



# IRS Interest Netting Rules: Maximizing Benefits When the IRS Owes Interest on Employee Retention Credit Refunds

A Little-Known Rule  
can offset interest  
paid to the IRS on  
late- filed/paid  
federal taxes

**Steve Hastings, MBA, CPA/ABV/CFF, CGMA, ASA, CVA**  
Managing Director  
Marshall & Stevens

## INTRODUCTION

Employers who filed Employee Retention Credit (ERC) claims on amended employment tax returns (Form 941-X) have experienced processing delays measured in months and, in many cases, years. These delays generate a compounding benefit: the IRS owes overpayment interest under IRC § 6611 from the original quarter due date through refund issuance. But there is a second, often overlooked layer of benefit for taxpayers who simultaneously carried income tax underpayments during the same period: interest netting under IRC § 6621(d).

This white paper explains both layers of relief, quantifies the differential rates applicable to C corporations versus pass-through entities, outlines the procedural requirements under Rev. Proc. 2000-26, and provides practitioners with a practical framework for identifying, calculating, and claiming interest netting benefits in ERC-related engagements.

## I. Background: The Employee Retention Credit and Delayed Refunds

### A. ERC Overview

The Employee Retention Credit was enacted under the CARES Act (2020) and expanded by subsequent legislation. It is a refundable payroll tax credit under IRC § 3134 that eligible employers may claim against the employer share of Social Security taxes (and, for 2020, FUTA) reported on Form 941. Because it is refundable, a credit that exceeds the current liability creates an overpayment of employment taxes, which is refundable to the employer.

Eligible employers are those that either: (i) experienced a full or partial suspension of operations due to a governmental order, or (ii) suffered a significant decline in gross receipts—defined as gross receipts below 50% (2020) or 80% (2021) of the same calendar quarter in 2019.

The credit amounts are substantial:

- 2020: Up to \$5,000 per employee (50% of up to \$10,000 in qualified wages).
- 2021: Up to \$7,000 per employee per quarter (70% of up to \$10,000 in qualified wages per quarter).
- Maximum exposure: Up to \$26,000 per retained employee across 2020–2021.

## B. Processing Delays and the Interest Consequence

Most employers were unable to claim the ERC on originally filed Forms 941 because the credit was claimed retroactively or required amended returns. The IRS received millions of Form 941-X filings, creating a massive processing backlog. Many claims filed in 2021 and 2022 were not processed until 2024 or later—a delay spanning three or more years.

This delay has a direct economic consequence: under IRC § 6611, the IRS is required to pay overpayment interest on the ERC refund from the date the overpayment arose (generally the original Form 941 quarterly due date) through a date not more than 30 days before the refund check is issued—unless the IRS processes the refund within 45 days (§ 6611(e)), in which case no interest is owed.

*Important Note: Because ERC backlogs extended well beyond 45 days in virtually all cases, the 45-day interest-free window rarely applied. Taxpayers who waited for their ERC refunds have, in most cases, earned substantial interest.*

## II. Overpayment Interest Under IRC § 6611

### A. Statutory Framework

IRC § 6611(a) mandates that the IRS "shall allow and pay" interest on any overpayment of tax at the overpayment rate established under IRC § 6621. This is not discretionary—it is a statutory obligation. The ERC, as a refundable employment tax credit resulting in an overpayment of Form 941 liabilities, falls squarely within this framework.

### B. Interest Start Date for ERC Claims

For ERC claims made on Form 941-X (an amended return), the start date for overpayment interest follows the rule under IRC § 6611(b)(2): interest accrues from the date of the overpayment, which the IRS treats as the original due date of the Form 941 for the relevant quarter.

## III. Interest Netting Under IRC § 6621(d): The Second Layer of Benefit

### A. Why Interest Netting Matters

A taxpayer who simultaneously has an ERC overpayment pending refund and an income tax underpayment outstanding (e.g., from a prior-year exam, amended return, or deferred installment) faces a structural inequity: the IRS charges underpayment interest at a higher rate than it pays on overpayments—at least for C corporations. This creates a net interest cost even when the amounts effectively cancel out economically.

Congress addressed this inequity in 1998 by enacting IRC § 6621(d) as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). The provision mandates a net rate of zero on equivalent overlapping underpayments and overpayments by the same taxpayer.

## B. Statutory Text: IRC § 6621(d)

"To the extent that, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period." — IRC § 6621(d)

## C. How Interest Netting Operates Mechanically

Interest netting eliminates the interest rate differential—not the interest calculation itself—for the overlapping period and overlapping amounts. In practice, the IRS implements netting by equalizing the rates on the offsetting balances:

- Method 1 (most common): Reduce the underpayment interest rate to the lower overpayment rate, and refund any excess underpayment interest previously charged.
- Method 2: Increase the overpayment interest rate to equal the higher underpayment rate, and pay additional overpayment interest to the taxpayer.
- The net economic result is the same: no interest spread is earned by either party during the overlapping period on equivalent amounts.

## D. Rate Differential for C Corporations: Where Netting Provides the Greatest Benefit

Interest netting is primarily a C corporation benefit because non-corporate taxpayers pay and receive interest at the same rate (federal short-term rate + 3%).

With deficiency interest running at 7–9% (Q2 2026) against an ERC overpayment earning only 3.5–5%, the interest netting benefit can be financially significant over a three-to-six-year overlapping period. For many engagements, the dollar value of netting can exceed the cost of the engagement itself.

## E. Effective Date and Retroactive Application

IRC § 6621(d) applies to interest accruing on or after October 1, 1998. For the ERC context, all relevant quarters (2020–2021) fall well within this window. An uncodified transition rule in RRA 98 § 3301(c)(2) permits netting for pre-October 1, 1998 periods under certain conditions, but this is not relevant for ERC-era claims.

## F. Application Across Tax Types

A critical—and often underutilized—aspect of IRC § 6621(d) is that it applies to all types of federal taxes. This means an employer can net:



- Type 1: An ERC overpayment (Form 941 employment taxes) against an income tax underpayment (Form 1120 or Form 1040).
- Type 2: An ERC overpayment against a payroll tax underpayment in a different quarter.
- Type 3: An overpayment on one entity type against an underpayment on another tax type—so long as both belong to the same taxpayer.

*Important Note: For consolidated groups, netting may also be available between the overpayment of a subsidiary and the underpayment of the consolidated parent or another member, based on the Magma Power v. United States analysis. This fact pattern should be explored in complex corporate engagements.*

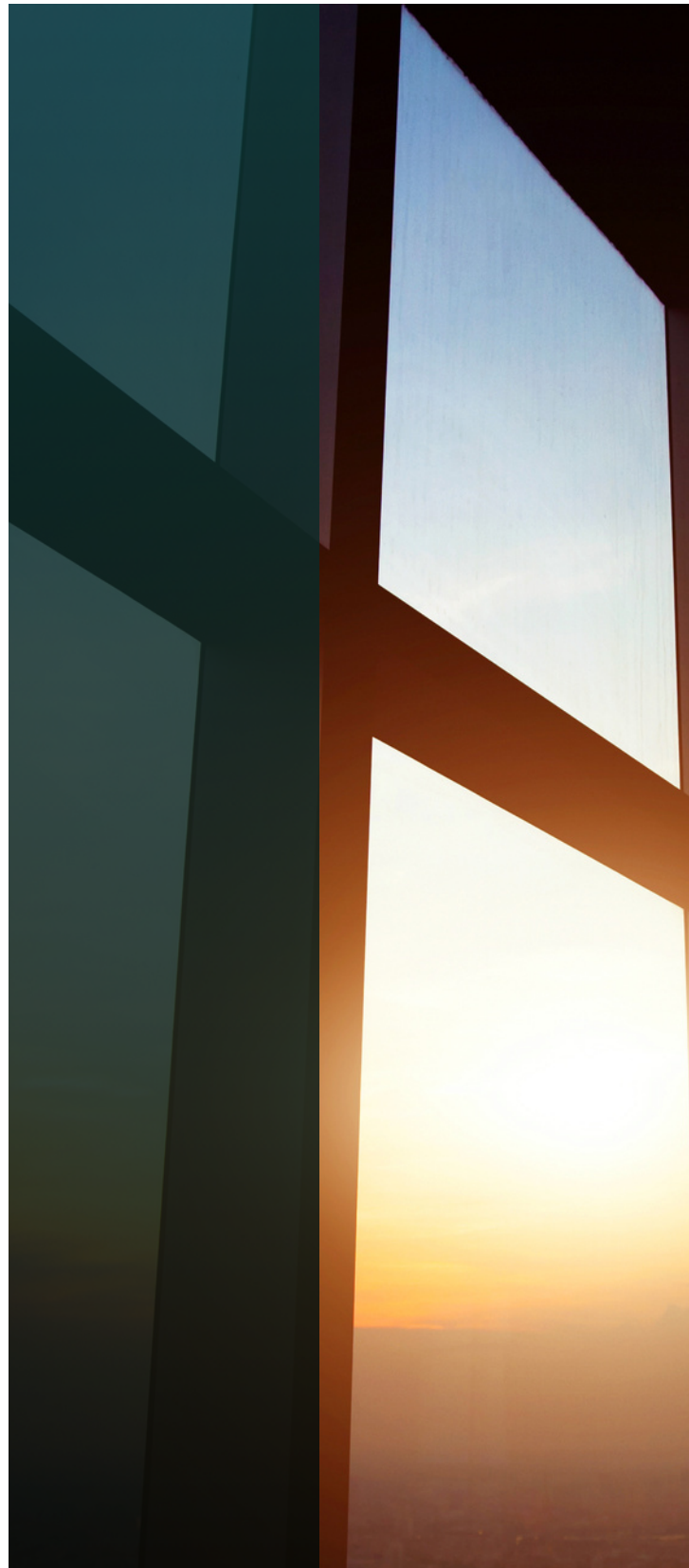
## IV. Two Types of Netting: Within-Module and Net Rate (Global) Netting

### A. Within-Module (Annual) Netting

Within-module netting equalizes interest rates during overlapping periods within a single tax module (i.e., the same return period, same tax type). This is the simpler of the two types and is sometimes applied automatically during IRS account processing. It addresses the situation where a taxpayer has both an overpayment and underpayment within the same tax account for the same period.

### B. Net Rate (Global) Netting Under IRC § 6621(d)

Net rate netting—sometimes called "global netting"—is the more powerful form. It equalizes interest rates between overpayments and underpayments across two or more tax modules for the same taxpayer. This is where ERC-related netting primarily arises: Module A: Form 941-X ERC overpayment (employment taxes, 2020–2021) Module B: Form 1120 income tax underpayment (e.g., 2019 exam deficiency, 2020 amended return balance due).



## C. Net Interest Refund

The IRS does NOT automatically apply global netting. The taxpayer must proactively request it, and the IRS has explicitly acknowledged it lacks the systems capability to apply it automatically (Rev. Proc. 2000-26, § 2.01). This means many taxpayers with legitimate netting claims receive zero benefit unless they or their advisors actively pursue the claim.

## V. Procedural Requirements: How to Claim Interest Netting

### A. Revenue Procedure 2000-26

The primary guidance for claiming net rate netting is Rev. Proc. 2000-26, 2000-1 C.B. 1257. This revenue procedure provides the procedural framework for requesting IRC § 6621(d) netting. Key requirements include:

- Claim for Refund and Request for Abatement, Form 843: The netting claim must be made on Form 843. This form serves as both a claim for additional overpayment interest (if netting increases the rate paid by the IRS) and a request for abatement of underpayment interest (if netting reduces the rate the taxpayer owes).
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- Overlapping period requirement: There must be actual concurrent periods during which the taxpayer simultaneously owes underpayment interest and is owed overpayment interest on equivalent amounts.

### B. Statute of Limitations Considerations

The statute of limitations for interest netting claims is a complex area that practitioners must carefully navigate. There are two applicable limitation frameworks:

- IRC § 6511: The standard refund claim period (generally 3 years from the date of filing or 2 years from the date of tax payment, whichever is later).
- 28 U.S.C. §§ 2401 and 2501 (six-year period): A claim for additional overpayment interest constitutes a general claim against the government and is governed by a six-year limitations period, which begins when the cause of action first accrues—generally the date the underlying refund is allowed.

For ERC claims allowed in 2023–2025, practitioners have until 2029–2031 to file netting claims under the six-year period. However, proactive filing is strongly recommended given IRS processing times.

### C. Steps for Filing an Interest Netting Claim

The following procedural steps should be followed when pursuing an ERC-related interest netting claim:

- Step 1: Identify all ERC overpayments by quarter and determine the exact overpayment date (original Form 941 due date) and the actual refund date.
- Step 2: Identify any income tax or payroll tax underpayments outstanding during the same periods. Pull transcripts for all federal tax accounts.
- Step 3: Determine the overlapping periods where both interest streams ran concurrently on equivalent amounts.
- Step 4: Calculate the interest differential savings (underpayment rate minus overpayment rate) over the overlapping period.
- Step 5: Prepare and file Form 843 with a detailed interest netting calculation, citing IRC § 6621(d) and Rev. Proc. 2000-26.
- Step 6: Follow up with the applicable IRS service center; if denied, consider raising the issue in Appeals (IRM 8.7.19 governs Appeals netting procedures).

## VI. Practical Scenarios

### Scenario 1: C Corporation with ERC Refund and Income Tax Deficiency

Facts: A C corporation filed Form 941-X in March 2022 claiming \$500,000 of ERC for Q2–Q4 2020. The IRS issued the refund in January 2025.

Simultaneously, the corporation has a \$300,000 income tax deficiency under examination for tax year 2020 that has been assessed and accruing interest since April 2021.

Issue: The corporation has been paying underpayment interest at Fed + 3% (or Fed + 5% if it qualifies as a large corporate underpayment) on the \$300,000 deficiency, while the ERC overpayment was earning only Fed + 2% (or GATT rate of Fed + 0.5% on the excess over \$10,000).

Netting Benefit: For the overlapping period (April 2021 through January 2025—approximately 45 months), the corporation can claim a net interest rate of zero on \$300,000 (the equivalent overlapping amount). At a 1% average differential, the savings approximates  $\$300,000 \times 1\% \times \sim 3.75 \text{ years} = \sim \$11,250$  at minimum. If the large corporate underpayment rate applies (3% differential), savings could approach \$33,750.

### Scenario 2: Pass-Through Entity (Partnership or S Corporation)

Facts: An S corporation claimed \$200,000 in ERC refunds for 2021. It also has a payroll tax underpayment from a separate payroll tax audit for 2021.

Analysis: For non-corporate taxpayers, the underpayment rate and overpayment rate are both set at the federal short-term rate + 3%. There is no rate differential, so IRC § 6621(d) global netting provides no economic benefit in terms of rate savings. However, within-module netting may still be applicable if the overpayment and underpayment arise within the same tax module, preventing double interest from running on offsetting amounts.

Key Insight: Interest netting under IRC § 6621(d) is most beneficial for C corporations due to the rate asymmetry. Pass-through entities do not have a rate differential to eliminate on a global basis, but should still monitor for within-module netting opportunities and ensure the IRS does not overcompute interest on offsetting balances.

### Scenario 3: ERC Claim Partially Disallowed After Refund

Facts: An employer received a \$400,000 ERC refund with \$45,000 in accrued overpayment interest. The IRS subsequently audits the claim and disallows \$150,000 as ineligible wages.

Consequences: The IRS will assess a \$150,000 employment tax deficiency and impose underpayment interest from the original return due date. The previously paid overpayment interest on the disallowed portion may be subject to recapture. However, to the extent the employer has any remaining overpayments in other tax accounts during the overlapping period, interest netting may partially offset the new underpayment interest charge.

ERC Voluntary Disclosure Program (VDP) note: Under the prior ERC VDP (repay 80–85% of erroneous credit), participants were not required to repay interest previously received on the ERC refund, and the IRS waived additional underpayment interest. The VDP window has closed, but these terms illustrate IRS policy considerations around ERC interest recapture.

## Expert Witness Considerations

In litigation involving disputed ERC claims, an expert may be called upon to calculate overpayment interest owed by the IRS, quantify the netting benefit foregone as a result of IRS delay or error, or opine on the appropriate application of IRC § 6621(d) to overlapping balances. Thorough account transcript analysis and quarterly rate tables are essential inputs to any expert interest calculation.

## VII. Conclusion

Employers that received—or are waiting to receive—ERC refunds have a two-pronged interest benefit to analyze: (1) the statutory overpayment interest the IRS must pay under IRC § 6611, which has been accruing for years given processing delays, and (2) the interest netting benefit under IRC § 6621(d), which can eliminate the rate differential between concurrent underpayments and overpayments—particularly powerful for C corporations facing large corporate deficiency interest.

The IRS will not proactively apply global interest netting. Practitioners must identify overlapping periods, calculate the benefit, and file Form 843 within the applicable limitations period. With ERC refunds issued across 2023–2025, the window for maximum benefit is open now, and well-documented netting claims can produce meaningful additional recoveries for clients at relatively low incremental cost.

Given the complexity of multi-period, multi-tax-type interest computations, engagement teams should consider retaining interest computation specialists and ensuring thorough account transcript review before filing any netting claim or settlement agreement.



**Steve Hastings, ABV, ASA, CFF, CGMA, CPA, CVA, MBA**  
Managing Director  
Transaction Advisory  
817.481.4901  
shastings@valuescopeinc.com

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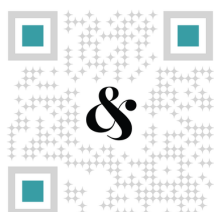
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