

August 4, 1997

**ACTION ON DECISION**

**Re:** The May Department Stores Co. v. United States

Citation: 36 Fed. Cl. 680 (1996)

**ISSUE:** Whether interest accrued on the taxpayers' underpayments of tax for 1983 and 1984 from the due date of the first or third estimated tax payment for the next succeeding years.

**DISCUSSION:** Pursuant to extensions, the taxpayers timely filed their income tax returns for 1983 and 1984 on October 15, 1984 and 1985, respectively. On these returns, the taxpayers reported overpayments of tax for 1983 and 1984, arising from amounts paid by the taxpayers on or before the unextended due date of the returns. The taxpayers elected to have their reported overpayments credited against their estimated tax liability for 1984 and 1985, but they did not designate the quarterly installment against which the overpayment should be applied. Accordingly, pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service applied the reported overpayments against the first quarterly installment of estimated tax of each year, the first installment of estimated tax due after the reported overpayments had been paid.

The Service subsequently determined deficiencies in tax with respect to the taxpayers' 1983 and 1984 tax years. The taxpayers paid the deficiencies, which were in amounts less than the overpayments reported on their returns for 1983 and 1984. Further, pursuant to Revenue Ruling 88-98, 1988-2 C.B. 356, the Service assessed and collected interest on the deficiencies from the due date of the first installment of estimated tax for 1984 and 1985, the effective dates of the credit elections, to the date on which the deficiencies were paid.

The taxpayers filed a claim for refund with respect to the interest which the Service alleged accrued from the due date of the first installment of estimated tax to the due date of the third installment of estimated tax of each year. The taxpayers argued that interest did not accrue on the deficiencies prior to the due date of the third installment of estimated tax of each year because, before that date, they had

made sufficient payments of estimated income tax to avoid estimated tax penalties for 1984 and 1985, without the application of the overpayments. Thus, the taxpayers argued that the reported overpayments were not used to pay their estimated tax for 1984 and 1985 before the due date of the third installment of estimated tax of each year, and that their 1983 and 1984 tax liabilities therefore were paid through those dates.

The Court of Federal Claims agreed with the taxpayers and held that interest on the deficiencies did not begin to accrue prior to the due date of the third installment of estimated tax of 1984 and 1985, notwithstanding the government's application of the overpayments to the first installments of estimated tax for the succeeding tax years. Inasmuch as the taxpayers had made sufficient payments to avoid the estimated tax penalty under I.R.C. § 6655 for the first and second installments of estimated tax without the application of the overpayments, the court concluded that the taxpayers were entitled to "offset" their deficiencies by their overpayments during the period between the first and third installments of estimated income tax. The May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996). The court stated that, "[b]efore October 15 of each relevant tax year, not only had plaintiff[s] paid the full sum for which [they were] liable, but [their] payment was not deficient in any respect." Id. at 689.

In the instant case, the taxpayers did not need to credit their reported overpayments against the first and second installments of estimated income tax for 1984 and 1985 to satisfy their estimated tax liability. Further, the taxpayers did not elect until October 15, 1984 and 1985, respectively, to have their reported overpayments for 1983 and 1984 credited against their estimated income tax liabilities for 1984 and 1985, and, at those times, the taxpayers did not designate to which installments the overpayments should be applied. Thus, we agree that, on the facts and circumstances of this case, the reported overpayments should not be deemed credited retroactively against the earlier installments of estimated income tax. Accordingly, for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment 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. To the extent that Revenue Ruling 88-98,

1988-2 C.B. 356, would require a different result, that revenue ruling will not be followed under these circumstances.

**RECOMMENDATION:** Acquiescence. Revenue Ruling 88-98, 1988-2 C.B. 356, should be modified.

/s/

---

RICHARD S. GOLDSTEIN  
Senior Attorney, Procedural

Branch

**REVIEWERS:**

GB           WF/SS  
DAB  
DJW

**APPROVED:** STUART L. BROWN  
Chief Counsel

/s/

By:

---

JUDITH C. DUNN  
Associate Chief Counsel

(Domestic)

THIS DOCUMENT IS NOT TO BE RELIED UPON OR  
OTHERWISE CITED AS PRECEDENT BY TAXPAYERS