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Code Section 6603 Cash Deposits to Stop the Running of Interest On a Deficiency: Factors to Consider Before Remitting a Deposit

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Many large corporations will sooner or later be faced with the following dilemma: An aggressive Internal Revenue Service agent has concluded an examination and determined a proposed deficiency of \$50 million, issuing a 30-day letter to that effect.

The corporation assigns a probability factor with respect to whether it may prevail in an administrative appeal of the issue(s) generating the large proposed deficiency. Next, the corporation must determine, assuming cash is available to make a tax code Section 6603 cash deposit, whether it is fiscally prudent to make a deposit to stop the running of deficiency interest should the assessment, or some portion thereof, ultimately be upheld.

In determining whether to make a cash deposit, a corporation must weigh, at a minimum, the following factors:

- Is it more likely than not that the corporation's position will ultimately prevail? Does it have strong precedent supporting its position?
- If the corporation does not make a cash deposit and ultimately loses the issue(s), will it have to pay code

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Section 6621(c) large corporation "hot" interest on the assessment from the date that is 30 days after the 30-day letter was issued?

■ If the corporation makes a cash deposit and prevails on the issues, the deposit will be returned with reduced IRS interest. Also, the overpayment cannot be used for code Section 6621(d) interest netting with any overlapping deficiencies. If the corporation over-deposits, a portion of the deposit will not be eligible to receive refund interest.

■ Finally, and most importantly, what is the corporation's return on investment (ROI) should it invest cash in its core business or other instruments or activities, as compared to using the funds to stop the accrual of deficiency interest?

Each of the factors above, and their interaction with one another, are discussed below.

Strength of Position

First, we address the strength of the corporation's position. Does it have ironclad precedent supporting its position, such as judicial decisions? Is it relying on lesser authorities such as technical advice memorandums, private letter rulings, and similar instruments of low value to a court (although they may have significant influence on an appeals officer)? Do we simply feel that an overzealous revenue agent has misinterpreted the code?

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We then move on to consideration of other influencing factors.

‘Hot’ Interest

Next, we must consider whether we are willing to risk having to pay the large corporation underpayment “hot” interest rate pursuant to code Section 6621(c) should the corporation fail to make a cash deposit and then lose the issues at controversy.

Hot interest carries a rate that is 200 basis points greater than the rate normally charged on a corporate deficiency. A triggering amount (\$100,000 tax deficiency) and event (30-day letter, 90-day letter, or assessment of tax) is required for the hot interest rate to apply.

Obviously, if the hot interest rate is 10 percent at the time of its possible application and the corporation can earn an ROI of 15 percent by investing funds in operations or elsewhere, the corporation will be in a position in which it simply makes business sense to keep the funds and then pay the hot interest should IRS prevail in the controversy.

Refund Interest

Note that if the corporation makes a cash deposit and then later receives a refund of all or part of the deposit after the controversy is resolved, refund interest, albeit at a reduced rate, may be paid with respect to all or part of the refund, subject to the following restrictions.

First, interest will only be paid on a deposit refunded pursuant to code Section 6603(d) to the extent the deposit is attributable to a disputable tax. For example, if the 30-day letter indicates a proposed assessment of \$50 million but the corporation deposits \$75 million, the excess \$25 million, when and if refunded, will not be refunded with any interest.

The purpose of this policy is simple—to discourage taxpayers from using the government as an investment-motivated depository. Corporations should refer to Revenue Procedure 2005-18, which superseded Rev. Proc. 84-58, for more specific details with respect to the cash deposit process.

Corporations should keep in mind that, as stated above, the refunded deposits cannot be utilized in interest-netting computations. The interest rate paid on refunded cash deposits is also reduced to the federal short-term rate, although that rate is only 50 basis points less than the interest rate paid on corporate refunds greater than \$10,000 (the GATT rate, for General Agreements on Tariffs and Trade).

Return on Investment

The final—and perhaps most important—consideration in determining whether to remit a cash deposit is knowledge of the corporation’s ROI.

As of this writing, the hot interest rate on deficiencies is 6.00 percent, compounded daily. Obviously, if a corporation can invest the \$50 million for a 10 percent ROI, it may not be concerned with making a cash deposit. Also, if it has a strong position and expects to prevail, it likewise will not be impressed with the dismal interest rate presently being paid on cash deposit refunds.

Conclusion

In conclusion, while there are certain easily quantifiable factors that impact the analysis needed to determine whether to make a code Section 6603 cash deposit, it all ultimately comes down to Clint Eastwood’s famous quote: “Do you feel lucky, punk?”

That, and of course whether the corporation has cash on hand. In this economic environment, that is rarely a given.