Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:HMT:CLE:POSTF-101139-02
RSBloom

date: January 28, 2002

to: Technical Support
Cincinnati, OH
Attn: Marianne Heck

from: Associate Area Counsel, LM:HMT:CLE

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subject: **Advisory Opinion: Restricted Interest Assessment**
Taxpayer: [redacted] **and Subsidiaries**
Year: [redacted]

This memorandum responds to your oral request for advice of January 7, 2002. This memorandum should not be cited as precedent. The opinion herein is subject to 10-day post review by our National Office and, therefore, is subject to modification. You will be notified once that review has been completed.

ISSUES

1) Whether interest on a "deficiency" in income tax, which deficiency was extinguished by a net operating loss carryback, can be assessed without either an agreement from the taxpayer or issuance of a notice of deficiency.

2) What is the statute of limitations for assessing such interest.

CONCLUSIONS

1) Interest on a "deficiency" in income tax, which deficiency was extinguished by a net operating loss carryback, can be assessed by the Service without either an agreement from the taxpayer or issuance of a notice of deficiency.

2) Such interest must be assessed before the expiration of the period of limitations for assessment of the tax to which the interest relates.

FACTS

The taxpayer filed its tax return for the year [redacted] in January [redacted]. On the return, it reported taxable income of $[redacted] and total tax of $[redacted]. Consents to extend the time to assess tax were timely and properly executed by the taxpayer and the Service for the year [redacted], extending the assessment period to December 31, [redacted].

The taxpayer filed its tax return for the year [redacted] on September 15, [redacted]. On the return, it reported a loss in the amount of $[redacted]. Consents to extend the time to assess tax were timely and properly executed by the taxpayer and the Service for the year [redacted], extending the assessment period to December 31, [redacted].

The taxpayer filed its tax return for the year [redacted] on September 15, [redacted]. On the return, it reported a loss in the amount of $[redacted] and elected to forego the net operating loss ("NOL") carryback period with respect to the loss. A consent to extend the time to assess tax was timely and properly executed by the taxpayer and the Service for the year [redacted], extending the assessment period to June 30, [redacted].

The taxpayer filed its tax return for the year [redacted] on January 20, [redacted]. On the return, it reported a loss of $[redacted]. It did **not** elect to forego the NOL carryback period with respect to such loss.

On [redacted], the taxpayer filed a Chapter [redacted] bankruptcy petition with the U. S. Bankruptcy Court for the [redacted] ([redacted]).

The taxpayer's tax returns for the years [redacted] through [redacted] were audited by the Service. The Revenue Agent's Report ("RAR") dated August 16, 2001, with respect to the audit reflects the following:

[redacted]:

Adjustments to Income:	legal fees	$[redacted]
	amortization	[redacted]
Deficiency: $[redacted]		

1996:

Adjustments to Income:	bad debts	$[redacted]
	amortization	[redacted]
	charitable	([redacted])
	NOL C/B [redacted]	([redacted])
Deficiency: $[redacted]		

[redacted]:
Adjustments to Income: amortization $[redacted]
charitable [redacted]
Sch. D [redacted]
Deficiency: $[redacted]
[redacted]:
Adjustments to Income: amortization $[redacted]
Deficiency: $[redacted]

Prior to December 31, [redacted], a notice of deficiency was issued to the taxpayer with respect to the year [redacted], reflecting a deficiency in income tax in the amount of $[redacted]. On December 31, [redacted], the Service assessed the "deficiency" and interest for the year [redacted] generated by the proposed adjustments to income (other than the NOL C/B from [redacted]) as set forth in the RAR.

LAW and ANALYSIS

Where a deficiency and interest have been validly assessed under applicable statutory procedure, a subsequent carryback of a net operating loss which results in the abatement of the deficiency does not abate the interest previously assessed on the deficiency. Manning v. Seeley Tube & Box Co., 338 U.S. 561 (1950). Although there has been an assessment of a "deficiency" in tax and interest for the year [redacted] in the case at hand, the **assessment of the tax** was not valid under the Internal Revenue Code. As a general rule, for a deficiency in income tax to be assessed, a notice of deficiency providing the taxpayer an opportunity to petition to the Tax Court must be first sent by the Service to the taxpayer. I.R.C. § 6213(a). The taxpayer can, in writing, waive such requirement.[1] Section 6213(d). Since there was neither a notice of deficiency issued to the taxpayer for the year [redacted] nor a written waiver received from the taxpayer relating thereto, **the tax (not the interest) which was assessed on December 31, [redacted], for the year [redacted] must be abated.**

In Seeley Tube & Box, the Supreme Court's focus was, unlike the case at hand, on income tax and interest assessments which had been made prior to the reporting by the taxpayer of a net operating loss. In fact, the Court stated "[w]hether the language of the Code requires a different result when the loss is claimed before the attempted assessment of the deficiency is a question which is not considered by us on this record." Seeley

[1]Other exceptions to the general rule also exist (e.g., assessment of mathematical errors), none of which are applicable to the case at hand.

Tube & Box, at 570. In the case at hand, there was no deficiency in income tax to be assessed. In making the Service's determination of the taxpayer's tax liability for the year [redacted], the agent applied, pursuant to section 172(a)[2], the taxpayer's [redacted] net operating loss as a deduction for its [redacted] year. The term "deficiency" means the amount by which the tax imposed by subtitle A exceeds the excess of (1) the sum of (A) the tax shown on the taxpayer's return, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over (2) the amount of rebates. In this case, after application of the net operating loss carryback, the tax imposed by subtitle A, as set forth in the RAR, was equal to the tax shown on the taxpayer's return. Thus, there was no deficiency in income tax. A similar situation was encountered in Rodgers v. United States, 108 F. Supp. 727 (Ct. Cl. 1952). In Rodgers, the court held that there is no requirement for a separate assessment of a deficiency, by reason of its extinguishment by a subsequent carryback, as a prerequisite to the assessment of interest on that deficiency. However, in Rodgers, unlike the case at hand, the taxpayer agreed to the underlying adjustments making up the potential deficiency which was extinguished by the carryback[3] and a net overassessment resulted from the audit for such year.

The case of Standard Oil Company v. McMahon, 139 F. Supp. 690 (S.D. NY 1956), aff'd, 244 F.2d 11 (2nd Cir. 1957), although involving excess profits tax and an excess profits tax credit carryback, more closely resembles the present case. Like the situation at hand, the Service did not issue the taxpayer a

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[2]I.R.C. § 172(a) allows a deduction for the taxable year of an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. Net operating losses are carried back 2 years and forward 20 years. Section 172(b)(1)(A).

[3]The taxpayer in Rodgers executed a written waiver consenting to the assessment and collection of a deficiency for one year and accepting the over-assessment for another year (the year to which the net operating loss was carried back). It must be noted that such an agreement with the taxpayer is not necessary to allow the Service to challenge the taxpayer from later claiming any portion of the net operating loss which was applied to extinguish the [redacted] deficiency. Although a carryback year may be a closed year for purposes of assessing a deficiency, adjustments to income in such carryback year can be made for purposes of determining how much, if any, of the net operating loss may be carried over to subsequent years. See State Farming Co. v. Commissioner, 40 T.C. 774 (1963).

notice of deficiency for the excess profits tax which was eliminated by the carryback, but did assess the interest on the extinguished deficiency. Also, as in the case at hand, the taxpayer did not consent in writing to the adjustments; it brought suit to enjoin the collection of the interest, asserting that its assessment without a prior notice of deficiency was prohibited by statute.[4] The 2nd Circuit held the following:

> We find no overriding policy which requires us to depart from the normal rule that the jurisdiction of the Tax Court depends upon the assertion of a present "deficiency." As the 1945 carryback precluded the Commissioner from asserting such a "deficiency," the Tax Court is without jurisdiction of the dispute in the case at bar. Accordingly it was not necessary for the Commissioner to send appellant a deficiency notice as a condition precedent to assessment of the interest on the asserted former "deficiencies."

Standard Oil Company, 244 F.2d at 14. Thus, the court held that, even without agreement from the taxpayer or issuance of a notice of deficiency, the Government is entitled to assess interest on extinguished deficiencies in excess profits tax if asserted deficiencies did exist for a period of time.

In line with the holding of the 2nd Circuit in Standard Oil Company is section 6601(e)(1). The paragraph provides the following:

> **Interest treated as tax.** Interest prescribed under this section on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes. Any reference in this title (except subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax.

I.R.C. § 6601(a) provides that, if any amount of tax imposed by this title is not paid on or before the last date prescribed for payment, interest on such amount at an annual rate established under section 6621 shall be paid for the period from such last date to the date paid. If the amount of any tax imposed by subtitle A is reduced by reason of a carryback of a net operating

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[4]The taxpayer relied upon section 272(a)(1) of the Internal Revenue Code of 1939, which is similar to present day section 6213(a).

loss or net capital loss, such reduction in tax shall not affect the computation of interest under this section for the period ending with the last day of the taxable year in which the net operating loss or net capital loss arises. Section 6601(d)(1). In this case, interest is owed by the taxpayer on the extinguished [redacted] deficiency. The interest is assessed in the same manner as taxes. Assessment is made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules and regulations prescribed by the Secretary. Section 6203. However, unlike the assessment procedure for income taxes, the deficiency procedures of subchapter B of chapter 63 (sections 6211 through 6216) do not apply with respect to interest. Consequently, the interest in question can be assessed without regard to the restrictions imposed by section 6213(a).[5]

Section 6601(g) provides that interest on any tax may be assessed and collected at anytime during the period within which the tax to which such interest relates may be collected.[6] In the case at hand, the tax to which the interest relates was not **properly** assessed[7]; therefore, the interest on the "deficiency" must be assessed during the assessment period for the tax to which the interest relates. As a general rule, taxes must be assessed within 3 years after the return to which they relate was filed. Section 6501(a). However, section 6501(c)(4) allows the Secretary and the taxpayer to consent in writing to extend the time in which to assess income tax. In the case at hand, the Secretary and the taxpayer timely executed consents extending the time in which to assess tax for the [redacted] tax year to December 31, [redacted]. Since the interest was assessed on December 31, [redacted], the assessment was timely and proper. See Ltr. Rul. 8201022 (September 30, 1981).

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[5]The automatic stay, resulting from the taxpayer's filing of the Chapter 11 bankruptcy petition, does **not** operate as a stay of the making of the assessment. 11 U.S.C. § 362(b)(9)(D). As you were previously advised, the insolvency unit must be notified of the interest assessment for the year [redacted], as well as the proposed deficiency in income tax for the year [redacted], so that a proper and timely proof of claim can be filed in the bankruptcy proceeding.

[6]I.R.C. § 6502(a) generally provides that taxes may be collected within 10 years after their assessment.

[7]See page 3, above. Since the assessment was not proper, it cannot be relied upon to extend the statutory period in which to assess the interest on the "deficiency."

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