

COMMONWEALTH OF VIRGINIA

Department of Taxation  
Richmond, Virginia 23219

MEMORANDUM

TO: Patti Higgins  
Information Services Division

DATE: December 22, 1986

SUBJECT: Computation of interest

In response to your memorandum of December 4, 1986, requesting clarification of the interest computation rules, I offer the following:

Section 58.1-1812 permits the department to charge interest on only the interest included in the original assessment. This is sometimes referred to as the "one compounding" rule. To understand its application to specific cases, one must distinguish between the terms "assess," "charge" and "bill."

As used in § 58.1-1812, the term "assessment" has a definite meaning in the law. It means the act of determining that a tax or penalty is due. Until that act of assessment occurs the taxpayer has no obligation to pay, and we have no right to collect. Even in jeopardy cases, we must first assess before we can proceed to immediate collection. Once a tax and/or penalty have been assessed, various rights and obligations flow automatically from the act of assessment. Examples are interest, right to apply for correction to the department or the courts, collection methods, etc., many of which are tied to the date of assessment. Section 58.1-1820 defines the date of assessment as being the date on which we mail a written notice that an act of assessment has occurred.

Section 58.1-1812 uses the term "assess" when referring to taxes and penalties. Then it says that interest shall be "charged" on unpaid balances. The second paragraph talks about billing and allows a 30 day grace period to pay a bill. Thus the law distinguishes between formally assessing a tax or penalty, charging interest on unpaid balances and billing. We must assess a tax or penalty before we can collect it. Once an assessment is made, we can charge and collect interest up to the date of payment without formally assessing it.

This distinction is significant. We cannot apply a refund to a tax or penalty we have not yet assessed. However, if there is an unpaid assessment, we can apply a refund to pay off the assessment with interest accrued to date. We do not have to "assess" current interest before we can collect it.

There can be several "assessments" for a taxable period. This can occur when several penalties are assessed at different times, e.g. 5% per month, or when there are a series of changes in federal taxable income due to federal audits. Each assessment of tax or penalty must be made within the applicable statute of limitations. Subsequent billings are not subject to the statute of limitations. This is the primary reason why we must keep track of the date of an assessment and distinguish an assessment from a statement of account.

The responses to your examples are based on an analysis of which piece of paper sent to the taxpayer is actually an assessment and which is merely a second billing.

1. TRUE & TRUE

The "original assessment" is the only assessment. All subsequent notices are merely bills or statements of account with updated interest.

2. FALSE & FALSE

The original assessment is an assessment. No penalty can be assessed, or interest charged, if the return was filed early and the "notice of assessment" is mailed before the due date. If this assessment is made after the due date then it should include interest and any applicable penalties.

The "first additional assessment" is also an assessment because a penalty is being assessed for the first time. All subsequent notices are statements of accounts. Thus, any interest included in the "first additional assessment" could be included in subsequent computations of interest on the outstanding balance of this assessment.

When the second 5% penalty is assessed this will also be an assessment because another penalty is being assessed. The interest included in this assessment should be computed on the unpaid balance of the previous assessment (i.e. the "first additional assessment").

Note that under § 58.1-1820 the early filing of a return is treated as a self-assessment of tax which is deemed made on the date the return is due.

3. TRUE

This stems from the rule applying payments first to tax, then penalty, then interest. In practice, it is possible that small amounts of interest in this situation may be treated as "hot date" interest and manually charged off.

4. FALSE

The original assessment is the only assessment by the department (the return is a "self assessment"). If we "assess" the tax before the due date of the return we cannot include penalty or interest. In fact, we really have no legal right to demand payment until the due date.

Interest accrues from the due date of the return until the date of payment. § 58.1-1812. However, when certain penalties are assessed, the law imposing the penalty states that interest shall accrue from some date other than the due date of the return. For example: Late payment of individual or corporate income tax, interest accrues from one month after due date. §§ 58.1-351 and 58.1-455. (Note that this is in conflict with § 58.1-1812.)

Because a taxpayer is not obligated to pay a tax before the due date, perhaps an early tax due return should be handled with a letter thanking the taxpayer for the early filing, but advising the taxpayer that if we do not receive the tax by the due date (or postmarked) we will have to assess penalty and interest. Then our system would show only one assessment which would include penalty and interest because it was made after the due date.

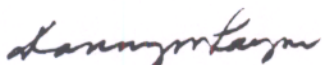
5. TRUE & TRUE

The "original assessment" is the only assessment. All subsequent notices are merely bills or statements of account with updated interest.

6. TRUE

The "original assessment" is the only assessment. All subsequent notices are merely bills or statements of account with updated interest.

I hope this answers your questions about interest.



Danny M. Payne, Director  
Tax Policy Division