

ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

**Office of Chief Counsel
Internal Revenue Service**

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memorandum

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date: February 2, 1998

to: Chief, Accounts Resolution Branch T:C:O:A

from: Assistant to Chief, Branch 1 CC:DOM:IT&A:1

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As we discussed in our meeting of October 8, 1997, you have submitted questions to us regarding the TRA '97 amendment to section 6621(c) of the Internal Revenue Code. That section provides for an increased rate of interest in the case of large corporate underpayments ("hot interest"). Below, we restate your questions and your seven case illustrations, which were included in your memorandum to us dated November 17, 1997, and provide answers to each.

QUESTIONS

Question 1: When computing the additional two percent corporate debit interest ("hot interest") after December 31, 1997, for any tax period, does the amendment supersede pre-existing statutory requirements, or are pre-existing statutory requirements retained and supplemented? Outline the statutory requirements which apply through December 31, 1997, and those which apply January 1, 1998, and later.

Answer: Pre-existing statutory requirements are retained and supplemented. The amendment only changes the application of hot interest to periods beginning after December 31, 1997. Hot interest which may have accrued up to December 31, 1997 may stop on that date if, under the new provision, no applicable date for starting hot interest has been triggered.

As you requested, the following is a brief outline of the statutory requirements that apply through December 31, 1997 and the statutory requirements that apply after that date. Under section 6621(c), large corporate underpayments of tax are subject to an interest rate two percent above the normal underpayment rate set forth in section 6621(a)(2). The term "large corporate underpayment" means any underpayment of a tax by a C corporation for any taxable period if the underpayment exceeds \$100,000. Section 301.6621-3(b)(2)(ii) of the Regulations on Procedure and Administration provides that for purposes of meeting this

\$100,000 threshold underpayment, only underpayments of tax are considered (not interest, penalties, additional amounts or additions to tax). The underpayment is the excess of tax due over the amount paid by the last date prescribed for payment. Once the threshold is met, the hot interest rate applies to the entire underpayment, including tax, interest, penalties, etc. Section 301.6621-3(b)(2)(i) of the regulations.

Hot interest begins to run on a large corporate underpayment after the "applicable date." Under the law covering the period before January 1, 1998, the applicable date is the 30th day after the date on which the first letter of proposed deficiency (30-day letter), notice of deficiency, or notice/letter of assessment or proposed assessment is sent to the taxpayer. The amount shown in the letter or notice is not relevant. The letter or notice is disregarded for purposes of setting an applicable date if the taxpayer pays the amount shown in the letter or notice within 30 days from the date it is sent.

As stated, for the period before January 1, 1998, the applicable date may be 30 days after the date of any notice/letter, regardless of the amount shown in that letter. Thus, a small notice, for a deficiency or assessment of under \$100,000, or even a notice for a small math error, may trigger an applicable date. If a large corporate underpayment is later determined to exist, hot interest will start running from the applicable date.

Under the new section 6621(c) in TRA '97, for the period beginning after December 31, 1997, the applicable date will now be the 30th day after the first letter or notice for a deficiency or assessment of an amount over \$100,000 (not including interest, penalties or additions to tax). Small notices, setting forth amounts not greater than \$100,000, are disregarded and can no longer trigger an applicable date.

Question 2: Does the reference "for purposes of determining interest for periods after December 31, 1997", refer to taxable periods having a return due date after December 31, 1997, or to underpayment periods occurring after December 31, 1997, during which hot interest applies?

Answer: The reference "for purposes of determining interest for periods after December 31, 1997" refers to underpayment periods occurring after December 31, 1997, not to taxable periods having a return due date after December 31, 1997. Thus, the amendment is effective for the accrual of interest after December 31, 1997.

Question 3: If an applicable date for computing hot interest was set prior to January 1, 1998, should it be voided based on the amendment?

Answer: No, the applicable date is never voided. However, the period of hot interest may have to be modified. If the letter or notice triggering hot interest stated a deficiency or assessment in an amount not exceeding \$100,000, hot interest on a large corporate underpayment starts on the applicable date and stops on 12/31/97. It would begin again 30 days after a letter or notice is issued stating a deficiency or assessment in an amount exceeding \$100,000.

Question 4: Based on the amendment, if the taxpayer receives numerous notices/letters regarding multiple underpayments which individually do not exceed \$100,000, but the total underpayment exceeds the \$100,000 threshold, is the taxpayer subject to hot interest in each period (See Cases 1 and 2 attached)?

Answer: It depends. There must be a notice or letter setting forth an underpayment of over \$100,000. It is our understanding that notices of assessment state a cumulative unpaid balance, so that a taxpayer who does not pay in response to small notices will eventually receive a notice for an amount exceeding \$100,000. Therefore, if the taxpayer's total underpayment is over \$100,000, but the taxpayer never receives a notice/letter stating an underpayment of over \$100,000 (because, for example, the taxpayer paid part of the underpayment), the taxpayer would not be subject to hot interest.

Question 5: On what date would the hot interest rate begin to be computed if the taxpayer had an applicable date set prior to January 1, 1998, and a notice/letter is issued on January 12, 1998, for an amount exceeding \$100,000, and full payment is not received within 30 days? Would hot interest be charged from the applicable date set prior to January 1, 1998? On what amounts would hot interest be charged (See Case 3 attached)?

Answer: In Case 3, hot interest on the \$10,000 would begin on the applicable date - 30 days after the date of the first notice or letter (this appears to be sometime between 3/15/94 and 6/9/94). Hot interest ends when the amount is paid (7/10/94). An applicable date has been set which applies to other underpayments as well. Hot interest applies to the \$70,000 tax assessed on 11/15/95, from the applicable date until the date it is paid. Hot interest also runs on the \$101,000 assessed on 11/10/97, from the applicable date until the date paid. Hot interest also applies to any interest, penalties or additions to tax. Since there was a letter issued for an amount exceeding

\$100,000 on 3/14/97, the TRA amendment does not affect the running of hot interest in this case.

However, in your question, you also ask how hot interest would apply if a notice/letter for an amount over \$100,000 were issued on January 12, 1998. Hot interest is already running on all amounts due in Case 3, and will continue to apply to all amounts assessed. However, if there had been no notice/letter issued before 12/31/97 for an amount exceeding \$100,000, hot interest based on the original applicable date would cease to accrue as of 12/31/97. It would begin to accrue again on February 11, 1998, 30 days after the notice/letter issued on January 12, 1998 for over \$100,000.

Question 6: If an applicable date for hot interest is set after January 1, 1998, on what date can it be voided?

- a. On the date that payment reduces the underpayment balance to \$100,000 or less.
- b. On the date the underpayment balance is fully paid.
- c. Never

Answer: The answer is "c". The applicable date is never voided once it is determined. Even if the underpayment is paid, the applicable date remains, and any large corporate underpayment for that year will accrue hot interest from the applicable date.

Although the applicable date is never voided, the letter or notice which set the applicable date may be disregarded. The regulations state that if the statutory notice is rescinded, if the assessment is abated, or if the 30-day letter was issued to the wrong taxpayer or for the wrong year, such letter or notice is disregarded in determining the applicable date. See section 301.6621-3(c)(6) of the regulations. If the letter or notice which set the applicable date is disregarded, then hot interest does not accrue until 30 days after a letter or notice setting forth an underpayment of over \$100,000 is issued.

Question 7: In the legislative text, what is meant by "additions to tax"?

Answer: The term "additions to tax" refers to the penalties imposed under sections 6651 through 6663 of the Code (Subtitle F, Chapter 68A of the Code).

Question 8: When deciding how to treat cases in which hot interest accrues before 1998 and after 1998, which of the following rules apply?

- a. The only tax modules to which the new rules apply are when the return due dates are after December 31, 1997, or
- b. the only interest periods/tax modules to which the new rules would apply are periods that begin with an "applicable date" on or after January 1, 1998, or
- c. the old provision would apply to all tax modules with a return due date prior to January 1, 1998.

Answer: None of these alternatives apply, as they are contrary to the effective date stated in the legislation ("determining interest for periods after December 31, 1997"). See answer 2 above.

Question 9: Are subsequent notices for amounts that are less than \$100,000 included in or excluded from the tax underpayment that makes up the "threshold amount"?

Answer: Section 6621(c) of the Code provides for hot interest in the case of a "large corporate underpayment", defined as an underpayment for a taxable period which exceeds \$100,000. The regulations further define the term "large corporate underpayment" as any underpayment of a tax if the amount of the "threshold underpayment" of the tax for the tax period exceeds \$100,000. See section 301.6621-3(b) of the regulations. The term "threshold underpayment" of tax is defined in the regulation as the excess of a tax imposed by the Code (exclusive of interest, penalties, additional amounts, and additions to tax) for the tax period over the amount of such tax paid on or before the last date prescribed for payment. Section 301.6621-3(b)(ii).

Therefore, the threshold underpayment is the amount of tax unpaid as of the last date prescribed for payment (typically, the due date of the return). This amount, which does not include interest or penalties, must exceed \$100,000 for hot interest to apply. Once there is a threshold underpayment exceeding \$100,000, hot interest applies to the full underpayment for the pertinent tax period -- tax, interest and penalties. The existence of a threshold underpayment is determined only when an assessment is made. Thus, the amount of a deficiency or assessment set forth in a notice or letter does not determine whether there is a large corporate underpayment. See section 301.6621-3(b)(2)(iii) of the regulations.

Letters and notices are relevant only with respect to the period over which hot interest may apply; i.e., letters and notices set the applicable date. The only significance to the amount shown in a letter or notice is that under the new amendment, the applicable date is 30 days after the first letter or notice stating an amount in excess of \$100,000. Letters and notices are not relevant for determining whether there is a large corporate underpayment. Therefore, regardless of the amounts set forth in individual letters and notices, if there is a threshold underpayment, hot interest applies to all amounts due after the applicable date.

Question 10: Is the "applicable date" the notice/letter date plus 30 days or is it the notice/letter date?

Answer: The applicable date is the 30th day after the date of the \$100,000 notice/letter. See section 6621(c)(2)(A).

Question 11: How much of the amount shown as due in a notice or letter is a taxpayer required to pay to avoid setting an "applicable date"?

Answer: The taxpayer must pay the full amount stated in the notice or letter to avoid setting an applicable date. Section 6621(c)(2)(B)(ii) of the Code; section 301.6621-3(c)(5)(i) of the regulations.

CASES

CASE 1: Tax Period 9012

TC	150	210,000	3/15/91	Tax liability
	610	200,000	3/15/91	Payment with the return
				The \$10,000 unpaid balance is NOT paid within 30 days of the notice on 6/1/91
			8/8/91	\$10,000 balance fully paid (plus interest & penalties)
	290	95,000	11/10/91	Tax assessment paid within 30 days
	300	11,000	4/15/92	Assessment made, 30 day letter issued 3-1-92 for \$11,000 NOT paid within 30 days
			2/14/98	Balance fully paid

The applicable date was 30 days after the date of the \$10,000 notice. Based on the new legislation, would that applicable date be voided since none of the notices/letters exceeded \$100,000?

Answer: The applicable date would not be voided (see answer 6 above). Hot interest runs on the \$10,000, the \$95,000, and the \$11,000 (and any interest and penalties as well) from 7/1/91. Hot interest stops accruing as to the \$10,000 and \$95,000 on the dates those amounts are paid; however, it continues with respect to the \$11,000 assessment until 12/31/97. Since there is no letter or notice in an amount over \$100,000, pursuant to the new amendment there is no hot interest in this case after 12/31/97.

CASE 2: Tax Period 9712

TC	150	1,210,000	3/15/98	Tax liability
	290	20,000	5/15/98	Notice issued for unpaid amount and paid within 30 days
	290	50,000	10/5/98	Assessment 1120X not paid within 30 days
	300	43,000	12/7/98	Partial assessment made, payment received 12/30/98
	300	11,000	1/20/99	Audit assessment paid within 30 days

What is the applicable date for beginning to compute hot interest? On what amount is the hot interest charged?

Answer: There is no applicable date in this case, as there is no letter/notice for an amount over \$100,000.

CASE 3: Tax Period 9312

TC	150	210,000	3/15/94	Tax Liability
	610	200,000	3/15/94	Payment with the return The \$10,000 unpaid balance is NOT paid within 30 days of the notice. Payment made 7/10/94.
	290	70,000	11/15/95	Tax assessment paid within 30 days
	300	101,000	11/10/97	Assessment made and underpayment remains unpaid as of 3/15/98. 3/14/97 30 day letter issued for 101,000 and NOT paid within 30 days

The threshold underpayment is \$181,000. On what date and what amount would hot interest begin to be computed?

Answer: See answer 5 above.

CASE 4: Tax Period 8912

TC	150	210,000	3/15/90	Tax liability
	290	95,000	12/10/90	Tax assessment notice issued NOT paid within 30 days
			3/14/91	Balance fully paid
			1/31/98	30 day letter issued for 111,000 and is Not paid within 30 days.
	300	111,000	3/31/98	Audit assessment is made and payment received

What is the applicable date for beginning to compute hot interest? On what amount is the hot interest charged?

Answer: The applicable date is 1/9/91, 30 days after the 12/10/90 notice. Hot interest runs on any balance due from that date. Hot interest on the \$95,000 runs until that amount is paid on 3/14/91, although if the interest is not fully paid at that time it will continue to compound at the additional 2% rate. Hot interest also runs on the \$111,000 from the applicable date. The hot interest stops on 12/31/97, as there is no letter/notice for an amount over \$100,000 prior to that date. Regular interest runs from 1/1/98. Hot interest begins again on 3/2/98 (30 days after the 1/31/98 30-day letter). Interest stops on 3/31/98 when the assessed amount of \$111,000 is paid, assuming all interest due is also paid at that time. If there is still a balance due, hot interest continues to run until all amounts due are paid in full.

CASE 5: Tax Period 8912

TC	150	210,000	3/15/90	Tax Liability
	290	95,000	12/10/90	Tax Assessment notice issued and NOT paid within 30 days
			3/14/91	\$80,000 paid, \$15,000 remains unpaid.
			1/31/98	90 day letter sent for \$111,000 and is not paid within 30 days.
	300	111,000	5/31/98	Audit assessment made and is NOT paid within 30 days Underpayment of \$111,000 and \$15,000 remains unpaid as of 5/31/98

What is the applicable date for beginning to compute hot interest? On what amount is hot interest charged?

Answer: As in Case 4, the applicable date is 1/9/91. All amounts due carry hot interest from that date. In this case hot interest on the \$80,000 stops when paid on 3/14/91, but the \$15,000 not yet paid, plus any accrued and unpaid interest due, continues to accrue hot interest until 12/31/97. Likewise, the \$111,000 later assessed accrues hot interest from 1/9/91 until 12/31/97. Hot interest stops on 12/31/97, regular interest accrues, and hot interest resumes on 3/2/98 on the balance due until all amounts, including interest, are paid in full.

CASE 6: Tax Period 9712

TC	150	210,000	3/15/98	Tax Liability
		110,000	5/15/98	Math error - \$60,000 paid within 30 days of 5/15/98 notice and the \$50,000 balance is NOT paid within 30 days of notice date
			9/30/98	30 day letter issued for \$21,000 and is NOT paid within 30 days
	300	21,000	11/7/98	Audit assessment is made and payment is received

What is the applicable date for beginning to compute hot interest? On what amount is hot interest charged?

Answer: Assuming the entire assessment of \$110,000 is the subject of one notice, the applicable date is 6/14/98, 30 days after that notice. Since only part of the amount stated in the notice is paid within 30 days, the notice is not disregarded. Hot interest applies to any amounts due for that tax period (\$50,000 and \$21,000 and any interest thereon) after 6/14/98.

CASE 7: Tax Period 9612

TC	150	1,210,000	3/15/97	Tax Liability
	290	120,000	5/15/97	Assessment, notice issued for unpaid amount and paid within 30 days
	290	50,000	10/5/97	Assessment 1120X not paid within 30 days
	300	21,000	12/7/97	Audit assessment determined and is NOT paid within 30 days
	300	111,000	1/20/98	Audit assessment paid within 30 days

What is the threshold underpayment? What is the applicable date for beginning to compute hot interest? On what amount is hot interest charged?

Answer: The threshold underpayment (tax unpaid as of the date of the return) is \$302,000 unless some of the assessments are duplicative. There is, therefore, a large corporate underpayment. The applicable date for hot interest is 11/4/97, 30 days from the first notice of assessment which is not paid within 30 days. (We understand that in this example, the taxpayer filed a Form 1120X showing tax due of \$50,000, did not pay that amount, and received a notice of assessment on 10/5/97 for \$50,000 plus interest.) Hot interest runs on all amounts due (\$50,000, \$21,000, \$111,000, plus all interest due thereon) from 11/4/97. However, hot interest stops on 12/31/97 because the only notice or letter prior to that date which shows an amount exceeding \$100,000 was paid within 30 days and is therefore disregarded. Hot interest in this case never resumes because the assessment letter for \$111,000 on 1/20/98 is also paid within 30 days.

We hope this response is helpful to you in interpreting and implementing this legislative change. If you need additional assistance, please contact Nancy Rose at (202) 622-4910.

/s/
ROCHELLE L. HODES