Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Associate Area Counsel (New York)
(Large Business & International)

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subject: The Availability of Interest Netting When the Taxpayer That Had the Underpayment Was Not the Same Taxpayer that Made the Overpayment.

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Corporation 1 =
Corporation 2 =
Corporation 3 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
State =
TY1 =
TY2 =
Amount 1 =
Amount 2 =
Amount 3 =

Amount 4 =
Amount 5 =
Amount 6 =

ISSUE

A domestic corporation underpaid its income taxes for TY1; its foreign parent overpaid its income taxes for TY1. On Date 5, the domestic corporation converted to an LLC, still 100% owned by the foreign parent, and on Date 6, the LLC dissolved and transferred its existing assets and liabilities to its foreign parent pursuant to an asset and liability transfer agreement. Is the domestic corporation the "same taxpayer" as the foreign parent for purposes of zero net-rate interest netting under section 6621(d)?

CONCLUSION

No. The corporation and its former parent are not the “same taxpayer” for purposes of interest netting.

FACTS

Deficiency and Overpayment

The Internal Revenue Service audited the TY2 income-tax returns of Corporation 1 and its former foreign parent, Corporation 2. As a result of the audit, the Service made a section 482 adjustment that allocated a TY2 bad-debt deduction from Corporation 1 to Corporation 2, the foreign parent. As a result of this adjustment and other adjustments to the foreign parent’s TY1 tax return, the foreign parent ended up with an overpayment of its TY1 taxes,[1] which the Service refunded in the amount of Amount 1, including interest, on Date 1.

Corporation 1, on the other hand, as a result of other adjustments to its TY1 tax return, ended up with a deficiency for TY1[2] of Amount 2, which the Service assessed on Date 2. A payment in the amount of Amount 3 was posted to Corporation 1’s TY1 account on Date 3, and another payment was posted in the amount of Amount 4 on Date 4. (We are unaware what part of these payments were attributable to tax and what part of these payments were attributable to interest, but it is irrelevant to this discussion.).

Corporate Structure

[1] The section 482 adjustment increased the foreign parent’s TY2 net operating loss (NOL), which the foreign parent carried back to TY1, resulting in an overpayment of its TY1 taxes.
[2] The section 482 allocation did not have any effect on Corporation 1’s TY1 tax liability. Corporation 1 carried back a TY2 consolidated net operating loss to TY1. The Service determined that of the Amount 5 that Corporation 1 had carried back to TY1, only Amount 6 was allowable. This adjustment resulted in Corporation 1’s deficiency for TY1.

Corporation 1 filed its TY1 corporate tax return as the parent of a consolidated group. In TY1, Corporation 1 was 100% owned by Corporation 2, a foreign parent. On Date 5, Corporation 1 restructured, liquidated several subs, and converted to a State LLC that was also 100% owned by the same foreign parent, Corporation 2. As a result of this restructuring, Corporation 1 was treated, for federal tax purposes, as a disregarded entity. In determining the taxation of Corporation 1's change in classification for federal income taxes from a "C" corporation to a disregarded entity, Corporation 1 was deemed to have transferred its assets and liabilities to its foreign parent. Corporation 1 filed a final tax return and ceased to exist as a "C" corporation for federal income tax purposes even though Corporation 1 continued in existence as an LLC under State law.[3] On Date 6, under State law, the LLC (previously Corporation 1) dissolved. In so doing, the LLC actually transferred all of its assets and liabilities to Corporation 2, its foreign parent, pursuant to an asset and liability transfer agreement. The foreign parent consented to the transfer and legally assumed full responsibility for all of the LLC's liabilities. Subsequently, the foreign parent changed its name to Corporation 3.

On Date 7, Corporation 1 filed a claim for interest netting, seeking a refund of a portion of the underpayment interest that had accrued on its TY1 underpayment. Corporation 1 claimed that the Service should apply a net interest rate of zero for the periods that its TY1 underpayment overlapped with its foreign parent's TY1 overpayment – Date 8 through Date 1. Our advice is based on the information that the taxpayer provided in its claim as well as the additional background materials that you submitted.

LAW AND ANALYSIS

To the extent "interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period." Section 6621(d). The purpose of interest netting is to relieve corporate taxpayers from owing more interest than the Service owes them on equal amounts of money for equal lengths of time.

Interest netting only applies, however, if the "same taxpayer" makes both the underpayments and the overpayments in issue. *Energy East Corp. v. United States*, 645 F.3d 1358, 1362 (Fed. Cir. 2011) (Energy East II). Although the Code provides a general definition of a "taxpayer" ("any person subject to any internal revenue tax"), and "person" includes a corporation, company, association, or partnership (I.R.C. §§ 7701(a)(1), (a)(14)), the statute does not define the term "same taxpayer." The Court of Federal Claims has interpreted the term "same taxpayer" in two different ways. In *Energy East I*, the court relied on the dictionary to determine that "same" meant "being one without addition, change, or discontinuance: identical." *Energy East v. United States*, 92 Fed. Cl. 29, 34 (2010) (Energy East I). In contrast, the Court of Federal Claims in *Magma Power Co. v. United States* allowed "same taxpayer" status to

[3] *See* I.R.C § 332.

taxpayers with the same EIN, "irrespective of any intervening mergers;" it declined to adopt the definition the court identified in *Energy East I*. No. 09-419T, slip op. at 21 (Fed. Cl. Oct. 28, 2011).

Section 6621(d) does not explicitly address whether the same taxpayer requirement is met for situations in which a taxpayer's identity changes over time or one corporation's liabilities and assets are transferred to another. Same taxpayer status, however, is not applied retroactively. *See Energy East II*, 645 F.3d at 1363 (even though the "underpayment" taxpayer had acquired the "overpayment" taxpayers before filing a interest netting claim, taxpayers were not the same when their respective underpayments and overpayments were made). To be entitled to interest netting under section 6621(d), the taxpayer that underpaid the tax must be the same taxpayer that overpaid the tax. *Id.* at 1361-63.

Under the facts presented, the taxpayer that underpaid its TY1 tax liability is not the same taxpayer that overpaid its TY1 tax liability. Corporation 1 and Corporation 2, its former foreign parent, were not "identical." Moreover, the corporations had separate and distinct EINs and were not members of the same consolidated group. Corporations do not retroactively become the same taxpayer because of reorganizations subsequent to the tax years in issue. Thus, at least under the facts presented in the instant case, the subsequent merger activity involving Corporation 1 and Corporation 2 is irrelevant. *See id.*

Therefore, Corporation 1 is not entitled to net interest that accrued on its TY1 underpayment with interest that accrued on its former foreign parent's TY1 overpayment.

Please call (202) 622-4910 if you have any questions.