



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 PATRICK E. WHELAN
ASSISTANT DISTRICT COUNSEL, NORTHEAST REGION,
NEW JERSEY CC:NER:NJD:NEW

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

SUBJECT: Request for Refund of Deficiency Interest

This Field Service Advice responds to your memorandum dated January 6, 1999. 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 2 =
Year 3 =
Year 4 =

\$e =
\$f =

\$a =
\$b =
\$c =
\$d =

ISSUE:

At what date does interest commence to run on an underpayment of tax for a particular year, 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 year, but the Service subsequently determined a deficiency in tax.

CONCLUSION:

To the extent X's deficiency results from the use of a credit elect to satisfy estimated tax liabilities, deficiency interest will be assessed as of the dates the excessive credit is applied to the succeeding year's estimated taxes. Interest will be computed as of the original due date of the succeeding year's income tax return, if the excessive credit was not needed to satisfy specific installments of estimated tax.

FACTS:

X timely filed its tax returns for the years ended December 31, Year 1 and December 31, Year 2, on the extended due dates of September 15, Year 2, and September 15, Year 3, respectively. The Year 1 and Year 2 returns reflected overpayments of \$a and \$b, respectively, which X elected to apply to the corresponding subsequent tax year's estimated taxes. Since X did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined net deficiencies for Year 1 in the amount of \$c (greater than the \$a reported as overpayment on the return), and \$d (less than the reported return overpayment) for Year 2. In determining when deficiency interest would begin to run on the amount of X's Year 1 underpayment equal to the credit elect, the District concludes X did not need to use any of the credit elect to satisfy estimated tax liabilities for Year 2. With respect to estimated tax payments in Year 3, only \$e of the "excessive" credit elect for Year 2—that part of the credit to which X ultimately was not entitled--was used to satisfy estimated tax liabilities for the third quarter.¹

¹ In discussing the credit elect X used to satisfy its Year 3 estimated tax liabilities, this Field Service Advice addresses only the "excessive" credit taken by X. Thus, with a purported overpayment of \$b in Year 2, which X elected for use against estimated tax liabilities in Year 3, and a subsequently determined Year 2 deficiency of \$d, which was less than the reported overpayment, X originally overpaid its tax for Year 2. X's use of the credit elect to which it was entitled, is not at issue here, and is not discussed, although clearly X used that surplus in making estimated tax payments, before (Continued next pg)

All other installments of X's estimated tax—the first, second, and fourth installments—were fully paid without the using the “excessive” credit from Year 2.

LAW AND ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer claims a credit elect on a return filed either on the original due date or on extension, and the credit is applied in full against an installment of the succeeding 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 equal to or less than the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted e section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid.² 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. Prior to that date the government has had the use of the funds with respect to the prior year's tax.

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 apply the credit. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed 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. 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 light of the May Department Stores decision, the Service has reconsidered the manner in which deficiency interest is computed under section 6601(a), when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When such election is made, 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

making use of the “excessive” credit that created its Year 2 deficiency. Here, only \$e of the excessive credit was used to pay X's third quarter estimated tax liabilities.

² Code § 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.”

interest on a subsequently determined deficiency from the date the credit 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 is used will determine the amount of estimated taxes due, and thus, the amount of the credit needed to satisfy the quarterly 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.

Where the credit is not needed to satisfy any installment of estimated tax, as is the case with the entire Year 1 credit elect and \$f of the excessive credit from Year 2, that amount should be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of 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 shall be allowed for the taxable year in which the overpayment arises. See also § 6513(a)(income tax paid before the date prescribed for payment considered paid on the due date). The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). § 6151. Further, it is on this date that the credit is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under section 6611(a) and (d). Thus, we conclude that the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year, which is not needed to satisfy estimated taxes, should be treated as a payment against the subsequent year's income tax as of the due date of the return.

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