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TAXATION--INCOME TAX-EFFECT OF LOSS CARRY--BACK ON DEFICIENCY ASSESSMENT INTEREST CHARGES

William R. Worth S.Ed.
University of Michigan Law School

TAXATION—INCOME TAX—EFFECT OF LOSS CARRY-BACK ON DEFICIENCY ASSESSMENT INTEREST CHARGES—In 1943 the Commissioner of Internal Revenue assessed deficiencies against respondent taxpayer in its 1941 income and excess profits taxes, adding interest from the date the tax was properly due to the assessment date. The taxpayer suffered a net operating loss in 1943 sufficient to abate completely all tax liability for 1941.[1] When application for a refund of the amount paid and abatement of the deficiency was made, however, the commissioner deducted the interest assessed from the amount to be returned, claiming that the liability to pay interest on the deficiency was still outstanding. The district court held for the collector when the taxpayer brought suit for full refund, but was reversed by the court of appeals on the theory that if the taxpayer owed the government nothing, the interest on that debt was nothing. *Held,* reversed. Cancellation of the duty to pay a validly assessed deficiency does not cancel the duty to pay interest on such deficiency. *Manning v. Seeley Tube & Box Co. of New Jersey,* 338 U.S. 561, 70 S.Ct. 386 (1950).

The collection of interest on delinquent taxes is based on the theory that the obligation to pay taxes is in the nature of a debt,[2] the debt being created because of the necessity of the government's collection of a reasonably certain amount sufficient to meet anticipated expenses. A delay in payment therefore results in damages, which are compensated for by the payment of interest.[3] As such, the interest payment is not regarded as a part of the debt itself in theory,[4] although the duty to pay the tax and that to pay interest constitute a single liability[5] and the interest is collected "as a part of the tax."[6] However, where the tax itself is erroneously assessed and collected, it is established law that the taxpayer is entitled to a refund of the interest paid on such tax.[7] The basic problem of the principal case is whether a tax correct when assessed but rendered incorrect by subsequent events should be held to fall within the foregoing rule. The answer to this is to be found in the nature of the carry-back provision as it affects tax liability—does its presence in the code make the deficiency merely an inchoate liability until the expiration of the two-year period, or does it remain a presently subsisting liability? This provision can be approached primarily from the accounting view-

[1] I.R.C., §§23(s), 122(b)(1).

[2] Billings v. United States, 232 U.S. 261, 34 S.Ct. 421 (1914). The interest paid on back taxes is regarded as interest on a debt and is therefore deductible in computing net taxable income. United States v. Jaffray, (C.C.A. 8th, 1938) 97 F. (2d) 488, affd. *sub nom.* United States v. Bertelsen & Petersen Co., 306 U.S. 276, 59 S.Ct. 541 (1939); Max Thomas Davis, 46 B.T.A. 663 (1942).

[3] United States v. Childs, 266 U.S. 304, 45 S.Ct. 110 (1924); Owens v. Commissioner, (C.C.A. 10th, 1942) 125 F. (2d) 210. Cf. Rodgers v. United States, 332 U.S. 371, 68 S.Ct. 5 (1947).

[4] Penrose v. United States, (D.C. Pa. 1937) 18 F. Supp. 413; Capital Bldg. & Loan Assn., 23 B.T.A. 848 (1931); Brandtjen & Kluge v. United States, (D.C. Minn. 1948) 78 F. Supp. 509.

[5] Nelson-Wiggen Piano Co. v. United States, (C.C.A. 7th, 1936) 84 F. (2d) 47; Western Maryland Ry. Co. v. United States, (D.C. Md. 1938) 23 F. Supp. 554.

[6] I.R.C., §§292(a), 294(a)(1), 294(b), 295.

[7] Big Diamond Mills Co. v. United States, (C.C.A. 8th, 1931) 51 F. (2d) 721; Colorado Milling & Elevator Co. v. Howbert, (C.C.A. 10th, 1932) 57 F. (2d) 769; Phelps v. United States, (C.C.A. 2d, 1939) 105 F. (2d) 904.

point, regarding the shifting of losses from one year to another as effectuating, when coupled with the carry-forward provision, a five-year accounting period for corporations for the purpose of computing tax liability, and aimed at reducing the impact of the tax system on fluctuating income. Under such an analysis, the first assessment would be held to be wrongful, the theory being that the prior determination of income was in error by the difference between bookkeeping earnings and the true earnings as they were later shown to be. The other approach emphasizes the forgiveness aspect of the provision. It was added to the code in 1942 as part of the wartime amendments,[8] and was originally intended to relieve hardship cases where wartime restrictions required postponement of maintenance and repair expenses to peacetime years, and to permit reconversion costs and losses to be offset against wartime income.[9] Thus payment was to be made in the year of abnormal profits and the refund claimed after the loss was suffered.[10] In this view, the government is entitled to have the use of the amount of the tax assessed on the basis of the first year's unadjusted figures until a net operating loss is subsequently suffered. If that amount has not been paid, the liability for the principal is then extinguished by the coming due of a type of subsidy—the refund—but the collateral loss occasioned by the failure to meet this liability promptly remains outstanding until made good by the payment of interest. This analysis is in better conformity with other sections of the code,[11] despite the seeming illogicality of collecting interest on a non-existent debt, and avoids the paradoxical bonus to defaulters which would result from the opposite rule. It was suggested after the district court decision in the principal case that the amendment of §292(a),[12] applicable to taxable years beginning after 1942, might alter the result in the future,[13] but it is submitted that the Supreme Court's interpretation of the effect of a loss carry-back will make it far from easy to term such carry-back a "prior satisfaction."

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[8] Revenue Act of 1942, §153(a).

[9] S. Rep. 1631, 77th Cong., 2d sess. 51-52 (1942); PAUL, TAXATION FOR PROSPERITY 109 (1947); GROVES, POSTWAR TAXATION AND ECONOMIC PROGRESS 143 (1946).

[10] I.R.C., §§52(a), 53(a), 56(a); S. Rep. 1631, 77th Cong., 2d sess. 123-124 (1942).

[11] See especially §56(a), providing that the tax imposed shall be paid on or before the 15th day of the third month following the close of the taxpayer's fiscal year; §3771(e), providing that no interest shall be *paid* on an overpayment due to carry-back of a net operating loss or unused excess profits credit; and §3779(i), providing that, when an extension has been granted to a corporation expecting carry-backs, the taxpayer must pay 3% interest from time the tax would normally have been paid to the date of satisfaction by the occurrence of the loss *on the amount satisfied,* and 6% on the balance until paid.

[12] Individual Income Tax Act of 1944, §14(c).

[13] DeFosset, "Interest on Potential Deficiencies," 27 TAXES 33 (1949). The pertinent part of §292(a) as amended reads as follows: "If any portion of the deficiency assessed is not to be collected by reason of a prior satisfaction, in whole or in part, of the tax, proper adjustment shall be made with respect to the interest on such portion."