 (“GATT interest”) after 12/31/94:

<table>
<thead>
<tr>
<th>Period</th>
<th>Large Corporate Underpayment Rate</th>
<th>Over $10K Corporate Overpayment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 1/1/91 thru 3/31/91:</td>
<td>13%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 4/1/91 thru 12/31/91:</td>
<td>12%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 1/1/92 thru 3/31/92 (leap year):</td>
<td>11%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 4/1/92 thru 9/30/92 (leap year):</td>
<td>10%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 10/1/92 thru 12/31/92 (leap year):</td>
<td>9%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 1/1/93 thru 6/30/94: (non-leap year):</td>
<td>9%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 7/1/94 thru 9/30/94:</td>
<td>10%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 10/1/94 thru 12/31/94:</td>
<td>11%</td>
<td>N/A</td>
</tr>
<tr>
<td>From 1/1/95 thru 3/31/95:</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 4/1/95 thru 6/30/95:</td>
<td>12%</td>
<td>7.5%</td>
</tr>
<tr>
<td>From 7/1/95 thru 12/31/95:</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 1/1/96 thru 3/31/96 (leap year):</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 4/1/96 thru 6/30/96 (leap year):</td>
<td>10%</td>
<td>5.5%</td>
</tr>
<tr>
<td>From 7/1/96 thru 12/31/96 (leap year):</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 1/1/97 thru 3/31/98 (non-leap years):</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 4/1/98 thru 12/31/98:</td>
<td>10%</td>
<td>5.5%</td>
</tr>
<tr>
<td>From 1/1/99 thru 3/31/99:</td>
<td>9%</td>
<td>4.5%</td>
</tr>
<tr>
<td>From 4/1/99 thru 12/31/99:</td>
<td>10%</td>
<td>5.5%</td>
</tr>
<tr>
<td>From 1/1/2000 thru 3/31/2000 (leap year):</td>
<td>10%</td>
<td>5.5%</td>
</tr>
<tr>
<td>From 4/1/2000 thru 12/31/2000 (leap year):</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Period</td>
<td>Large Corporate Underpayment Rate</td>
<td>Over $10K Corporate Overpayment Rate</td>
</tr>
<tr>
<td>--------------------------------------------</td>
<td>-----------------------------------</td>
<td>-------------------------------------</td>
</tr>
<tr>
<td>From 1/1/2001 thru 3/31/2001 (non-leap year):</td>
<td>11%</td>
<td>6.5%</td>
</tr>
<tr>
<td>From 4/1/2001 thru 6/30/2001:</td>
<td>10%</td>
<td>5.5%</td>
</tr>
<tr>
<td>From 7/1/2001 thru 12/31/2001:</td>
<td>9%</td>
<td>4.5%</td>
</tr>
<tr>
<td>From 1/1/2002 thru 12/31/2002:</td>
<td>8%</td>
<td>3.5%</td>
</tr>
<tr>
<td>From 1/1/2003 thru 9/30/2003:</td>
<td>7%</td>
<td>2.5%</td>
</tr>
<tr>
<td>From 10/1/2003 thru 12/31/2003:</td>
<td>6%</td>
<td>1.5%</td>
</tr>
<tr>
<td>From 1/1/2004 thru 3/31/2004 (leap year):</td>
<td>6%</td>
<td>1.5%</td>
</tr>
<tr>
<td>From 4/1/2004 thru 6/30/2004 (leap year):</td>
<td>7%</td>
<td>2.5%</td>
</tr>
<tr>
<td>From 7/1/2004 thru 9/30/2004 (leap year):</td>
<td>6%</td>
<td>1.5%</td>
</tr>
<tr>
<td>From 10/1/2004 thru 12/31/2004 (leap year):</td>
<td>7%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>
Appendix B

Replication of TAXINT backup

Generated for the computation of assessed interest in Illustration 1 (Page 42)

Simple interest 2/1/78 thru 1/31/80 at rate of 6%
Amount of tax: $90,943.00
Interest period:  
End: 80 1 31
Start: 79 3 15
Length: 0 10 16
Interest factor:  
For years: 0.000000
For months: 0.050000
For days: 0.002630
Total: 0.052630
Interest amount: $4,786.34

Simple interest 2/1/80 thru 1/31/82 at rate of 12%
Amount of tax: $90,943.00
Interest period:  
End: 82 1 31
Start: 80 1 31
Number of days: 731
Interest factor: 0.2403286770
Interest amount: $21,856.21

Simple interest 2/1/82 thru 12/31/82 at rate of 20%
Amount of tax: $90,943.00
Interest period:  
End: 82 12 31
Start: 82 1 31
Number of days: 334
Interest factor: 0.1830136300
Interest amount: $16,643.81

Aggregate interest through 12/31/82: $43,286.36

Compound interest 1/1/83 thru 6/30/83 at rate of 16%
Amount of tax and interest thru 12/31/82: $134,229.36
Interest period:  
End: 83 5 19
Start: 82 12 31
Number of days: 139
Interest factor: 0.0628119260
Interest amount: $8,431.20

Aggregate interest through end of the last period: $51,717.56

- 54 -
Replication of a Compressed Backup Schedule generated by **TAXINT** for the computations shown above

**TAXINT**

*Compressed Backup Schedule*

*Underpayment Interest*

<table>
<thead>
<tr>
<th>Base Date</th>
<th>Starting Date</th>
<th>Ending Date</th>
<th>Days</th>
<th>Factor</th>
<th>Interest</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>90,943.00</td>
<td>15-Mar-79 to 31-Jan-80</td>
<td>322</td>
<td>0.052630136</td>
<td>4,786.34</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>90,943.00</td>
<td>01-Feb-80 to 31-Jan-82</td>
<td>731</td>
<td>0.240328677</td>
<td>21,856.21</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>90,943.00</td>
<td>01-Feb-82 to 31-Dec-82</td>
<td>334</td>
<td>0.183013630</td>
<td>16,643.81</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>134,229.36</td>
<td>01-Jan-83 to 19-May-83</td>
<td>139</td>
<td>0.062811926</td>
<td>8,431.20</td>
<td>16%</td>
<td></td>
</tr>
<tr>
<td><strong>51,717.56</strong></td>
<td><strong>---</strong></td>
<td><strong>---</strong></td>
<td><strong>---</strong></td>
<td><strong>---</strong></td>
<td><strong>---</strong></td>
<td><strong>---</strong></td>
</tr>
</tbody>
</table>
Appendix C
Pre-SCA 1998-014 Examples of GATT Interest Computations

In February, 1995, the National Office of the Internal Revenue Service issued instructions to the field as to how GATT interest computations should be made in various circumstances, particularly when the overpayment occurred before January 1, 1995, the effective date of the GATT interest provision. Those instructions specifically provided that the GATT interest rate applies only to the overpayment of “tax” (which the IRS said includes assessed interest and penalties) in excess of $10,000, and not to any overpayment interest accrued before 1995. A number of examples were provided based on the premise that that was what the statute required. In SCA 1998-014, the IRS reversed its position on the application of the GATT interest rates to overpayment interest accrued through December 31, 1994, and held that, beginning January 1, 1995, the GATT interest rates apply not only to the overpayment of “tax” in excess of $10,000 but also to interest accrued through December 31, 1994, on a pre-1995 overpayment of tax in excess of $10,000 (but not to interest accrued through December 31, 1994, on the pre-1995 overpayment equal to the $10,000 GATT threshold amount). Thus the examples in the February, 1995, instructions to the field are no longer in conformity with the IRS’s interpretation of the statute. Nevertheless, the examples illustrate not only the IRS’s then interpretation of the statute as to the treatment of pre-1995 accrued interest, but also some other issues that might also occur under the IRS’s revised position.

The following five examples (which are derived from the National Office instructions to the field) will illustrate some of the possible variables that might arise.

**Example 1**

All of the overpayment occurs **before 1995**

<table>
<thead>
<tr>
<th>Tax overpayment on 6/15/94</th>
<th>$25,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>to be refunded in 1995</td>
<td></td>
</tr>
<tr>
<td>Refund computation date 3/31/95</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Overpayment interest accrued to</th>
<th>$1,027.29</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/94 on $25,000</td>
<td></td>
</tr>
<tr>
<td>6/15/94 - 12/31/94 on $25,000 at normal rate</td>
<td>$1,027.29</td>
</tr>
</tbody>
</table>

| Overpayment interest on first $10,000 of tax plus interest accrued to 12/31/94 ($1,027.29) | 219.66 |
| 12/31/94 - 3/31/95 on $11,027.29 at normal rate |        |
Overpayment interest on $15,000 excess
12/31/94 - 3/31/95 on
$15,000 at GATT rate __242.33

Total interest 1,489.28

Total payment due $26,489.28

If the normal overpayment rate applied to the entire $25,000 overpayment for the period, the overpayment interest would have been $1,545.74 rather than $1,489.28, and it would have been computed as a single element for the period from 6/15/94 through 3/31/95.

As noted above, with earlier versions of TAXINT it was necessary to make the computations for this example in the three steps shown above. However, with the current version of the TAXINT program, the interest computations for this example can be made in a single step as follows:

Overpayment of tax $25,000.00

GATT interest on $25,000 with
$10,000 threshold at normal interest
6/15/94 - 3/31/95 1,489.28

Total amount payable $26,489.28

Nevertheless, as can be seen from the examples that follow, where the aggregate overpayment amount arises at different times, it is necessary to compute the interest in separate elements.

Example 2

Overpayment in excess of $10,000 occurs before 1995 plus additional overpayment after 1994

Tax overpayment on 8/31/94 $22,000.00
Add’l tax overpayment on 1/31/95 3,000.00
Total tax overpayment to be refunded $25,000.00
Refund computation date 3/31/95

Overpayment interest accrued to
12/31/94 on $22,000
8/31/94 - 12/31/94 on $22,000 at normal rate $577.58
Overpayment interest on first
$10,000 of tax plus interest
accrued to 12/31/94 ($577.58)
12/31/94 - 3/31/95 on
$10,577.58 at normal rate 210.70

Overpayment interest accrued to
1/31/95 on $12,000 excess
12/31/94 - 1/31/95 on
$12,000 at GATT rate 66.42

Overpayment interest to 3/31/95 on
$15,000 excess ($12,000 + $3,000)
tax plus GATT interest accrued to
1/31/95 ($66.42)
1/31/95 - 3/31/95 on
$15,066.42 at GATT rate 159.12

Total interest 1,013.82

Total payment due $26,013.82

If the normal overpayment rate applied to the two overpayment amounts, the overpayment interest would have been $1,066.36 rather than $1,013.82. (It would have been computed in two elements, one on $22,000 for the period from 8/31/94 to 3/31/95 -- $1,027.32 -- and the other on $3,000 for the period from 1/31/95 to 3/31/95 -- $39.04.)

The computations in this Example 2 could as well be made with a different approach for the last two interest elements, but with the same results, as follows:

Tax overpayment on 8/31/94 $22,000.00
Tax overpayment on 1/31/95 3,000.00
Total tax overpayment to be refunded $25,000.00
Refund computation date 3/31/95

Overpayment interest accrued to
12/31/94 on $22,000
8/31/94 - 12/31/94 on
$22,000 at normal rate 577.58

Overpayment interest on first
$10,000 of tax plus interest
accrued to 12/31/94 ($577.58)
12/31/94 - 3/31/95 on

- 58 -
$10,577.58 at normal rate

Overpayment interest on $12,000 excess
12/31/94 - 3/31/95 on
$12,000 at GATT rate

Overpayment interest on additional
$3,000 excess
1/31/95 - 3/31/95 on
$3,000 at GATT rate

Total interest 1,013.82

Total payment due $26,013.82

Thus, the result is the same whether you aggregate all of the GATT interest and principal to the additional overpayment date and then compute GATT overpayment interest on that aggregate amount from that date to the refund computation date (a “vertical” approach for the two GATT interest elements) or, alternatively, compute GATT overpayment interest to the refund computation date separately for each GATT principal overpayment (a “horizontal” approach for the two GATT interest elements).

With the current version of the TAXINT program, the foregoing computations can be made in two steps instead of four, as follows:

Overpayment of tax $25,000.00

GATT interest on $22,000 with
$10,000 threshold at normal interest
8/31/94 - 3/31/95 $982.14

GATT interest on $3,000 with zero threshold (no add’l normal interest)
1/31/94 - 3/31/95 31.68

Total interest 1,013.82

Total amount payable $26,013.82

For those individuals interested in the “horizontal” versus the “vertical” conceptualization discussed above, it may be noted that the first computation given above for this Example 2 is a wholly “vertical” approach. That is, in the first computation there are four elements to the computation of the aggregate interest. The first element computes the normal overpayment interest on $22,000. The second element adds the interest so-computed to the $10,000 threshold...
amount and computes interest thereon to the refund computation date. The third element computes interest on the $12,000 excess of the initial overpayment over the threshold amount to date when the overpayment is increased by $3000. And the fourth element adds the interest computed in the third element to the increased amount of the overpayment and computed interest thereon to the refund computation date. This computation could be diagramed (not to scale) as follows:

<table>
<thead>
<tr>
<th>8/31/94</th>
<th>1/31/95</th>
<th>3/31/95</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overpayment</strong></td>
<td><strong>Interest Period</strong></td>
<td><strong>Overpayment</strong></td>
</tr>
<tr>
<td>Element 1</td>
<td>Element 2</td>
<td>Element 3</td>
</tr>
<tr>
<td>Normal Interest on Initial $22,000 Overpayment</td>
<td>Normal Interest on $10,000 Threshold Amount plus interest to 12/31/94</td>
<td>GATT Int. on $12,000 Excess</td>
</tr>
<tr>
<td>12/31/94</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The alternative four-element computation for this Example 2 is a hybrid “vertical” and “horizontal” approach which could be diagramed as follows:

<table>
<thead>
<tr>
<th>8/31/94</th>
<th>1/31/95</th>
<th>3/31/95</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overpayment</strong></td>
<td><strong>Interest Period</strong></td>
<td><strong>Overpayment</strong></td>
</tr>
<tr>
<td>Element 1</td>
<td>Element 2</td>
<td>Element 3</td>
</tr>
<tr>
<td>Normal Interest on Initial $22,000 Overpayment</td>
<td>Normal Interest on $10,000 Threshold Amount plus interest to 12/31/94</td>
<td>GATT Int. on $12,000 Excess</td>
</tr>
<tr>
<td>12/31/94</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

On the other hand, the TAXINT program uses essentially a “horizontal” approach in that it computes the same aggregate interest in two elements from the date each overpayment amount arises to the refund computation date. (Of course, one of the two elements includes both normal overpayment interest and GATT interest.) This computation could be diagramed as follows:
<table>
<thead>
<tr>
<th>Date</th>
<th>GATT Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>8/31/94</td>
<td>$3,000 Excess</td>
</tr>
<tr>
<td>12/31/94</td>
<td>GATT Interest</td>
</tr>
<tr>
<td></td>
<td>$12,000 Excess</td>
</tr>
</tbody>
</table>

**Example 3**

Overpayment before 1995 not in excess of $10,000 but with additional overpayment after 1994 and with total overpayment in excess of $10,000

Tax overpayment on 12/1/94 $8,000.00
Additional tax overpayment on 1/12/95 8,000.00
Total tax overpayment to be refunded 16,000.00
Refund computation date 3/31/95

Overpayment interest accrued to 1/12/95 (when overpayment first exceeded $10,000)
12/1/94 - 1/12/95 on $8,000 at normal rate $73.98

Overpayment interest on first $10,000 of tax plus interest accrued to 1/12/95 ($73.98)
1/12/95 - 3/31/95 on $10,073.98 at normal rate 173.69

Overpayment interest on $6,000 excess
1/12/95 - 3/31/95 on $6,000 at GATT rate 83.92

Total interest 331.59
If the normal overpayment rate applied to the entire $16,000 overpayment for the period, the overpayment interest would have been $351.11 rather than $331.59. (It would have been computed in two elements, one on $8,000 for the period from 12/1/94 to 3/31/95 -- $213.18 -- and the other on $8,000 for the period from 1/12/95 to 3/31/95 -- $137.93.)

With the current version of the TAXINT program, the foregoing computations can be made in two steps instead of three, as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overpayment of tax</td>
<td>$16,000.00</td>
</tr>
<tr>
<td>Normal overpayment interest on $8,000 (part of threshold amount after 1994)</td>
<td></td>
</tr>
<tr>
<td>12/1/94 - 3/31/95</td>
<td>$213.18</td>
</tr>
<tr>
<td>GATT interest on $8,000 with $2,000 threshold (balance of $10,000 threshold amount)</td>
<td></td>
</tr>
<tr>
<td>1/12/95 - 3/31/95</td>
<td>118.40</td>
</tr>
<tr>
<td>Total interest</td>
<td>331.58</td>
</tr>
<tr>
<td>Total amount payable</td>
<td>$16,331.58</td>
</tr>
</tbody>
</table>

The one-cent difference between the two computations is presumable due to rounding.

**Example 4**

Two overpayments under $10,000 before 1995 aggregating more than $10,000; one refunded before 1995 (i.e., the previous refund does not exceed the $10K threshold)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax overpayment on 6/15/93</td>
<td>$ 4,000.00</td>
</tr>
<tr>
<td>Tax refund already issued 4/15/93</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Total tax overpayment</td>
<td>$12,000.00</td>
</tr>
<tr>
<td>Less tax refund already issued</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Remaining tax overpayment to be refunded</td>
<td>$ 4,000.00</td>
</tr>
<tr>
<td>Refund computation date 3/31/95</td>
<td></td>
</tr>
</tbody>
</table>

Overpayment interest accrued to 12/31/94 on $4,000

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/15/93 - 12/31/94 on</td>
<td></td>
</tr>
<tr>
<td>$4,000 at normal rate</td>
<td>$421.85</td>
</tr>
</tbody>
</table>
Overpayment interest on remaining part of first $10,000 (i.e., $2,000) plus interest accrued on 12/31/94 ($421.85)

12/31/94 - 3/31/95 on
$2,421.85 at normal rate 48.24

Overpayment interest on $2,000 excess
12/31/94 - 3/31/95 on
$2,000 at GATT rate 32.31

Total interest 502.40

Total payment due $ 4,502.40

If the normal overpayment rate applied to the entire $4,000 remaining tax overpayment for the period, the overpayment interest would have been $509.93, rather than $502.40, and it would have been computed as a single element for the period from 6/15/93 to 3/31/95.

With the current version of the TAXINT program, the foregoing computations can be made in one step instead of three, as follows:

Remaining overpayment of tax $4,000.00

GATT interest on $4,000 with $2,000 threshold at normal interest (balance of first $10,000 overpayment amount)
6/15/93 - 3/31/95 502.40

Total amount payable $4,502.40

Example 5

Overpayment over $10,000 refunded before 1995; additional overpayment before 1995 to be refunded after 1994 (i.e., the previous refund exceeds the $10K threshold)

Tax overpayment on 4/15/93 $10,000.00
Tax refund previously issued 15,000.00
Total tax overpayment $25,000.00
Less tax refund already issued 15,000.00
Remaining tax overpayment to be refunded $10,000.00
Refund computation date 4/30/95

Overpayment interest accrued to
12/31/94 on $10,000
4/15/93 - 12/31/94 on $10,000 at normal rate $1,166.03

Overpayment interest on interest
accrued to 12/31/94 ($1,166.03)
12/31/94 - 4/30/95 on $1,166.03 at normal rate 32.06

Overpayment interest on remaining
$10,000 tax to be refunded
12/31/94 - 4/30/95 on $10,000 at GATT rates 224.38

Total interest 1,422.47
Total payment due $11,422.47

If the normal overpayment rate applied to the $10,000 overpayment for the period, the overpayment interest would have been $1,473.00, rather than $1,422.47, and it would have been computed as a single element for the period from 4/15/93 to 4/30/95.

With the current version of the TAXINT program, the foregoing computations can be made in one step instead of three, as follows:

Remaining overpayment of tax $10,000.00

GATT interest on $10,000 with
Zero threshold (i.e., nothing
at normal interest after 1994)
4/15/93 - 4/30/95 1,422.47

Total amount payable $10,422.47

Note that the effect of the principle underlying Examples 4 and 5 is to reduce the post-1994 $10,000 GATT initial threshold amount by any pre-1995 refund of tax for the taxable period involved. One may question the propriety of that principle -- the reduced GATT interest rate is to be applicable “to the extent that an overpayment of tax ... exceeds $10,000,” and it would seem that a refund of part of a tax overpayment would first reduce any excess over $10,000 before it reduces the threshold amount. However the application of that principle has a relatively modest impact, since its effect is only to reduce the initial 1995 normal overpayment interest base (and thus increase the GATT interest base) by not more than $10,000. The interest
rate differential of 1.5% per year applied to that amount, although potentially significant if compounded over a long enough period, is probably not likely to produce a difference sufficient to warrant serious controversy. In any event, since that appears to be the interpretation of the Internal Revenue Service, a computation of GATT interest for a period that spans December 31, 1994, and involves a pre-1995 refund of tax to the taxpayer should take account of the possibility that such an interpretation will prevail.

A potentially more significant issue not addressed by any of the foregoing examples is the effect of a post-1994 payment to the taxpayer in reducing either the GATT interest base or the normal overpayment interest base, or both. Consider the following example, which is not included in the National Office’s instructions to the Field referred to above:

**Example 6**

*(Not included in the IRS instructions to the Field)*

**Overpayment occurs before 1995; Partial payment after 1994**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax overpayment on 6/15/92 to be refunded in 1997</td>
<td>$25,000.00</td>
</tr>
<tr>
<td>Payment to taxpayer issued 2/15/95</td>
<td>14,000.00</td>
</tr>
<tr>
<td>Refund computation date 6/30/97</td>
<td>$29,428.67</td>
</tr>
</tbody>
</table>

Initial overpayment | $25,000.00 |

Overpayment interest accrued to 12/31/94 on $25,000:
- 6/15/92 - 12/31/94 on $25,000 at normal rate | 4,428.67 |

Amount owed to taxpayer on 12/31/94 | $29,428.67 |

Overpayment interest on first $10,000 of tax plus interest accrued to 12/31/94 ($4,428.67):
- 12/31/94 - 2/15/95 on $14,428.67 at normal rate | $146.19 |

Overpayment interest on $15,000 excess:
- 12/31/94 - 2/15/95 on $15,000 at GATT rate | 123.37 |

Total post-1994 interest | 269.56 |
Amount owed to taxpayer on 2/15/95 $29,698.23

At this point, the normal overpayment interest base is $14,574.86 (the $10,000 threshold amount plus $4,428.67 normal overpayment interest accrued to 12/31/94 plus $146.19 normal overpayment interest accrued from 12/31/94 to 2/15/95), and the GATT interest base is $15,123.37 (the $15,000 excess of the $25,000 tax overpayment over the $10,000 threshold amount plus $123.37 GATT interest accrued to 2/15/95). When the $14,000 payment is made to the taxpayer on 2/15/95, what is the effect on the normal overpayment interest base and on the GATT interest base?

Arguably, the correct answer is that any post-1994 payment should first be applied to reduce the GATT interest base, so the $14,000 payment should all be applied to reduce that base. In that case, the interest computations for the balance of the interest period would be made as follows:

**Example 6A**

**Post-1994 payment applied first to GATT interest base**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount owed to taxpayer on 2/15/95</td>
<td>$29,698.23</td>
</tr>
<tr>
<td>Amount paid to taxpayer on 2/15/95</td>
<td>$14,000.00</td>
</tr>
<tr>
<td>Balance owed to taxpayer on 2/15/95</td>
<td>$15,698.23</td>
</tr>
</tbody>
</table>

Normal overpayment interest to 6/30/97 on normal overpayment interest base ($14,574.86)

- 2/15/95 - 6/30/97 on $14,574.86 at normal rate $3,042.29

GATT interest to 6/30/97 on GATT interest base ($15,123.37 - $14,000.00)

- 2/15/95 - 6/30/97 on $1,123.37 at GATT rate $187.08

Total interest 2/15/95 - 6/30/97 $3,229.37

Amount owed to taxpayer on 6/30/97 $18,927.60

If, instead, the $14,000 payment on 2/15/95 were applied first to reduce the normal overpayment interest base rather than the GATT interest base -- a result which would seem clearly to be incorrect for the reason stated above as to why the pre-1995 refund of tax should not reduce the GATT threshold amount -- the interest computations for the balance of the interest period would be made as follows:
**Example 6B**

**Post-1994 payment applied first**

to normal overpayment interest base

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount owed to taxpayer on 2/15/95</td>
<td>$29,698.23</td>
</tr>
<tr>
<td>Amount paid to taxpayer on 2/15/95</td>
<td>14,000.00</td>
</tr>
<tr>
<td>Balance owed to taxpayer on 2/15/95</td>
<td>$15,698.23</td>
</tr>
<tr>
<td>Normal overpayment interest to 6/30/97 on base</td>
<td>($14,574.86 - $14,000.00)</td>
</tr>
<tr>
<td>2/15/95 - 6/30/97 on normal overpayment interest base</td>
<td>$574.86 at normal rate</td>
</tr>
<tr>
<td>GATT interest to 6/30/97 on GATT interest base ($15,123.37)</td>
<td>2/15/95 - 6/30/97 on $15,123.37 at GATT rate</td>
</tr>
<tr>
<td>Total interest 2/15/95 - 6/30/97</td>
<td>2,638.51</td>
</tr>
<tr>
<td>Amount owed to taxpayer on 6/30/97</td>
<td>$18,336.74</td>
</tr>
</tbody>
</table>

Thus, there is a $590.79 difference between the amounts of interest under the two alternatives. This, obviously, could become very significant as the numbers increase.

For the reason stated above, the second alternative (Example 6B) should be rejected. However, an intermediate approach may be the most rational. That approach would be to look to see how much of the post-1994 payment was designated at the time of its payment as a payment of normal overpayment interest accrued to 12/31/94 (and possibly normal overpayment interest thereon to the date of such payment) and to apply that much of the post-1994 payment as a reduction of the normal overpayment interest base, with any excess then first applied to reduce the GATT interest base (and only any amount in excess of the GATT interest base then again applied to reduce any remaining normal overpayment interest base). The rationale for such an approach is that, if the interest accrued before 1995 were paid before 1995, such interest would never have been in the post-1994 normal overpayment interest base in the first place, so a payment of such interest to the taxpayer after 1994 should remove it from the normal overpayment interest base.

To illustrate this approach, assume that the $14,000 payment on 2/15/95 was made because the IRS concluded (erroneously, it turned out) that the overpayment of tax was only $11,776.71 and that interest on such overpayment was $2,223.29. The interest amount consisted
of $2,086.22 normal interest accrued to 12/31/94, $122.46 interest accrued from 12/31/94 to 2/15/95 on the $12,086.22 sum of the $10,000 threshold amount and the interest accrued to 12/31/94 ($21.14 of which was interest on the interest accrued to 12/31/94 and the $101.32 balance of which was on the $10,000 threshold amount), and $14.61 interest at the GATT rate on the $1,776.61 excess of the assumed tax overpayment over the $10,000 threshold amount. (This is the actual amount of interest on such an overpayment of tax for that period.)

Based on the foregoing numbers, the application of this approach would produce the following results: As of 2/15/95, the normal overpayment interest base would be reduced by $2,107.36 (the $2,086.22 interest accrued to 12/31/94 plus the $21.14 interest thereon from 12/31/94 to 2/15/95). Consequently, the normal overpayment interest base would be reduced from $14,574.86 to $12,467.50 on 2/15/95. At the same time, the GATT interest base would be reduced by the $11,892.64 balance of the $14,000 payment ($14,000 minus $2,107.36). Consequently, the GATT interest base would be reduced from $15,123.37 to $3,230.73. Then, the interest computations under this example for the balance of the interest period would be made as follows:

**Example 6C**

Post-1994 payment applied first to pre-1995 accrued interest in the normal overpayment interest base, then to the GATT interest base

| Amount owed to taxpayer on 2/15/95 | $29,698.23 |
| Amount paid to taxpayer on 2/15/95 | 14,000.00  |
| Balance owed to taxpayer on 2/15/95 | $15,698.23 |

Normal overpayment interest to 6/30/97 on normal overpayment interest base ($14,574.86 - $2,107.36)

| 2/15/95 - 6/30/97 on $12,467.50 at normal rate | $2,602.41 |

GATT interest to 6/30/97 on GATT interest base ($15,123.37 - $11,892.64)

| 2/15/95 - 6/30/97 on $3,230.73 at GATT rate | 538.02   |

Total interest 2/15/95 - 6/30/97 3,140.43

Amount owed to taxpayer on 6/30/97 $18,838.66
Thus, this approach produces $88.94 less interest payable to the taxpayer than would be payable to the taxpayer under the first alternative shown above and $501.92 more interest than would be payable under the second alternative.
Appendix D
The Super-GATT Phenomenon

During the course of the GATT interest dispute described above (pp. 27-30), a somewhat complicating and distracting issue surfaced, namely, the suggestion of the possibility of an interest computation sometimes termed “Super-GATT.”¹ The advocates of such a computation would assert that, for compounding purposes, all overpayment interest (including interest initially computed as GATT interest) should be compounded at the normal overpayment rate (which would be 1.5 percentage points higher than the GATT rate), because section 6621(a)(1) imposes the lower GATT rate only as to “an overpayment of tax” in excess of $10,000, whereas interest that accrues on an overpayment of tax does not become part of the overpayment of tax. The suggestion by such advocates was that such a Super-GATT computation would be applicable not only to a transition case (involving a pre-1995 overpayment still outstanding as of 1/1/95 and the compounding after 1994 of interest accrued before 1995 interest on such overpayment), but also to the compounding of all interest accrued after 1994 on all of an overpayment of tax, including all of an overpayment in excess of $10,000 arising only after the GATT interest effective date.

If the proposed Super-GATT concept were to be implemented, it would be necessary for the IRS to publish a whole new set of interest factors, comparable to the set of compound interest factors provided in Rev. Proc. 97-17, to be applied to compute Super-GATT interest for each calendar quarter after 1994. The procedure for computing such factors would use the formula to compute the future value of an ordinary annuity. For each calendar quarter, the “annuity” would be the daily amount computed as the daily simple interest amount at the GATT interest rate on the overpayment of tax in excess of the threshold amount (normally the overpayment of tax in excess of $10,000), and the future value of that daily “annuity” would be determined by adding daily compound interest at the normal corporate overpayment interest rate to that “annuity.”²

¹ To the best of our knowledge, the term “Super-GATT” was first publicly used in the complaint filed on August 8, 2001, in the United States Court of Federal Claims on behalf of Texaco, Inc. and Subsidiaries, Docket No. 01-461T, asserting that the term applies to certain computations filed with the complaint based on the plaintiff’s position that “beginning on January 1, 1995, the lower GATT rate applies only to overpayments of tax in excess of $10,000 and not to interest that had previously accrued on such overpayments or to interest that accrues thereafter on such overpayment.” Complaint paragraph 23(a).

² The formula for the future value of an ordinary annuity may be found on the Internet at:


The future value of the “annuity” so-computed for a specified number of days in the calendar quarter, when divided by the overpayment of tax on which such simple interest at the GATT rate was computed for that quarter, would be the Super-GATT interest factor for that number of days in the calendar quarter. As a matter of academic interest, the author of this article prepared (but has not distributed) a version of his TAXINT computer program that can optionally compute Super-GATT interest. He also prepared a
In both the United States Court of Federal Claims and in the Court of Appeals for the Federal Circuit, the plaintiff/appellant (General Electric) strongly and repeatedly disavowed the Super-GATT argument, asserting that the GATT interest issue in dispute would arise only in a transition case where the overpayment arose before 1/1/95 (the effective date of the GATT interest provision) and the issue was only the compounding rate to be used after that date in compounding the interest that had accrued at the normal overpayment interest rate before 1995.

Nevertheless, from the very outset of its change of position on the transition issue, the government has displayed a tendency to initiate its argument against the taxpayer’s position in the transition case, and to attempt to justify the IRS’s revised transition position, by reference to the way GATT interest must necessarily be computed in a post-effective date case, even after the tax overpayment has been fully refunded, and then contend that there is no basis for concluding that there would be a difference in such computation in a transition case.

Thus, even in SCA 1998-014, dated April 24, 1997, in which the IRS reversed the position it had initially taken as to post-effective date interest on interest accrued before the effective date (see pages 26-29), the IRS started its “DISCUSSION” as follows, “Before discussing whether the GATT interest rate applies only to the ‘excess portion’ of a corporate overpayment outstanding on GATT’s effective date (January 1, 1995) or whether the GATT rate applies to the excess overpayment and the interest that accrued on such excess portion prior to January 1, 1995, it is important to analyze the proper application of the GATT rate without regard to the effective date of the statute.” The IRS concluded that, in the case of a post-effective date overpayment, the lower GATT interest rate would apply both to the overpayment of tax in excess of the $10,000 threshold and to the overpayment interest accrued on such post-effective date excess amount. Otherwise, it concluded, “one rate of interest would be applicable to the excess overpayment … for the accrual period of one day under I.R.C section 6622(a), and then, the interest that is calculated on the interest would be accrued under a different [i.e., higher, normal-overpayment] interest rate.” (Bracketed material added.) Obviously, this is a description of what was subsequently termed “Super-GATT.” The IRS concludes that such a result would be contrary to the section 6622 requirement of daily compounding of interest and, therefore, that the lower GATT rate must be applied to both the post-effective date excess tax overpayment amount and to the accrued interest on that excess tax overpayment amount. The SCA then stated that the IRS computers had been programmed to compute interest on post-effective date excess overpayments in that way, but had applied a “different rule” for pre-effective date accrued interest, and it stated that the IRS has found “no legal justification for [such] different treatment.”

In its arguments in the General Electric case, the government repeatedly suggested that the taxpayer’s argument, if successful, would inevitably result in clearly irrational “Super-GATT” consequences, namely, simple interest (not compound interest) at the lower GATT interest rate on the overpayment in excess of the $10,000 threshold amount and compound interest at the higher normal overpayment interest rate on the simple interest so-computed.

mechanism that has computed all of the daily Super-GATT interest factors that would have to be published in the unlikely event that the use of Super-GATT interest were sanctioned.
To the contrary, General Electric and amicus in the General Electric case contended that there is no statutory or regulatory basis for compounding previously computed interest at the GATT rate unless such previously computed interest has also be computed at the GATT rate. That is, they contended that, in creating the new subcategory of overpayment (i.e., a corporate overpayment of tax in excess of the $10,000 threshold amount), Congress contemplated that all interest attributable to that subcategory from January 1, 1995 forward would compound at the GATT rate. That result would follow under section 6622 and the regulations thereunder. In other words, with respect to that portion of an overpayment of tax that accrues interest at the GATT rate, such interest would be compounded at the GATT rate. For that portion of an overpayment of tax that accrues interest at the regular rate, such interest would be compounded at the regular rate. But nothing in section 6621, or in section 6622 or its regulations, authorizes the application of a daily GATT rate for purposes of compounding any portion of interest previously accrued at the normal overpayment interest rate either before or after the GATT interest effective date.
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