



What's News in Tax

Analysis that matters from Washington National Tax

All Is Not Lost: Interest Netting after Federal Circuit's *Wells Fargo* Decision

August 22, 2016

by Rhonda Gibson, Complex Interest Services, and Lawrence Mack, Washington National Tax*

Corporations pay a higher interest rate on underpayments of tax than the IRS pays corporations for overpayments of tax, but interest netting can eliminate this rate differential. This article describes how a court interpreted the interest netting rules to allow merged corporations the benefit of interest netting.

Wells Fargo's 2014 taxpayer-favorable interest netting decision has been partially reversed but retains good news for merged corporations looking for interest netting opportunities.

In 2014, the U.S. Court of Federal Claims ruled that, for interest netting purposes, an acquired corporation could be treated as though it had always been part of the surviving entity following a statutory merger—i.e., the corporations become the “same taxpayer” by virtue of the merger—without regard to the timing of overpayments and underpayments on which interest is to be calculated and which a taxpayer seeks to net under section 6621(d)¹ and Revenue Procedure 2000-26.² Not surprisingly, the government sought interlocutory review of the grant of Wells Fargo's motion for partial

* Rhonda Gibson is a director with the Complex Interest Services practice (Greensboro). Lawrence Mack is a director in the Practice, Procedure, and Administration group of Washington National Tax.

¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

² *Wells Fargo & Co. v. United States*, 117 Fed. Cl. 30 (Fed. Cl. 2014).

summary judgment and appealed the decision. On June 29, 2016, the U.S. Court of Appeals for the Federal Circuit issued its decision, affirming in part and reversing in part the Court of Federal Claims' ruling.³

The case involved three representative situations chosen by the parties. The government conceded interest netting availability in one situation. While the Court of Federal Claims held that Wells Fargo could similarly net interest in the other two situations, the Federal Circuit, after considering several alternative arguments, upheld the taxpayer's position in only one of those two situations. Thus, Wells Fargo ultimately prevailed in two of the three situations presented.

In the first situation, Wells Fargo sought to net interest on a *pre*-merger overpayment of the acquired corporation with a *pre*-merger underpayment of the surviving corporation. Based in part on the question, "Is the entity that made the underpayment at the time of the underpayment the 'same taxpayer' as the entity who made the overpayment at the time of the overpayment?" the Federal Circuit found that at the respective times of the overpayment and underpayment, there were two distinct entities, in part because each corporation had a separate taxpayer identification number ("TIN") at the relevant time. Thus, the "same taxpayer" requirement of section 6621(d) was not met, the Federal Circuit held. The court reasoned that the two entities' later merging does not change the fact that they were separate entities at the relevant time. Citing its own decision in *Energy East Corp. v. United States*⁴ as authority and "markedly similar," the Federal Circuit refused to apply general merger law retroactively and held that Wells Fargo may not net interest in situation one.

In the second situation, Wells Fargo sought to net interest on a *pre*-merger overpayment of a corporation that would become a surviving corporation in several later mergers with a *post*-merger underpayment of the same corporation after those later mergers. Before, during, and after the mergers, the corporation retained the same TIN. The government conceded that Wells Fargo may net interest in this situation because the TIN remains the same and the corporation is the "same taxpayer" under the statute, despite acknowledging that the *pre*-merger corporation was not identical to the *post*-merger corporation.

In the third situation, Wells Fargo sought to net interest on a *pre*-merger overpayment of the acquired corporation with a *post*-merger underpayment of the surviving corporation when the surviving corporation retained a TIN different from the TIN of the acquired corporation at the time of its overpayment. The Federal Circuit found for the taxpayer but provided a more complex legal analysis than the prior two situations due to the lack of clarity in the law and the *post*-merger nature of the relationship between the entities. The question to be resolved remained the same—whether the *post*-merger underpayment entity is the "same taxpayer" as the *pre*-merger overpayment entity.

³ *Wells Fargo & Co. v. United States*, No. 2015-5059, 2016 U.S. App. LEXIS 11855 (Fed. Cir. June 29, 2016).

⁴ 645 F.3d 1358 (Fed. Cir. 2011).

Finding that Congress intended section 6621(d) to be remedial, the Federal Circuit construed the statute broadly, contrasting congressional efforts to instruct the IRS to implement a broad interest-netting process with the IRS's continued interpretation of its power to net interest narrowly. The Federal Circuit explained that Congress chose the term "same taxpayer" against a background of merger law and cited a number of cases and authorities supporting the proposition that a merger of two corporate entities mixes and combines the personalities of the predecessor corporation into the survivor. Concluding that the authorities "suggest that a post-merger surviving corporation in Situation Three is the 'same taxpayer' as the pre-merger acquired corporation under section 6621(d)," and that "federal tax law and the IRS's treatment of the predecessor statutes to section 6621(d) also both suggest that Wells Fargo meets the statute's 'same taxpayer' requirement," the Federal Circuit held that an acquired corporation that makes an overpayment before a merger is the same taxpayer for the purposes of section 6621(d) as the post-merger surviving entity that has absorbed the acquired corporation by merger.

Conclusion

The Federal Circuit allowed netting in two of the three situations and specifically addressed mergers qualifying under section 368(a)(1)(A). Companies with a similar fact pattern may choose to analyze the account transcripts of both the acquiring and acquired corporations to determine if interest netting opportunities exist for merged corporations. Pending other cases or administrative guidance, the "same taxpayer" question remains open for other types of acquisitions.

□ □ □ □

The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.