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MEMORANDUM FOR DIRECTOR, OFFICE OF INTEREST AND PENALTY
ADMINISTRATION OP:EX:ST:I&P

FROM:

Senior Technician Reviewer, Branch 1 (Income Tax &
Accounting) CC:DOM:IT&A

SUBJECT:

Overpayment Interest on Refunds of § 847 Special
Estimated Tax Payments

This responds to your request for advice regarding whether the Service must pay interest on overpayments of "special estimated tax payments" made pursuant to § 847(2) of the Internal Revenue Code (Code).

ISSUE

Whether the Service must pay interest under § 6611(a) on overpayments of special estimated tax payments made pursuant to § 847(2) of the Code.

CONCLUSION

Because of the revenue neutrality concept underlying § 847, special estimated tax payments should be treated as payments of "tax" within the meaning of § 6611(a), and the Service must generally pay interest on overpayments of these amounts. However, overpayments of special estimated tax payments are subject to the same limitations that the Code places on overpayments generally. Further, § 847(2) provides certain rules for special estimated tax payments that have not been used to offset additional tax within 15 years from the date the payments were made. Additional limitations apply to the payment of interest on refunds of these amounts.

DISCUSSION**Overview of Section 847**

Section 832 of the Code requires that property and casualty insurance companies discount their deductions for insurance loss reserves in order to take into account the time value of money. Section 846 provides the methodology for computing the discount and determining the amount of the discounted loss deduction.

Section 6077(a) of the Technical and Miscellaneous Revenue Act of 1988, P.L. No. 100-647, 102 Stat. 3342, added § 847 to the Code, effective for taxable years beginning after 1987. Section 847(1) of the Code permits an insurance company an additional deduction for the amount of the discount computed under § 846. Thus, by claiming a deduction for discounted losses in accordance with § 846, and the additional deduction for the amount of the discount in accordance with § 847(1), a taxpayer may essentially deduct its full, undiscounted, reserve for losses.

Section 847 was not intended to give the taxpayer an additional tax benefit, however. The purpose of § 847 is to offset the negative effects on financial accounting reporting caused by the discounting requirement of § 846. Thus, the legislative history indicates that § 847 was intended to be revenue neutral.¹ While § 847(1) allows the taxpayer an additional deduction, § 847(2) offsets the tax benefit of that deduction by requiring that the taxpayer make a “special estimated tax payment” in an amount equal to the tax benefit derived from the § 847(1) deduction. Section 847(2) provides that the taxpayer must make this special estimated tax payment to the government on or before the date on which any taxes (determined without the benefit of § 847) would be due for the taxable year for which the § 847(1) deduction is claimed.

Taxpayers who are allowed a deduction under § 847(1) are required by § 847(3) to establish and maintain a “special loss discount account” to keep track of the unreversed discount for each year for which a § 847(1) deduction was claimed. The amount of the discount claimed as a deduction for any taxable year is added to the account. Pursuant to § 847(5), amounts are subtracted from the account, and simultaneously included in the taxpayer’s gross income, as time passes and the unreversed discount decreases. Assuming this inclusion in income gives rise to an additional tax liability, § 847(2) provides that the special estimated tax payments previously made are used to pay the additional tax liability.

Section 847(2) also provides that to the extent a special estimated tax payment was not used to pay additional tax due for any of the first 15 taxable years beginning

¹ H.R. Conf. Rep. No. 1104, 100th Cong. 2d Sess. 173 (1988) (“TAMRA Conference Report”).

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after the year for which the payment was made, the special estimated tax payment shall be treated as an estimated tax payment made under § 6655 (a “regular” estimated tax payment) for the 16th year after the year for which the payment was made.

The TAMRA Conference Report clarifies that if the amount of special estimated tax payments that are treated as “regular” estimated tax payments made under § 6655 for the 16th year, along with the taxpayer’s other payments credited against tax liability for the 16th year, exceed the tax liability for that year, then the excess may be refunded to the taxpayer to the same extent provided under existing law with respect to overpayments of tax.

Revenue Neutrality

As indicated above, Congress intended that § 847 operate in a revenue neutral manner. The statute ensures revenue neutrality by requiring a special estimated tax payment in an amount equal to the tax benefit derived from the additional § 847(1) deduction. The TAMRA Conference Report notes that, because of this neutrality, the total payments made by a taxpayer, including regular tax payments and special estimated payments made pursuant to § 847(2), are generally the same as the total tax payments that the taxpayer would make if the taxpayer did not elect to claim the additional deduction provided by § 847(1). See, H.R. Conf. Rep. No. 1104, 100th Cong. 2d Sess. 173 (1988).

An example demonstrates this concept. Taxpayer A is a taxpayer entitled to claim a § 847(1) deduction of \$100. Taxpayer A’s taxable income, computed without regard to the deduction allowed by § 847(1), is \$250. Assuming a marginal tax rate of 34%, Taxpayer A will pay \$85 in federal income tax if it claims no § 847(1) deduction ($\$250 \times 34\% = \85). On the other hand, if Taxpayer A claims the § 847(1) deduction, its taxable income is \$150, resulting in federal income tax of \$51 ($\$150 \times 34\% = \51). In addition, Taxpayer A must make the special estimated tax payment required by § 847(2) of \$34, the amount of the tax benefit derived from the § 847(1) deduction ($\$100 \times 34\% = \34).² Accordingly, Taxpayer A will pay a total of \$85 ($\$51 + \$34 = \85) with its return for the taxable year, the same amount as it would have paid had it not claimed the § 847(1) deduction.

If, in the case where Taxpayer A did not claim the § 847(1) deduction, the Service later determined that Taxpayer A’s tax was overpaid, the amount of the overpayment would constitute an “overpayment of tax” on which interest is

² Taxpayers calculate and report the amount of the special estimated tax payments on Form 8816, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies. Form 8816 is attached to the income tax return for the taxable year in which a § 847(1) deduction is claimed.

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allowable. In order for § 847 to be revenue neutral, the same result should occur in the situation where Taxpayer A claimed the § 847(1) deduction. In both cases, the taxpayer was required to make total payments of \$85 on or before the due date of the return.

There is evidence in the legislative history accompanying the Omnibus Budget Reconciliation Act of 1989 (OBRA)³ amendments to § 847 which suggests that Congress intended § 847 to be revenue neutral not only with respect to the amount of a taxpayer's tax, but with respect to interest on that tax as well. The text of the OBRA Committee Report (and its related footnote) provide:

The bill also provides that special estimated tax payments are to be made on or before the due date (determined without regard to extensions) for filing the return for the taxable year for which the deduction is allowed. This provision is necessary in order to clarify the due date of such payments for any taxable year for which a deduction for unreversed discount is allowed due solely to the carryback of a net operating loss. This provision is not intended to affect the revenue neutral nature of the provision, including the amount of interest payable to or by the Federal government where special estimated tax payments are timely made.² (Emphasis added).

² For example, in the case where a deduction for unreversed discount results in a refund of taxes paid in an earlier taxable year, if the insurance company makes the required special estimated tax payments on or before the date that the refund is paid and the Internal Revenue Service is not required to pay interest with respect to the refund, no interest or penalty is to be imposed on the insurance company. To the extent that the special estimated tax payment is made after the payment of the refund, interest and penalties will apply only from the date that the refund is paid (or, if applicable, the first date with respect to which the Internal Revenue Service was required to pay interest).

This text suggests that § 847 should be applied in a manner that is revenue neutral with respect to both the amount of interest and the amount of tax. Thus, to ensure neutrality, a taxpayer that claimed the § 847(1) deduction and overpaid its tax should be entitled to interest on that overpayment to the same extent as if it had not claimed the § 847(1) deduction. A contrary conclusion would directly violate the revenue neutral policy underlying § 847.

No Express Disallowance of Overpayment Interest

In addition to its suggestion that both tax and interest are to be considered in determining revenue neutrality, the legislative history of the OBRA amendments to § 847 implies that underpayment interest is payable on amounts of special

³ P.L. 101-239, 103 Stat. 2106 (1989).

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estimated tax payments. Specifically, the footnote reproduced above indicates that penalties and interest will apply to special estimated tax payments that are not timely made. This statement, accompanied by the lack of any express prohibition on the payment of overpayment interest, further supports the conclusion that interest is allowable on overpayments of special estimated tax payments.

Where Congress intends to deny overpayment interest on refunds of particular overpayments, it does so expressly. See e.g., § 547(b)(2) (overpayments of the personal holding company tax resulting from the allowance of a deficiency dividend deduction are to be refunded without interest); § 6412(a)(1) (a portion of the amount of excise taxes imposed on certain floor stocks of a manufacturer, producer, or importer are to be refunded without interest); § 2011(c) (overpayments of the federal estate tax resulting from a credit for state death taxes are to be refunded without interest); § 7519(f)(3) (no interest is allowed on refunds of “required payments”).⁴

Section 847 contains no comparable provision denying interest on an overpayment of special estimated tax payments. This supports the conclusion that Congress intended for the Service to pay interest on these overpayments.

Offsetting Additional Tax Arising Under § 847(5)

Further evidence that Congress intended for special estimated tax payments to constitute payments of “tax” is found in § 847(2), which provides, in part:

If amounts are included in gross income under paragraph (5) or (6) for any taxable year and an additional tax is due for such year (or any other year) as a result of such inclusion, an amount of special estimated tax payments equal to such additional tax shall be applied against such additional tax.

The fact that special estimated tax payments are required to be used to pay income taxes due as a result of the reversal of the discount in the reserve account further supports the conclusion that special estimated tax payments are payments of “tax” within the meaning of § 6611(a), and should accrue interest to the same extent as

⁴ One year prior to its enactment of § 847, Congress enacted § 7519. Section 7519 requires partnerships and S corporations that maintain a fiscal year under § 444 to make certain “required payments” to compensate the government for the value of the tax deferral obtained by using a fiscal year instead of the calendar year. These monies remain on account with the government until the taxpayer’s § 444 election is terminated or the taxpayer is liquidated, at which point the amounts are refunded to the taxpayer. See § 7519(c)(2) of the Code and § 1.7519-1T(c) of the Income Tax Regulations. Section 7519(f)(3) provides that for purposes of determining interest, the required payment shall be treated as a tax; except that no interest shall be allowed with respect to the refund of these required payments.

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overpayments of any other tax. The TAMRA Conference Report supports this view, providing that to the extent special estimated tax payments are not applied against additional taxes arising under §§ 847(5) or (6), and are not needed to pay § 6655 estimated taxes in the 16th year, then such amounts should be refunded to the taxpayer to the same extent provided under existing law with respect to overpayments of tax.

Application of § 6611 to Refunds of Special Estimated Tax Payments

Section 6611(a) provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.

Section 301.6611-1(a) of the Regulations on Procedure and Administration adds that the interest allowed by § 6611(a) of the Code shall be allowed from the date of overpayment of the tax.

Section 301.6611-1(b) of the regulations clarifies the date of overpayment, providing in part:

. . . there can be no overpayment of tax until the entire tax liability has been satisfied. Therefore, the dates of overpayment of any tax are the date of payment of the first amount which (when added to previous payments) is in excess of the tax liability . . . and the dates of payment of all amounts subsequently paid with respect to such tax liability.

Based on the analysis above, we conclude that special estimated tax payments made pursuant to § 847(2) are payments of “tax” within the meaning of § 6611(a). Further, we conclude that these amounts become payments of tax on the date they are made or the date prescribed for payment, whichever is later.⁵ Accordingly, despite the fact that special estimated tax payments may be held in suspense by the Service until they are needed to offset tax arising from the discount reversal, the special estimated tax payments should not be considered either a deposit or an advance payment of tax during that suspension period.⁶

⁵ Under § 847(2), the date prescribed for payment is the due date (determined without regard to extensions) for filing the return for the taxable year for which the § 847(1) deduction is allowed.

⁶ Service Centers record and account for special estimated tax payments on a non-masterfile (NMF) account. As we understand the facts, when the discount in the loss reserve account reverses and amounts are taken into gross income pursuant to § 847(5), the Service applies an amount of special estimated tax payments against the resulting income tax.

Examples of Interest Computations

The following examples demonstrate the effect of various interest provisions on a refund of special estimated tax payments. These examples illustrate that the provisions of §§ 6611(e) and (f) may limit the amount of interest payable on refunds of special estimated tax payments. In each example, we assume that the taxpayer is a calendar year property and casualty insurance company with a constant marginal tax rate of 34 percent. We also assume that the taxpayer in each example files its return and pays its tax on the due date of the return (March 15 of the year following the taxable year), and there are no audit or other adjustments to the original return other than those specifically mentioned in the examples.

Example 1: Refunds Resulting From a Net Operating Loss Carryback to a Year in Which the § 847(1) Deduction Was Claimed

Facts: For taxable year 1995, the taxpayer has \$100 of taxable income prior to the § 847(1) deduction. The taxpayer claims a \$100 § 847(1) deduction for which it makes timely special estimated tax payments of \$34. For taxable year 1996, the taxpayer has a \$100 net operating loss without regard to § 847. On September 15, 1997, the taxpayer files a refund claim, carrying back the \$100 net operating loss to the 1995 taxable year. On October 1, 1997, the Service refunds the \$34 of special estimated tax payments made for the 1995 year.

Analysis: Pursuant to § 6611(f)(1), the overpayment of special estimated tax payments is deemed to have been made on March 15, 1997, the filing date for the 1996 return. In addition, because the Service refunded the overpayment within 45 days after the refund claim was filed, no interest is allowed on the overpayment. See §§ 6611(e)(1) and (f)(4).

Example 2: Refunds Resulting From an Amended Return for the Year in Which the § 847(1) Deduction Was Claimed

Facts: For taxable year 1996, the taxpayer has \$100 of taxable income prior to the § 847(1) deduction. The taxpayer claims a \$100 § 847(1) deduction for which it makes timely special estimated tax payments of \$34. On September 15, 1998, the taxpayer files an amended return for taxable year 1996, claiming additional operating expenses of \$100, which were mistakenly omitted from the original return. The additional expenses reduce the taxable income (prior to the § 847(1) deduction) to zero, thus eliminating the need for the § 847(1) deduction. On October 1, 1998, the Service allows this refund claim and refunds the \$34 of special estimated tax payments made for the 1996 year.

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Analysis: The overpayment of special estimated tax payments arises on March 15, 1997, the date on which the taxpayer's total tax payments first exceed its tax liability. However, because the Service refunded the overpayment within 45 days after the refund claim was filed, interest is allowed on the overpayment only from March 15, 1997, to September 15, 1998. See § 6611(e)(2).

Example 3: Refunds in the 16th Year Following the Year the Special Estimated Tax Payment Was Made

Facts: For taxable year 1988, the taxpayer claims a § 847(1) deduction of \$100 for which it makes timely special estimated tax payments of \$34. During taxable year 2004, the taxpayer determines that \$10 of the original \$34 special estimated tax payments has not been used to offset additional tax due pursuant to § 847(5) for the 15 taxable years beginning with 1989. The taxpayer's regular estimated tax payments made pursuant to § 6655 are equal to the amount of the taxpayer's tax liability for the taxable year 2004, and the Service refunds the \$10 of special estimated tax payments on April 1, 2005.

Analysis: The date of overpayment with regard to the special estimated tax payments is March 15, 2005. Pursuant to § 847(2), the \$10 of special estimated tax payments which was not used to offset additional tax pursuant to § 847(5) becomes a regular § 6655 estimated tax payment for the taxable year 2004. Pursuant to §§ 6611(d) and 6513(b)(2), this regular estimated tax payment is deemed to have been made on March 15, 2005. Because this amount was not needed to satisfy the taxpayer's tax liability, it was refunded to the taxpayer on April 1, 2005. Because the Service refunded the overpayment within 45 days after the return for taxable year 2004 was filed, no interest is allowed on the overpayment. See § 6611(e)(1).

If you have any questions, please contact

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