



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

ATTN: PAUL KRUG

FROM: Deborah A. Butler
Assistant Chief Counsel (Field Service) CC:DOM:FS

SUBJECT: Accrual of underpayment interest and overpayment interest

This Field Service Advice responds to your memorandum dated February 15, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

X =

X's Representative =

Year 1 =	Year 7 =	\$a = \$
Year 2 =	Year 8 =	\$b = \$
Year 3 =	Year 9 =	\$c = \$
Year 4 =	Year 10 =	\$d = \$
Year 5 =	Year 11 =	\$e = \$
Year 6 =		\$f = \$

LEGEND (continued)

WTA-D-104085-00

\$g = \$	\$o = \$
\$h = \$	\$p = \$
\$i = \$	\$q = \$
\$j = \$	\$r = \$
\$k = \$	\$s = \$
\$l = \$	\$t = \$
\$m = \$	\$u = \$
\$n = \$	\$v = \$

ISSUES

1. At what date does interest begin to run on an underpayment, where X reported an overpayment of tax on its return and elected to have the overpayment credited against its estimated tax liability for the succeeding taxable year, but the Service subsequently determined a deficiency in tax for the taxable year of the purported overpayment.
2. Where the Service offsets an overpayment in Year 1 against underpayments for Year 2, Year 3, Year 4, and Year 5, whether the taxpayer is entitled to overpayment interest under I.R.C. section 6611 from the return due date of the underpayment, against which the overpayment is credited, to the later date that the underpayment actually arose and the offset was effective.

CONCLUSIONS

1. Interest runs on any portion of the subsequently determined deficiency which exceeds the overpayment from the original due date of the tax. Interest runs on that portion of the deficiency less than or equal to the overpayment from the date the overpayment is credited to the succeeding year's estimated taxes, or the original due date of the succeeding year's income tax return to the extent the overpayment is not needed to satisfy specific installments of estimated tax.
2. The statutory terms of section 6611 should not be construed to allow the taxpayer overpayment interest up until the date the underpayment actually arose and the offset was effective. Overpayment interest runs only to the due date of the income tax return for the year in which the overpayment is applied, not the actual date the underpayment arose.

FACTSYear 1

WTA-D-104085-00

In August, Year 11, the Service posted a general adjustment overassessment of \$a to Year 1. The Service offset \$b of the overassessment to Year 2 effective March 15, Year 3 (unextended due date of Year 2). The Service offset \$c of the overassessment to Year 3 effective March 15, Year 4 (unextended return due date of Year 3). The Service offset \$d of the overassessment to Year 4 effective March 15, Year 5 (unextended return due date of Year 4). Additionally, the Service offset \$e of the overassessment to Year 5 effective March 15, Year 6 (unextended return due date of Year 5) and April 15, Year 6. Finally, the Service issued a refund of \$f consisting of the remaining overassessment, plus allowable interest on July 28, Year 11.

Year 2

Taxpayer filed Form 1120 for Year 2 on September 15, Year 3, electing to credit an overpayment of \$g to the estimated taxes for Year 3. Subsequently, on August 18, Year 11, the Service assessed a general adjustment deficiency for Year 2 of \$b. The deficiency was paid by offset from Year 1 effective March 15, Year 3 (unextended return due date of Year 2).

The taxpayer contends, pursuant to May Department Stores v. U.S., 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), and Sequa Corporation v. U.S., 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996), summary judgment granted by, dismissed by, 99-1 USTC ¶ 50,379 (S.D.N.Y. 1998), that when an overpayment is credited to the subsequent year, interest should not start on a deficiency for the earlier year until the taxpayer actually received benefit for the overpayment applied to the following year. In effect, taxpayer contends, the deficiency in Year 2 was not both “due and unpaid” until the taxpayer received a benefit with respect to the amount credited in Year 3. Taxpayer argues that it received no benefit on \$h of the credit elect in Year 3 until March 15, Year 4 (unextended return due date of Year 3), because the taxpayer satisfied its requirements for all estimated tax payments due for Year 3 by making estimated tax payments and utilizing portions of the Year 2 credit elect. Accordingly, the taxpayer concludes that the Year 2 deficiency was not both due and unpaid until March 15, Year 4, thus no deficiency interest was due during this period, and the Service should have allowed interest on the offset from Year 1 to March 15, Year 4.

Year 3

Taxpayer filed Form 1120 for Year 3 on September 15, Year 4, electing to credit an overpayment of \$i to the estimated taxes for Year 4. Subsequently, on August 18, Year 11, the Service assessed a general adjustment deficiency for Year 3 of \$c.

WTA-D-104085-00

The deficiency was paid by offset from Year 1 effective March 15, Year 4 (unextended due date of Year 3).

Taxpayer applied the same rationale as set forth above (see Year 2) and argued that it received no benefit on \$j of the credit elect in Year 4 until March 15, Year 5 (unextended due date of Year 4), because the taxpayer satisfied its requirements for all estimated tax payments due for Year 4 by making estimated tax payments and utilizing portions of the Year 3 credit elect. Accordingly, the taxpayer concludes that the Year 3 deficiency was not both due and unpaid until March 15, Year 5, thus no deficiency interest was due during this period, and the Service should have allowed interest on the offset from Year 1 to March 15, Year 5.

Year 4

Taxpayer filed Form 1120 for Year 4 on September 15, Year 5, electing to credit an overpayment of \$k to the estimated taxes for Year 5. Subsequently, on August 18, Year 11, the Service assessed a general adjustment deficiency for Year 4 of \$d. The deficiency was paid by offset from Year 1 effective March 15, Year 5 (unextended due date of Year 4).

Taxpayer applied the same rationale as set forth above (see Year 2) and argued that it received no benefit on \$l of the credit elect in Year 5 until March 15, Year 6 (unextended due date of Year 5), because the taxpayer satisfied its requirements for all estimated tax payments due for Year 5 by making estimated tax payments and utilizing portions of the Year 4 credit elect. Accordingly, the taxpayer concludes that the Year 4 deficiency was not both due and unpaid until March 15, Year 6, thus no deficiency interest was due during this period, and the Service should have allowed interest on the offset from Year 1 to March 15, Year 6.

Year 5

Taxpayer filed Form 1120 for Year 5 on September 15, Year 6, electing to credit an overpayment of \$m to the estimated taxes for Year 6. Subsequently, on August 18, Year 11, the Service assessed a general adjustment deficiency for Year 5 of \$e. The deficiency was paid by offset from Year 1 effective March 15, Year 6 (unextended due date of Year 5) and April 15, Year 6.

Taxpayer applied the same rationale as set forth above (see Year 2) and argued that it received no benefit on \$n of the credit elect in Year 6 until March 15, Year 7 (unextended due date of Year 6), because the taxpayer satisfied its requirements for all estimated tax payments due for Year 6 by making estimated tax payments and utilizing portions of the Year 5 credit elect. Accordingly, the taxpayer

WTA-D-104085-00

concludes that \$n of the Year 5 deficiency was not both due and unpaid until March 15, Year 7, thus no deficiency interest was due during this period, and the Service should have allowed interest on the offset from Year 1 to March 15, Year 7. Taxpayer also argues that \$o of the Year 5 deficiency was not both “due and unpaid” until April 15, Year 6, and the remaining \$p was not both “due and unpaid” until June 15, Year 6. Thus, according to taxpayer, no deficiency interest was due during these periods, and the Service should have allowed interest on the offsets from Year 1 to those dates.

Year 6

Taxpayer filed Form 1120 for Year 6 on or about September 15, Year 7, electing to credit an overpayment of \$q to the estimated taxes for Year 7. Subsequently, the Service assessed net general adjustment deficiencies of \$r. Interest was charged on \$q of the net deficiency beginning April 15, Year 7. Interest on the remaining deficiency was started on March 15, Year 7.

Taxpayer applied the same rationale as set forth above (see Year 2) and argued that it received no benefit on the credit elect in Year 7 until September 15, Year 7, the due date of the third estimated tax payment for Year 7, because taxpayer’s first two estimated tax liabilities for Year 7 were timely paid. Accordingly, the taxpayer concludes that the Year 6 deficiency was not both due and unpaid until September 15, Year 7.

Year 8

Taxpayer filed Form 1120 for Year 8 on or about September 15, Year 9, electing to credit an overpayment of \$s to the estimated taxes for Year 9. Subsequently, the Service assessed a general adjustment deficiency of \$t. Interest was charged on the deficiency beginning April 15, Year 9.

Taxpayer applied the same rationale as set forth above (see Year 2) and argued that it received no benefit on \$u of the credit elect in Year 9 until March 15, Year 10, the unextended due date for Year 9. Accordingly, the taxpayer concludes that the Year 8 deficiency was not both due and unpaid until March 15, Year 10.

LAW AND ANALYSIS

Issue 1

Rev. Rul 88-98, 1988-2 C.B. 356, holds that when a taxpayer claims an overpayment on a return filed either on the original due date or an extension, and the claimed overpayment is applied in full against an installment of the succeeding

WTA-D-104085-00

year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency that is equal to or less than the claimed overpayment, and from the original due date of the return on the remainder. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid.¹ The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run.

In May Department Stores Co. v. United States, 36 Fed Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should credit the overpayment. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed by the Service on the deficiency from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984 for the first and second installments of estimated tax due for 1984. The court concluded the Service's application of taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, 1999-40 IRB 441, which modified and superseded Rev. Rul. 88-98, the Service has reconsidered the manner in which interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency for the overpayment year from the date(s) that the overpayment is applied to the succeeding year's estimated taxes. In all situations, the estimated tax rules in effect for the tax year in which the credit elect is used determine the amount of estimated taxes due, and thus, the amount of the overpayment needed to satisfy

¹ Section 6601(a) provides "[i]f any amount of tax . . . is not paid on or before the last date prescribed for payment, interest on such amount . . . shall be paid for the period from such last date to the date paid."

WTA-D-104085-00

the installments of estimated tax. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.²

With respect to the deficiency in Year 2, a portion of the credit elect from Year 2 was applied to the first quarter of the succeeding year's estimated tax. Because the remaining portion of the credit elect exceeded the subsequently determined deficiency, interest did not begin to run for the Year 2 deficiency on the first installment due date. A portion of the overpayment was also applied to the second installment of the succeeding year's estimated tax. Again, because the remaining portion of the credit elect exceeded the deficiency, underpayment interest did not begin to run on the second installment due date. The credit elect was not needed to satisfy any other installments of estimated tax. The remaining credit elect should be applied as of March 15, Year 4 (unextended due date of Year 3), thus interest runs on the full amount of the Year 2 deficiency (\$b) as of that date.

With respect to the deficiency in Year 3, a portion of the credit elect from Year 3 was applied to the third quarter of the succeeding year's estimated tax. Because the remaining portion of the credit elect exceeded the subsequently determined deficiency, interest did not begin to run for the Year 3 deficiency on the third installment due date. The credit elect was not needed to satisfy any other installments of estimated tax. The remaining credit elect should be applied as of March 15, Year 5 (unextended due date of Year 4), thus interest runs on the full amount of the Year 3 deficiency (\$c) as of that date.

With respect to the deficiency in Year 4, a portion of the credit elect from Year 4 was applied to the first, second and fourth quarters of the succeeding year's estimated tax. After each application of the credit elect, the remaining portion of the credit elect exceeded the subsequently determined deficiency, so interest did not begin to run for the Year 4 deficiency on the first, second, or fourth installment due dates. The credit elect was not needed to satisfy any other installments of estimated tax. The remaining credit elect should be applied as of March 15, Year 6 (unextended due date of Year 5), thus interest runs on the full amount of the Year 4 deficiency (\$d) as of that date.

² Section 6513(d) provides that if any overpayment of income tax is, in accordance with section 6402(b), claimed as a credit against estimated tax for the succeeding taxable year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises.

WTA-D-104085-00

With respect to the deficiency in Year 5, \$v of the credit elect from Year 5 was applied to the first quarter of the succeeding year's estimated tax. As of the first installment due date, the subsequently determined deficiency exceeded the remaining credit elect by \$o, thus interest runs on \$o of the Year 5 deficiency beginning on the first installment due date. A portion of the credit elect was also applied to the second installment of the succeeding year's estimated tax. As of the second installment date, the subsequently determined deficiency equaled the remaining credit elect, therefore interest begins to run on the deficiency amount equal to the amount of the credit elect applied (\$p) on that installment date. The credit elect was not needed to satisfy any other installments of estimated tax. The remaining credit elect should be applied as of March 15, Year 7 (unextended due date of Year 6), thus interest runs on the remaining amount of the Year 5 deficiency (\$n) as of that date.

The subsequently determined deficiency for Year 6 (\$r) exceeded the credit elect reflected on the Year 6 return (\$q), so underpayment interest should run on the deficiency in excess of the credit elect beginning on the unextended return due date for Year 6. The remaining credit elect was applied in full to the third installment of the succeeding year's estimated tax. As of the third installment date, the remaining deficiency equaled the remaining credit elect, so interest begins to run on the remaining deficiency in an amount equal to the credit elect applied on that installment date. Thus, interest runs on the remaining amount of the Year 6 deficiency (\$q) as of September 15, Year 7.

With respect to the deficiency in Year 8, a portion of the credit elect from Year 8 was applied to the third quarter of the succeeding year's estimated tax. Because the remaining portion of the credit elect exceeded the subsequently determined deficiency, interest did not begin to run for the Year 8 deficiency on the third installment due date. The credit elect was not needed to satisfy any other installments of estimated tax. The remaining credit elect should be applied as of March 15, Year 10 (unextended due date of Year 9), thus interest runs on the full amount of the Year 8 deficiency (\$t) as of that date.

Issue 2

“In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment” Section 6402(a). See also, Treas. Reg. section 301.6402-1 (“Commissioner . . . may credit any overpayment of tax, including interest thereon, against any outstanding liability”). Interest, however, is not recoverable on an obligation owed by the Government unless explicitly provided by statute or contract. Rosenman v. United States, 323 U.S.

WTA-D-104085-00

658, 663 (1945). The taxpayer claims a right to interest under section 6611. Section 6611(b)(1) provides that “interest shall be allowed and paid . . . [i]n the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken.” (emphasis added). Treasury Regulation section 301.6611-1(h)(2) provides that, in general, the term due date means “the last day fixed by law or regulations for the payment of the tax.”

Section 6151(a) provides that “when a return of tax is required under this title or regulations, the person required to make such return shall . . . pay such tax at the time . . . fixed for filing the return (determined without regard to any extension of time for filing the return).” See also, Treas. Reg. section 1.6151-1(a). Section 6072 governs the time for filing income tax returns stating that “ [r]eturns of corporations [required] under section 6012 . . . made on the basis of a fiscal year shall be filed on or before the 15th day of the third month following the close of the fiscal year.” See also, Treas. Reg. section 1.6072-2(a). Thus, the last day fixed by law for the payment of income tax is the due date of the return (determined without regard to any extension of time).

With respect to the general adjustment overassessment of \$a, the due date of the amount against which the overpayment was credited (on these facts, the underpayments for Years 2 through 5), is the due date of the return for the year in which the taxes were underpaid. Overpayment interest runs only to the due date of the income tax return for the year in which the overpayment is applied, not the actual date the underpayment arose. Thus, overpayment interest accrues, as follows:

1. until March 15, Year 3 (unextended return due date for Year 2) with respect to \$b of the offset;
2. until March 15, Year 4 (unextended return due date for Year 3) with respect to \$c of the offset;
3. until March 15, Year 5 (unextended return due date for Year 4) with respect to \$d of the offset, and;
4. until March 15, Year 6 (unextended return due date for Year 5) with respect to \$e of the offset.

The statutory terms of section 6611 should not be construed to allow the taxpayer overpayment interest up until the date the underpayment actually arose and the offset was effective. Overpayment interest runs only to the due date of the income tax return for the year in which the overpayment is applied, not the actual date the underpayment arose.

WTA-D-104085-00

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

With respect to the second issue regarding the accrual of overpayment interest, [REDACTED]. The courts as evidenced by May Department Stores v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), and Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), have employed a use-of-money analysis in interpreting the statutory terms of section 6601, which are substantially similar to the terms used in section 6611 and regulation section 301.6611-1(h)(2)(i). Nevertheless, the conclusion that interest runs only to the due date of the income tax return is compelled by our interpretation of the regulation as having a fixed meaning for the term "due date" for the payment of tax.

Please call if you have any further questions.

By: GEORGE E. BOWDEN
Technical Assistant
CC:DOM:FS