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INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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INTERNAL REVENUE SERVICE NATIONAL OFFICE SIGNIFICANT SERVICE CENTER ADVICE

MEMORANDUM FOR T. RICHARD SEALY III
ASSOCIATE AREA COUNSEL
CC:SB:AUS

FROM: Pamela W. Fuller
Senior Technician Reviewer
CC:PA:APJP:B01

SUBJECT: Computing Interest on Large Corporate Underpayments

This Chief Counsel Advice responds to your memorandum dated September 26, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

What date is the "applicable date" for computing I.R.C. § 6621(c) interest (hot interest) on a large corporate underpayment of tax that was proposed in a second 30-day letter, where the taxpayer did not fully pay the amount reflected in the first 30-day letter within thirty days?

CONCLUSION

The applicable date was established thirty days after the issuance of the first 30-day letter. Once triggered, the applicable date is effective for all subsequent underpayments determined for that year. The fact that the second underpayment did not exist when the applicable date arose is not relevant. Accordingly, because the second 30-day letter was mailed after the applicable date, it is appropriate to use the I.R.C. § 6621(c) interest rate beginning from the date that tax become both due and unpaid, and ending the date that such tax was completely paid.

FACTS

In the hypothetical that you provided, taxpayer ("TP") is a C corporation. TP's 1992 tax return was examined by the IRS, and on January 3, 1994, the IRS issued a 30-day letter to TP, asserting a deficiency of $250,000,000.00.

On February 2, 1994, the IRS and TP agreed to a settlement of this deficiency for $50,000,000.00. TP paid this deficiency on October 15, 1994.

The IRS calculated underpayment interest that accrued from the date TP's 1992 tax was due, through February 1, 1994, at the normal corporate underpayment interest rate. From February 2, 1994 through October 15, 1994, the IRS calculated underpayment interest at the I.R.C. § 6621(c)(1), large corporate underpayment rate. ("Hot interest.")

On TP's 1994 tax return, TP claimed a net operating loss, and carried this loss back to 1992. As a result of the carryback, TP claimed that it was entitled to a $40,000,000.00 refund for its 1992 tax year. The IRS processed this claim, and issued a $40,000,000.00 refund to TP on April 1, 1995.

The IRS examined the claimed net operating loss, and disallowed most of the loss that had been carried back to 1992. On September 4, 1998, the IRS issued a second 30-day letter to TP proposing a $35,000,000.00 deficiency for its 1992 tax year. TP does not appear to dispute this deficiency.

In calculating the interest that TP owed for the deficiency reflected in the second 30-day letter, the IRS used the normal corporate underpayment interest rate for interest that accrued from April 1, 1995 through October 3, 1998. For interest that accrued from October 4, 1998 through the date the $35,000,000.00 deficiency was paid, the IRS calculated underpayment interest at the hot interest rate.

TP filed a claim for the return of interest with respect to the overpayment it claimed on its 1992 tax return. In processing this claim, the IRS determined that it should have used the hot interest underpayment rate in calculating interest that accrued from April 1, 1995, through the date the deficiency from the second 30-day letter was paid.

TP disputes this determination, and argues that the hot interest underpayment rate should only apply from October 4, 1998, through the date that the deficiency from the second 30-day letter was paid.

LAW AND ANALYSIS

I.R.C. § 6601(a) requires that interest be paid, if any amount of tax "is not paid on or before the last date prescribed for payment". "The last date prescribed for payment" is the date mandated by chapter 62 of the Internal Revenue Code, without regard to any extensions of time for payment of any outstanding tax. I.R.C.

§ 6601(b)(1). The Internal Revenue Code requires that a corporation file an income tax return. I.R.C. § 6012(a)(2). In the case of a corporation that is using a calendar year, a corporation must file a tax return by March 15 of the following year. I.R.C. § 6072(b).

In this case, TP's 1992 year is at issue. TP is a corporation and is filing its returns based on a calendar year. Accordingly, TP was required to file its 1992 income tax return by March 15, 1993.

In the case of a corporation, the general underpayment rate is the Federal short-term rate plus 3 percentage points. I.R.C. § 6621(a)(2)(A) and (B). The Federal short-term rate is determined by the Secretary, in accordance with I.R.C. § 1274(d), the first month for each calendar quarter and is rounded to the nearest full percent. I.R.C. §§ 6621(b)(1) and (3).

Where a corporation has a "large corporate underpayment" for any period after the applicable date, the interest rate for all interest that accrues after the applicable date increases to the Federal short-term rate plus 5 percent. I.R.C. § 6621(c)(1). This interest rate is also known as "hot interest."

A "large corporate underpayment" is an underpayment of tax that exceeds $100,000.00 for any single taxable period. Here, the taxable period at issue is 1992. TP was mailed two separate 30-day letters with respect to two separate deficiencies for 1992. The deficiency in the first 30-day letter is $250,000,000.00. The deficiency in the second 30-day letter is $35,000,000.00.

The "applicable date" is the thirtieth day after the earlier of the mailing of the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review ("30-day letter"), or the mailing of the notice of deficiency. I.R.C. §§ 6621(c)(2)(A)(i) and (ii); Treas. Reg. §§ 301.6621-3(c)(2)(i) and (ii).

TP was mailed two separate 30-day letters with respect to its 1992 tax year. The first one was mailed on January 3, 1994, and the second 30-day letter was mailed on September 4, 1998. There is no indication that a notice of deficiency was ever mailed to TP with respect to its 1992 tax year. Thirty days after January 3, 1994 is February 2, 1994. Accordingly, the applicable date for a large corporate underpayment is February 2, 1994, if the amount reflected in the notice was not paid in full by that date.

TP and the IRS agreed on February 2, 1994, that the deficiency for TP's 1992 tax year was $50,000,000.00. TP did not fully pay this liability until October 15, 1994. Accordingly, the interest rate for the $50,000,000.00 deficiency from March 15, 1992, through February 1, 1994, is the Federal short term rate plus 3 percent. The interest rate from February 2, 1994, through October 15, 1994, is the Federal short term rate plus 5 percent.

The IRS issued a second 30-day letter to TP on September 4, 1998, and proposed a $35,000,000.00 deficiency. The deficiency is based on the IRS's disallowance of a large portion of a carryback loss from 1994 to 1992. TP had received a refund on April 1, 1995, in the amount of $40,000,000.00 as a result of this loss.

At issue is the date "hot interest" begins to run with respect to this $35,000,000.00 deficiency. Interest under I.R.C. § 6601(a) begins running "when a tax becomes both due and unpaid." Avon Products, Inc. v. United States, 588 F.2d 342, 344 (2d. Cir. 1978). Here, as of October 15, 1994, TP had fully paid its 1992 tax liability. TP did not become unpaid with respect to the second deficiency until the IRS issued the $40,000,000.00 refund to TP on April 1, 1995. Thus, April 1, 1995, is the date that there was tax that was both due and unpaid with respect to TP's 1992 tax year. Accordingly, interest on the deficiency began to accrue on April 1, 1995.

As described above, the I.R.C. § 6621(c) rate, otherwise known as "hot interest" applies to large corporate underpayments that are outstanding for periods after the applicable date. I.R.C. § 6621(c)(1). The applicable date is the thirtieth day after the earlier of the mailing of the **first** 30-day letter, or the mailing of the notice of deficiency. I.R.C. §§ 6621(c)(2)(A)(i) and (ii); Treas. Reg. §§ 301.6621-3(c)(2)(i) and (ii).

In addition, the deficiencies from both the first 30-day letter and the second 30-day letter are underpayments of income tax. "A letter or notice relating to a particular type of tax creates an applicable date only for that type of tax. For example, a letter or notice with respect to FUTA tax will not create an applicable date with respect to income tax for the same taxable year." Treas. Reg. § 301.6621-3(c)(1).

In this case, the first 30-day letter was mailed on January 3, 1994. TP states that the first letter should be disregarded as the applicable date for computing interest on the second deficiency, because such deficiency was not unpaid at the time the first 30-day letter was issued.

A 30-day letter will be disregarded for purposes of determining the applicable date, where a taxpayer fully pays the amount provided in the 30-day letter within thirty days of the date that the 30-day letter was sent, or where the IRS has withdrawn the 30-day letter. I.R.C. §§ 6621(c)(2)(B)(ii) and 6621(c)(2)(flush language). Neither exception applies in this case. Here, TP did not pay the amount in the first 30-day letter within thirty days. Further, the first 30-day letter was not withdrawn by the IRS.

Because Congress specifically provided that the applicable date is triggered upon the issuance of the first 30-day letter, Congress must have been aware that the IRS may issue more than one 30-day letter or notice of deficiency, and intended that hot interest would also apply to subsequently arising underpayments. Accordingly, because both underpayments from 1992 are the same type of tax, and TP failed to pay in full the amount listed as due on the first 30-day letter, hot interest was triggered for all subsequent large corporate underpayments, including the

$35,000,000.00 deficiency reflected in the second 30-day letter. Consequently, the I.R.C. § 6621(c) interest rate will apply to the $35,000,000.00 deficiency from April 1, 1995, until the date it is paid.

This conclusion is also supported by Treas. Reg. § 301.6621-3(d)(Example 2). In Example 2, W is a C corporation that filed its 1990 tax return on March 15, 1991, reporting an income tax liability of $95,000.00. W, however, only paid $35,000.00 when it filed its 1990 return. On June 1, 1991, the IRS mailed a notice of assessment to W reflecting a balance due of $60,000.00. W paid this balance on August 1, 1991.

On July 1, 1993, the IRS sent a notice of deficiency to W asserting an $85,000.00 deficiency. W petitioned this notice, and the Tax Court determined that W had a deficiency of $50,000.00. The example states that W's underpayment of $60,000.00, which had been paid on August 1, 1991, combined with the $50,000.00 deficiency, equals a large corporate underpayment.

Further, the example concludes that the applicable date for computing "hot interest" is July 1, 1991, which is thirty days after the notice of assessment was mailed to W.[1] This is true, even though W had fully paid the $60,000.00 underpayment before the IRS issued a notice of deficiency to W. The example further states that had W paid the $60,000.00 underpayment prior to July 1, 1991, such notice would have been disregarded.

In the present case, TP also failed to pay within thirty days, the amount contained in the 30-day letter that was mailed to it on January 3, 1994. Accordingly, this 30-day letter triggers the applicable date for computing "hot interest" with respect to TP's 1992 tax year. The fact that TP paid the first deficiency, and a subsequent deficiency later arose, does not change the applicable date for TP's 1992 tax year.

If you have any questions, please contact the attorney assigned to this matter as 202-622-4910.

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[1]For tax years that begin after December 31, 1997, I.R.C. § 6621(c)(2)(B)(iii) provides that notices or letters that do not have a deficiency or proposed deficiency of at least $100,000.00 are to be disregarded for purposes of determining the applicable date.