

Part I

Section 6601.--Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax

26 CFR 301.6601-1: Interest on Underpayments.
(Also §§ 6402, 7805(b); 301.6402-3, 301.7805-1.)

Rev. Rul. 99-40

ISSUE

If an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without interest, from what date will interest be assessed on a subsequently determined deficiency for the overpayment return year?

FACTS

Situation 1. X Corporation files its federal income tax returns on a calendar year basis. For 1995, X made timely estimated tax payments of \$100x. On March 15, 1996, X filed Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax Return, and received a 6-month extension of time to file its income tax return. X paid \$120x with the request for extension. On September 15, 1996, X filed Form 1120, U.S. Corporation Income Tax Return, for 1995 showing a tax liability of \$210x and elected to have the overpayment of \$10x credited against its 1996 estimated tax. The \$10x overpayment is deemed to arise on March 15, 1996. X's required estimated tax for 1996 was \$100x. In order to avoid the addition to tax for underpayment of estimated tax for 1996, X was required to make payments of \$25x each on April 15, 1996, June 15, 1996, September

15, 1996, and December 15, 1996. X timely made the required \$25x payments in April and June. On September 15, X made a payment of \$15x. In 1998, the Internal Revenue Service examined X's 1995 return and determined that X's correct 1995 tax was \$215x, resulting in a deficiency of \$5x.

Situation 2. The facts are the same as in Situation 1 except that X paid \$23x on April 15, 1996, and \$14x on June 15, 1996, instead of the required payments of \$25x on each of these dates.

Situation 3. A, an individual, files federal income tax returns on a calendar year basis. In 1995, A made timely estimated tax payments of \$100x. On April 15, 1996, A filed Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, and received a 4-month extension of time to file A's income tax return. On August 15, 1996, A filed Form 1040, U.S. Individual Income Tax Return, for 1995 showing tax due of \$80x, and requested a refund of the \$20x overpayment. The overpayment is deemed to arise on April 15, 1996. The refund was made within 45 days of the date the timely return was filed, by a check dated September 14, 1996. In 1998, the Service examined A's 1995 return and determined that the correct tax was \$85x, resulting in a deficiency of \$5x.

Situation 4. The facts are the same as in Situation 3, except that A's correct tax liability was \$105x, resulting in a deficiency of \$25x.

LAW AND ANALYSIS

Section 6601(a) of the Internal Revenue Code provides that if any amount of tax is not paid on or before the last date prescribed for payment, interest will be paid on the amount from such last date to the date paid. Section 6151(a) provides, in general, that the date prescribed for payment is the time fixed for filing the return, determined without regard to any extension of time for filing. Section 6601(b)(1) provides that for determining interest on underpayments, the "last date prescribed for payment" is determined without regard to any extension of time for payment or filing.

Section 6402(b) states that the Secretary is authorized to prescribe regulations providing for the crediting against the estimated tax for any taxable year of the amount determined by the taxpayer or the Secretary to be an overpayment of the income tax for the preceding taxable year.

Section 301.6402-3(a)(5) of the Regulations on Procedure and Administration provides that a taxpayer may elect to apply all or part of the overpayment shown by its return to its estimated tax for the succeeding tax year by so indicating on its return. No interest is allowed on the portion of the overpayment credited and the amount of the credit is applied as a payment on account of the estimated income tax for the year or the installments thereof. See also § 301.6611-1(h)(2)(vii).

In Rev. Rul. 77-475, 1977-2 C.B. 476, revoked by Rev. Rul.

83-111, 1983-2 C.B. 245, reinstated and modified by Rev. Rul. 84-58, the Service held that if 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. If the overpayment occurs after the due date of the first installment of estimated tax for the succeeding taxable year, it may be credited only against an installment of estimated tax due on or after the date the overpayment was made. Under these circumstances, § 6655(b)(3) provides that a payment of estimated tax by a corporation is credited against unpaid required installments in the order in which the installments are required to be paid. Section 6654(b)(3) provides the same rule for individuals.

The Tax Reform Act of 1984, § 413, 1984-3 (Vol. 1) C.B. 301, provides that the application of the Code with respect to the crediting of an overpayment against estimated tax shall be determined without regard to Rev. Rul. 83-111 and with full regard to the rules in effect prior to Rev. Rul. 83-111. The legislative history provides that "[w]here the credit is made to an estimated tax payment arising prior to the election [to credit the overpayment], interest on the overpayment will not be payable, and interest on the underpayment which arises because of a deficiency in tax for the prior year will run from the date the

credit is effective." H. R. Rep. No. 98-432, Pt. 2, 98th Cong., 2d Sess. 1489-90 (1984).

Rev. Rul. 84-58, 1984-1 C.B. 254, holds that for returns filed after December 31, 1983, when a taxpayer elects to have an income tax overpayment credited against the succeeding year's estimated tax, the Service will apply overpayments arising on or before the due date of the return against the first installment payment of the succeeding year's estimated tax, unless the taxpayer requests that it be applied to a later installment.

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 on extension, and the claimed overpayment 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 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 § 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of § 6601(a). Prior to that date the government has the use of the funds with respect to the prior

year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). In the case of a refund made without interest under § 6611(e), the date on which the tax is both due and unpaid is the date when the amount in question is refunded, even when that date is subsequent to the date of the claim for refund.

In Situation 2 of Rev. Rul. 88-98, the Service applied the taxpayer's 1983 overpayment to the first installment of its 1984 taxes because the taxpayer did not indicate the installment to which the overpayment was to be applied. Rev. Rul. 88-98 held in Situation 2 that, because the overpayment was applied to the first installment, interest ran from April 15, 1984, on a subsequently determined deficiency for 1983 that was equal to or less than the claimed overpayment. However, Situation 2 does not indicate whether the taxpayer had actually made all or part of the April 15th estimated tax payment. Thus, it is not clear whether the taxpayer received any benefit of the overpayment as a payment of the April 15th installment.

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. Pursuant to Rev. Rul. 84-

58, the Service applied the overpayment to the first installment. 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 Situation 2 of Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by § 6655 for 1984 for the first and second installments of estimated tax due for 1984. The court concluded that the Service's application of the taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of the taxpayer's overpayment from the due date of the first installment (May 15) to the date the overpayment was applied to the third installment (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 interest on a subsequently determined deficiency is computed under § 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 income tax under §§ 6654 or

6655 with respect to such year. 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.

Since the overpayment will be applied in the order necessary to avoid the addition to tax for underpayment of estimated tax, designation of all or part of the overpayment to a specific estimated tax installment is not necessary. Accordingly, the Service will not accept such designations after October 4, 1999.

In Situation 1, interest on the \$5x deficiency for 1995 runs from September 15, 1996, the date on which the \$10x overpayment is applied to X's third installment of 1996 estimated taxes. The overpayment was not needed to satisfy an installment of estimated tax prior to September 15, 1996.

In Situation 2, interest on the \$5x deficiency for 1995 runs from June 15, 1996, the date on which the overpayment is applied to X's 1996 estimated taxes. A portion (\$2x) of the overpayment is applied to the April 15th installment of 1996 estimated tax. The remaining \$8x of the overpayment is applied to X's June 15th installment of 1996 estimated tax. Because the \$8x portion of the return overpayment exceeded the subsequently determined deficiency of \$5x, interest does not begin to run for 1995 before the date that portion was applied to X's 1996 estimated taxes.

In Situation 3, interest on the \$5x deficiency runs from September 14, 1996. Although A's 1995 taxes were due on April

15, 1996, A's 1995 taxes were not underpaid until the \$20x was refunded without interest to A on September 14, 1996.

In Situation 4, interest runs from September 14, 1996, on \$20x of the deficiency, and from April 15, 1996, on the remaining \$5x of the deficiency. Because A's 1995 taxes of \$105x were due on April 15, 1996, and A had only paid \$100x as of that date, A's 1995 taxes were underpaid by \$5x on April 15, 1996.

Nevertheless, A was not underpaid with respect to the \$20x until that amount was refunded to A on September 14, 1996.

In all situations, the estimated tax rules in effect for the tax year for which the election to credit a return overpayment is effective are used to determine when the overpayment is applied to that tax year's estimated taxes, and, thus, for determining when interest begins to run on the subsequently determined deficiency.

HOLDING

When a taxpayer reports an overpayment on its income tax return, interest will be assessed on that portion of a subsequently determined deficiency for the overpayment return year that is less than or equal to the overpayment as of: (1) the date on which the Service refunds the overpayment without interest; or (2) the date on which the overpayment is applied to the succeeding year's estimated taxes. Interest will be assessed on any remaining portion of the deficiency from the original due date of the tax for the overpayment return year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 88-98, Rev. Rul. 84-58, and Rev. Rul. 77-475 are modified and, as modified, are superseded.

PROSPECTIVE APPLICATION

Pursuant to § 7805(b), this ruling will not be applied adversely to a taxpayer that designated an overpayment to apply to an installment of estimated tax in accordance with Rev. Rul. 84-58 prior to October 4, 1999.

DRAFTING INFORMATION

The principal author of this revenue ruling is John J. McGreevy of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling contact Mr. McGreevy at (202) 622-4910 (not a toll-free call).