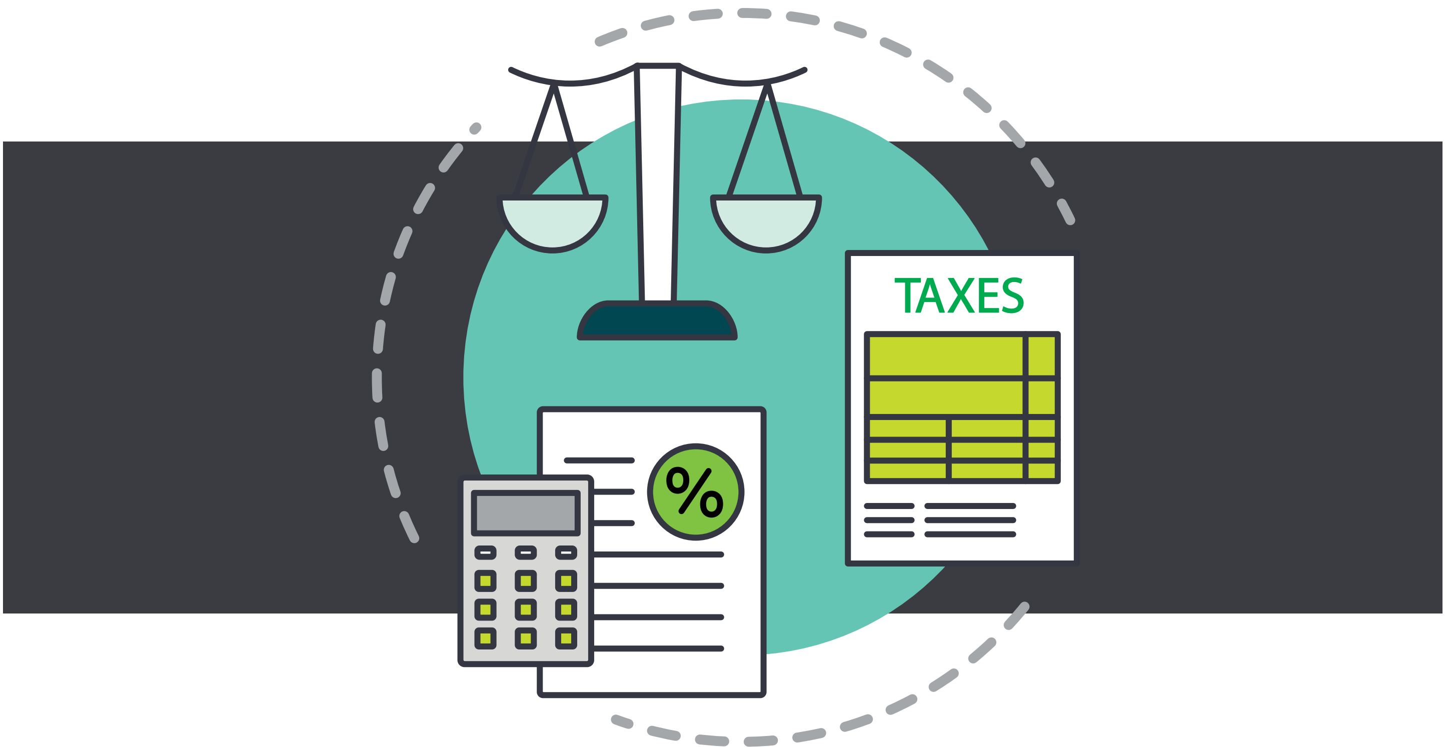

IRS Insights | A closer look

Interest Netting - The Hunt for the Definition of "Same Taxpayer"

In *Bank of America Corp. v. United States,*[1] a district court ruled that Bank of America ("BoA") was not entitled to interest netting under section 6621(d) of the Internal Revenue Code ("IRC" or "Code") for pre-merger underpayments and overpayments.[2] BoA is appealing the decision,[3] becoming the latest in a succession of cases addressing the interest netting "same taxpayer" requirement.

Statutory Background

In 1998, Congress enacted section 6621(d) to eliminate the corporate interest rate disparity on equivalent underpayments and overpayments accruing interest during the same period. Devoid of its application, a corporate taxpayer could pay up to 4.5% more interest on a tax underpayment than it would receive on an equal amount of tax overpayment accruing interest during the same period. Section 6621(d) reads:

> **(d) ELIMINATION OF INTEREST ON OVERLAPPING PERIODS OF TAX OVERPAYMENTS AND UNDERPAYMENTS**
>
> To the extent that, for any period, interest is payable under subchapter A *[Underpayments]* and allowable

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under subchapter B *[Overpayments]* 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.

The Issue

When periods of underpayment and overpayment relate to a single, corporate taxpayer with a single taxpayer identification number ("TIN"), the applicability of section 6621(d) is unchallenged. However, in situations where the tax histories of multiple TINs are involved, such as an acquisition or a statutory merger, the question of whether all the entities can be considered "same taxpayer" for purposes of interest netting is a source of controversy because the term is not defined in the Code.

Refund Claim

Beginning in 1998, several banks merged into BoA, including Merrill Lynch ("Merrill") in 2013, with BoA surviving. Between 2015 and 2017, BoA filed interest netting claims with the Internal Revenue Service ("IRS") for overlapping periods of underpayment and overpayment with respect to pre-merger tax years of the merged banks and BoA.[4] The IRS disallowed[5] the claims "taking the position that interest netting applies only when the taxpayer was the same entity at the time it originally made the overpayments and underpayments, even if the taxpayer is the same entity at the time the interest is due."[6]

District Court's Decision

BoA filed a refund suit maintaining that the merged banks and BoA are the same taxpayer for purposes of section 6621(d).[7] The parties narrowed the issues to two test cases, both involving pre-merger overpayments of Merrill with pre-merger underpayments of BoA.

BoA argued that "by" the same taxpayer does not impose a temporal limitation but rather means 'concerning' or 'with respect to' the same taxpayer. Once two corporations merge, the law treats the acquired corporation "as though it has always been part of the surviving entity." Since BoA, as the surviving corporation, is both liable for any underpayments previously made by the merged banks and eligible to receive refunds for the merged banks past overpayments, BoA argued that the same-taxpayer requirement is satisfied. BoA further argued that the IRS already determined that Merrill and BoA were the same taxpayer when it credited a pre-merger Merrill overpayment against a pre-merger BoA underpayment. BoA further argued that the legislative history and statutory purpose, along with section 6621(d)'s remedial nature, supports a broad reading of the statute consistent with BoA's request for interest netting.

The district court held that Merrill and BoA were not the same taxpayer explaining "[a]t the time of Merrill's overpayments and BoA's underpayment, the two were different corporations and different taxpayers. The payment dates ... precede the corporations' merger in 2013. When "the payments were . . . made before [a] merger," then "the payments were made by two separate corporations" that were not the "same taxpayer."[8]

As did the Federal Circuit Courts in prior "same taxpayer" interest netting cases, here too the district court inserted the word "made" into the section 6621(d) language, resulting in the statute providing "an *identified* point in time at which the taxpayer must be the same, i.e., when the overpayments and underpayments are made." The district court explained that "Congress conveyed that meaning with the words it chose. The presence of the verb 'made' is understood; it was left out merely by means of a grammatical ellipsis."[9] In so holding, the district court defined the point in time for determining same taxpayer as the last date prescribed for payment of tax (underpayment) and the first date when a taxpayer's payments and credits exceed their liabilities (overpayment). The district court concluded that Merrill and BoA were two different corporations and different taxpayers because the payment dates precede their merger in 2013.

The Court dismissed BoA' merger law argument stating "[t]rue, the surviving corporation becomes liable for the acquired corporation's debts, liabilities and duties. But liability and interest are two different things, and a surviving corporation's newly acquired liability does not determine availability of interest netting under section 6621(d)."[10] The district court dismissed BoA's credit argument providing that any crediting

"occurred because of a discretionary decision by the Secretary, and such a discretionary decision cannot abrogate the requirements for interest netting set out in section 6621(d)."[11] The district court dismissed BoA's legislative history argument finding that the plain language of the statute controls.

Current Appeal

BoA is currently appealing the district court decision, maintaining that the survivor of a corporate merger can net the interest on a pre-merger overpayment by one merged company with the interest on a pre-merger underpayment by another merged company. BoA asserts that the survivor and the companies that merged into it are all treated as one company, as if it always has been that way, both prospectively and retrospectively. BoA believes the district court erred in adding a temporal limitation by inserting the word "made" into the statute and by overlooking a key aspect of state merger law that a surviving corporation is retroactively considered the same as all merged companies.

The Chamber of Commerce of the United States of America and several professional associations have submitted an Amicus Curiae brief recommending reversal of the district court's ruling. The Amicus Brief's arguments mirror those of BoA, including that the district court erred in rewriting section 6621(d) to include a temporal limitation and did not follow the principals of merger law.

Conclusion

Since section 6621(d)'s enactment in 1998, the absence of a clear definition of "same taxpayer" has prolonged the quandary of the statute's applicability to situations involving acquisitions and/or mergers. BoA's appeal affords the 4th Circuit a fresh opportunity to examine "same taxpayer" and provide much needed clarity.

Just as interest grows over time, so does interest jurisprudence. Another recent interest case is *Goldring v. United States*[12] providing for a use-of-money deferral well beyond the one-year deferral provided by Rev. Rul. 99-40. Both the ongoing BoA case and *Goldring* affect how interest is computed and emphasize the importance of carefully reviewing federal interest computations to ensure their accuracy.

Important Reminder: The IRS does not apply interest netting on its own, requiring taxpayers to request the benefit of this taxpayer favorable interest saving provision.

Tax Court Invalidates Treasury Regulation for Conflicting with IRC

As part of the Tax Cuts and Jobs Act of 2017, Congress added section 245A and amended section 78. As discussed below, there was a timing mismatch between the effective dates of new section 245A and the amendment to section 78. In 2019, the IRS promulgated Treas. Reg. § 1.78-1 to "fix" the timing mismatch. However, the Tax Court did not give effect to the Treasury regulation in *Varian Medical Systems, Inc. and Subsidiaries v. Comm'r*,[13] and instead relied on the plain language of the statutes.

Overview of Section 245A and Section 78

As part of TCJA, Congress added section 245A, which provides a 100 percent dividends received deduction for U.S. corporations for certain dividends received from foreign corporations. Congress made this new section effective for distributions made after December 31, 2017.

Under section 78, deemed-paid foreign tax credits (FTCs) are treated as dividends received. Although Congress amended section 78 to not apply for purposes of section 245A, Congress made this change effective for tax years of foreign corporations beginning after December 31, 2017.

Thus, there was a timing mismatch—for taxpayers with fiscal year foreign corporations there was period when section 245A was in effect, but the section 78 amendments were not.

In 2019, the IRS amended Treas. Reg. § 1.78-1 to provide that a deemed-paid FTC treated as dividend under section 78 does not qualify as a dividend for purposes of section 245A. The regulations states that this rule applies to all section 78 dividends received after December 31, 2017. Thus, the regulation effectively eliminated the timing mismatch in which fiscal taxpayers could receive both a dividends received deduction for the section 78 gross up by changing the effective date of the amendments to section 78.

Tax Court Case

In *Varian Medical Systems, Inc. and Subsidiaries v. Comm'r*, Varian had several controlled foreign corporations (CFCs) using fiscal tax years. On its tax return for year ended September 28, 2018, Varian claimed a section 245A dividends-received deduction with respect to the section 78 gross-up resulting from the inclusion under section 965(a).

The IRS argued that Varian was not entitled to a section 245A deduction because (1) section 245A permits a deduction only for distributions from earnings (and not deemed distributions) and (2) Treas. Reg. § 1.78-1 bars the deduction.

The Tax Court disagreed with the IRS and ruled that for a fiscal year foreign corporation's last taxable year beginning before January 1, 2018, section 245A applies to deemed-paid FTCs treated as dividends under section 78 because section 78 as in effect for that period treated the gross-up as a dividend for all purposes of the Code (except section 245). Additionally, the Tax Court ruled that Treas. Reg. § 1.78-1 cannot change the effective date of the section 78 amendment. The Tax Court stated that the IRS cannot contravene Congressional intent and the section 78 statute clearly stated Congressional intent.

However, the Tax Court did agree with the IRS that if a taxpayer claims the deduction under section 245A for a section 78 dividend, it must reduce foreign taxes under section 245A(d) by the amount of its deemed paid foreign taxes that are attributable to the foreign earnings reflected in the section 78 dividend. The Tax Court set out the following formula for computing the disallowed tax amount:

$$Deemed\text{-}Paid\ FTCs \times \left(\frac{Section\ 78\ gross{-}up}{Net\ section\ 965\ inclusion + section\ 78\ gross{-}up}\right)$$

Conclusion

U.S. taxpayers with fiscal year foreign corporations that had inclusions bringing up deemed-paid FTCs during their transition tax year (the statutory timing mismatch period) may be entitled to a refund based on the Tax Court's opinion. There are several other pending court cases with this same issue in dispute and it is unknown how these cases and any appeals will ultimately be decided. Taxpayers should consult their tax advisors on the potential benefits and detriments of filing a protective claim or general refund claim, if their refund statute of limitations is still open.

Taxpayers Had Reasonable Cause Despite Failure to Provide a Document

In a recent decision, the Tax Court held that, despite failing to provide their accountant with certain documentation during the preparation of their tax returns for the years at issue, taxpayers still had reasonable cause based on reasonable reliance on an advisor and were not liable for section 6662(a) accuracy-related penalties.[14]

Background

Mr. and Mrs. Schwarz ("Taxpayers") are the sole owners of a partnership engaged in ecotourism, as well as farming and construction activities.[15] In 2020, the Internal Revenue Service ("IRS") made a determination that the partnership's activities were not engaged in for-profit pursuant to section 183 and therefore disallowed the Schedule F, *Profit or Loss From Farming*, loss deductions claimed by the partnership for tax years 2015 through 2017 (the "years at issue").[16] As a result, Taxpayers, who had claimed significant deductions for the partnership's Schedule F losses, were subsequently issued a notice of deficiency and assessed section 6662(a) accuracy-related penalties for the years at issue.[17]

Taxpayers filed a petition challenging the IRS's determinations, claiming that the partnership's Schedule F activity was engaged in for-profit and that Taxpayers had reasonable cause for their underpayment of tax, based on reliance on an advisor.[18] Specifically, Taxpayers claimed to have relied on the advice of their longtime accountant who had been engaged since the mid-2000s to prepare tax returns for Taxpayers, the partnership, and other entities also owned by Taxpayers.[19]

Tax Court Decision

In its decision, the Court upheld the IRS's determination that the partnership's Schedule F activity was not engaged in for-profit pursuant to section 183 and, therefore, denied Taxpayers' deductions for the partnership's Schedule F losses for the years at issue.[20] However, the Court held that Taxpayers still had reasonable cause based on reasonable reliance on an advisor and were therefore not liable for the section 6662(a) accuracy-related penalties.[21]

Section 6662(a) imposes a 20% accuracy-related penalty on underpayments of tax required to be shown on a return.[22] However, the accuracy-related penalty can be avoided if the taxpayer can show that he acted in good faith and had reasonable cause for the underpayment of tax.[23] To demonstrate reasonable cause, a taxpayer must also show that he "exercised ordinary business care and prudence".[24] The determination of whether a taxpayer acted in good faith is generally made on a case-by-case basis, with one of the most important factors being the extent of the taxpayer's efforts to properly assess his tax liability for the years at issue.[25] If a taxpayer engages a tax professional to help assess his tax liability and the taxpayer relies on the professional's advice but, nonetheless, still fails to properly assess his tax liability, the taxpayer can claim reasonable cause based on reliance on a professional.

However, to show reasonable cause based on reliance on a professional, the taxpayer must satisfy the *Neonatology* three-prong test to establish whether the taxpayer's reliance on the professional was reasonable – (1) the adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser's judgment.[26] If the taxpayer can satisfy the three-prong test and show that his underpayment of tax was due to reasonable cause based on reasonable reliance on a professional, the

section 6662 accuracy-related penalties will not apply for the years at issue.[27]

Accordingly, in determining whether Taxpayers had reasonable cause based on reliance on their accountant, the Tax Court applied the *Neonatology* three-prong test. In its analysis, the Court determined that Taxpayers satisfied the three-prong test because their accountant "was a competent professional who had sufficient expertise to justify reliance when returns were prepared for the years at issue", Taxpayers made a reasonable attempt to provide their accountant with "every (potentially) relevant document", and Taxpayers actually relied in good faith on the judgment of their accountant.[28] As such, the Court concluded Taxpayers reasonably relied in good faith on their accountant's advice. The IRS had argued that the second prong of the test was not met because Taxpayers failed to provide their accountant with copies of certain lease agreements between the partnership and the other entities also owned by Taxpayers.[29] The Court disagreed, stating that although Taxpayers did not provide their accountant with copies of these lease agreements, Taxpayers still satisfied the second prong because they made a reasonable attempt to provide their accountant with all relevant documents and any requested information; in addition, the lease agreements were never requested.[30] The Court emphasized that Taxpayers provided their accountant with thousands of other documents and because this was a complex case involving thousands of pages of evidence, Taxpayers could not have reasonably known the importance of the rent clause provision in the lease agreements.[31]

Conclusion

The Court held that Taxpayers were not liable for the section 6662 accuracy-related penalties because they had, in good faith, reasonably relied on their accountant's advice for the years at issue.[32] Although this was a taxpayer favorable decision, taxpayers should attempt to provide all relevant documentation to their tax advisors in order to avoid any question of whether they satisfied the second prong of *Neonatology*.

IRS Can Waive Requirement that Form 2848 Be Attached to Form 843

Recently, the Court of Federal Claims rejected the IRS's claim that a Form 843 was invalid because the attorney signing the Form 843 did not reattach a copy of the Form 2848 previously provided to the IRS.[33]

Factual Background

Taxpayer sought a refund of employment taxes and penalties by filing Form 843, *Claim for Refund and Request for Abatement*. The form was signed by an attorney authorized by Taxpayer. The attorney was authorized via Form 2848, *Power of Attorney and Declaration of Representative*. Taxpayer had previously provided the IRS copies of the Form 2848 on at least three occasions, and the POA had been faxed to the IRS's Centralized Authorization File ("CAF") unit twice. The IRS was aware that the attorney had a valid Form 2848 because when the IRS rejected Taxpayer's Form 843, it sent the rejection to the attorney under his authority as power of attorney for Taxpayer.

Taxpayer sued the IRS in the Federal Court of Claims for the refund. For the first time, the IRS argued that Taxpayer's Form 843 was invalid because the attorney did not attach a Form 2848 proving his authority to sign. The Federal Court of Claims agreed. Taxpayer appealed.

Appellate Decision

Taxpayers cannot sue the IRS for refunds in court until they have exhausted administrative remedies by "duly" filing a claim for refund with the IRS.[34] Refund claims must be "signed in accordance with forms or regulations prescribed by [IRS]."[35]

A refund claim may be filed by the taxpayer's agent, but a power of attorney must accompany the form.[36] The issue for the appellate court was whether this requirement was derived from statutory or if it was regulatory in nature. If it was derived from the statute, the requirement could not be waived. However, if it is regulatory, the IRS could waive it.

The IRS argued that a Form 2848 must accompany a Form 843 to establish that the signer has authority. The IRS conceded that a Form 2848 does not need to accompany refund claims on tax returns because the IRS records in the CAF system when a Form 2848 is on file for those forms. However, the IRS does not record in the CAF system when a taxpayer has filed a Form 2848 for Form 843.

The Federal Circuit Court of Appeals determined that "accompanying Form 2848" requirement was regulatory instead of statutory because the statute does not speak to the "when, where, and how" of filing a Form 2848. The court did not find it relevant that the IRS does not record Forms 2848 for Forms 843—"The IRS's prerogative to design systems and processes that suit its needs does not transform regulations into statutory provisions."

Because the "Form 2848 accompanying" requirement is regulatory, the IRS can waive the requirement. The appellate court remanded the case to the trial court to determine if the IRS waived the "duly" filed requirement by processing the claim without the Form 2848.

Conclusion

Although the court of appeals determined that failure to attach a Form 2848 does not automatically invalidate a Form 843, taxpayers should still attempt to comply with all statutory and regulatory requirements when filing refund claims to avoid protracted disputes and litigation with the IRS.

Endnotes

1. *Bank of America Corporation v. United States*, 656 F. Supp. 3d 574 (W.D. NC, Charlotte Division 2023).
2. Id.
3. *Bank of America Corporation v. United States of America*, No. 23-251 (4th Cir.)
4. Claim covered tax adjustments for 23 years across seven pre-merger banks.
5. The IRS disallowed two claims, didn't act upon the third.
6. *Bank of America Corporation v. United States of America*, No. 23-251 (4th Cir.)(Petition for Interlocutory Review Pursuant to 28 U.S.C. § 1292(b), Statement, Factual Background citing the IRS' Disallowance of September 14, 2015, *Bank of America v. United States*, W.D. NC case No. 3:17-cv-00546-RJC-WCM, Third Am. Compl. Dkt. 29-23).
7. *Bank of America Corporation v. United States*, No. 3:17-cv-00546-RJC-DSC, Plaintiff's Motion for Partial Summary Judgment (August 19, 2022).
8. *Bank of America Corporation v. United States*, 656 F. Supp. 3d 574, 578 (W.D. NC, Charlotte Division 2023).
9. *Bank of America Corporation v. United States*, 656 F. Supp. 3d 574, 579. (W.D. NC, Charlotte Division 2023).
10. *Bank of America Corporation v. United States,* 656 F. Supp. 3d 574, 582 (W.D. NC, Charlotte Division 2023).
11. Id.
12. *Goldring v. United States*, 15 F. 4th 639 (Fifth Cir. 2021).
13. *Varian Med. Sys. v. Commissioner*, No. 8435-23, 2024 U.S. Tax Ct. LEXIS 2106, at *3-4 (T.C. Aug. 26, 2024).
14. *Schwarz v. Comm'r*, T.C. Memo 2024-55.
15. Id. at 2.
16. Id.
17. Id.
18. Id.
19. Id.
20. Id. at 116.
21. Id.
22. Sections 6662(a), 6662(b).
23. Section 6664(c)(1).
24. *United States v. Boyle*, 469 U.S. 241, 243.
25. Treas. Reg. § 1.6664-4(b)(1).
26. *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 99.
27. *Schwarz v. Comm'r*, T.C. Memo 2024-55, 113.
28. Id. at 116.
29. Id. at 115.
30. Id. at 116.
31. Id.
32. Id.
33. *Vensure HR, Inc. v. United States*, No. 2023-1640, 2024 U.S. App. LEXIS 25126, at *1 (Fed. Cir. Oct. 4, 2024)
34. Section 7422.
35. Section 6061(a).
36. Treas. Reg. § 301.6402-2(e).

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