



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

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE  
MEMORANDUM FOR DISTRICT COUNSEL,

FROM: Assistant Chief Counsel (Field Service)

SUBJECT: Computation of Deficiency Interest On Tax Deficiency  
Tax Period:

This Field Service Advice responds to your request for advice dated . 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 =  
Year 1 =  
Year 2 =  
Year 3 =  
u = \$  
v = \$  
w = \$  
x = \$

ISSUE:

When does underpayment interest begin to accrue on X's deficiency in tax for Year 1.

CONCLUSION:

On the facts provided, underpayment interest on X's deficiency in tax of \$u for the Year 1 began to accrue on March 15, Year 3, the original due date, without extensions, of X's income tax return for Year 2.

FACTS<sup>1</sup>:

On September 15, Year 2, X timely filed, with extension, its Form 1120 (U.S. Corporation Income Tax Return) for Year 1. On its Form 1120 for Year 1, X reported an overpayment of \$v, which X elected to have credited against its liability for estimated tax for Year 2. X did not, however, designate against which installment of estimated tax the overpayment for Year 1 was to be applied. Thus, pursuant to Rev.Rul. 84-58, 1984-1 C.B. 254, the Service credited the overpayment against X's estimated tax for Year 2 as of March 15, Year 2, the due date for X's first installment of estimated tax for Year 2. X's tax liability for Year 2 was less than the amount of the overpayment applied from Year 1, and none of the Year 1 overpayment was needed to avoid the addition to tax imposed under I.R.C. § 6655 for failure to pay any estimated tax due for Year 2. \$w of the overpayment was used to pay X's tax liability for Year 2 which arose in the fourth quarter of Year 2 when there was a sale of an asset which resulted in investment tax credit recapture. X elected to have the balance of the overpayment of \$x credited against its estimated tax for Year 3. According to the facts provided, X has never used the balance of the overpayment from Year 1 against the estimated tax for any subsequent year in order to avoid the imposition of the addition to tax imposed under I.R.C. § 6655 for failure to pay estimated tax.

As a result of the audit of X's Year 1, the Service determined that there was a deficiency of \$u for that year which has yet to be assessed pending the resolution of this interest issue. X contends that interest should never begin to accrue on the subsequently determined deficiency for Year 1 since no portion of the Year 1 overpayment was ever used to avoid the imposition of the addition to tax under I.R.C. § 6655 for failure to pay estimated tax.

LAW AND ANALYSIS:

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); *Avon Products v. United States*, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next

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<sup>1</sup>The facts recited herein are taken from your Request for Field Service Advice. Inasmuch as we have not verified these facts, we express no opinion on their accuracy.

succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); *see also*, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.<sup>4</sup> Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.

1977-2 C.B. at 476 (emphasis added). Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); *see also* Rev. Rul. 88-98, 1988-2 C.B. 356.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that designated otherwise. However, in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). On August 4, 1997, the Service acquiesced in the *May Department Stores* decision. *May Department Stores Co. v. United States*, AOD CC-1997-008.<sup>5</sup>

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<sup>4</sup> In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to tremendous public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984.

<sup>5</sup> The *May Department Stores* action on decision provides that,

X's Year 1 does not fit within the fact pattern set forth in *May Department Stores* because X had full paid all of its installments of estimated tax for Year 2 and, therefore, did not need any of the return overpayment for Year 1 to pay the estimated tax for Year 2. X relies on the holding in *Sequa v. United States*, 1998 U.S. Dept. LEXIS 8556 (S.D.N.Y. June 8, 1998), for the proposition that interest on the deficiency for its Year 1 should not begin to run, because there has been, to date, no application of the overpayment to any estimated taxes, nor has the overpayment been refunded and only \$w was used to pay the tax liability that arose in the fourth quarter of Year 2 in connection with the sale of an asset. X contends that the Service has had the benefit of the overpayment since it was generated in Year 1 and therefore, no interest can begin to accrue on the subsequently determined deficiency for that year.

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) 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 tax under I.R.C. § 6655 with respect to such year. However, in all cases, the overpayment is a payment of the succeeding year's income tax liability no later than the due date (without regard to extensions) of the succeeding year's income tax return. Consequently, to the extent the overpayment is not needed to satisfy specific installments of estimated tax for the succeeding year's estimated tax, interest on the first year's deficiency begins to run from the original unextended due date of the succeeding year's income tax return. *See also Sequa Corp. v. United States, supra.*

In the instant case, no part of the Year 1 return overpayment was needed to avoid the addition to tax for failure to pay estimated income taxes in Year 2. Therefore, interest on the subsequently determined deficiency for Year 1 begins to run from the date on which the return overpayment is applied to the succeeding year's tax liability which is the unextended due date of the succeeding year's income tax

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for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

*May Department Stores Co. v. United States*, AOD CC-1997-008 (Aug. 4, 1997).

return - March 15, Year 3. It is on this date that the Year 1 deficiency became both due and unpaid.

Based on the foregoing, we recommend that the Service calculate the interest due for the underpayment of the assessed tax deficiency for X's Year 1 from March 15, Year 3. If you have any questions please call .

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By: \_\_\_\_\_  
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cc: Regional Counsel (Southeast)  
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