



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

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
LARGE AND MID-SIZE BUSINESS: AREA 3

FROM: John J. McGreevy
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Administrative Provisions & Judicial Practice
CC:PA:APJP

SUBJECT: Interest on Underpayments

This Chief Counsel Advice responds to your memorandum dated July 23, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer
Year 1
Year 2
Year 3
Year 5
Year 6
Year 7
Year 8
Year 9
Year 10
Date a
Date b
Period A
Period B
Period C

ISSUE

Whether interest on Taxpayer's Year 1 and Year 5 deficiencies should accrue during periods in which Taxpayer was overpaid for subsequent tax years?

CONCLUSION

Interest on Taxpayer's deficiencies for tax year's Year 1 and Year 5 accrues from the due dates of the succeeding years' income tax returns to the dates paid without regard to Taxpayer's overpayments arising in subsequent tax years.

FACTS

Taxpayer originally reported an overpayment for Year 1. Taxpayer elected to apply its Year 1 overpayment to its Year 2 estimated taxes. Taxpayer made estimated tax payments for Year 2 that were sufficient to satisfy its required installments. Therefore, the credit was not necessary to satisfy Taxpayer's estimated taxes for Year 2. Subsequent to the transfer of the overpayment to Year 2, a deficiency was determined and assessed for Taxpayer's Year 1. Taxpayer paid the deficiency on or about Date a.

Taxpayer originally reported an overpayment for Year 5. Taxpayer elected to apply its Year 5 overpayment to its Year 6 estimated taxes. Taxpayer made estimated tax payments for Year 6 that were sufficient to satisfy its required installments. Therefore, the credit was not necessary to satisfy Taxpayer's estimated taxes for Year 6. Subsequent to the transfer of the overpayment to Year 6, a deficiency was determined and assessed for Taxpayer's Year 5. Taxpayer paid the deficiency on or about Date b.

Taxpayer reported an overpayment for Year 6, which it elected to apply to its Year 7 estimated taxes. Taxpayer made estimated tax payments for Year 7 that were sufficient to satisfy its required installments. Therefore, the credit was not necessary to satisfy Taxpayer's estimated taxes for Year 7.

Taxpayer reported an overpayment for Year 8, which it elected to apply to its Year 9 estimated taxes. Taxpayer made estimated tax payments for Year 9 that were sufficient to satisfy its required installments. Therefore, the credit was not necessary to satisfy Taxpayer's estimated taxes for Year 9.

Taxpayer reported an overpayment for Year 9, which it elected to apply to its Year 10 estimated taxes. Taxpayer made estimated tax payments for Year 10 that were sufficient to satisfy its required installments. Therefore, the credit was not necessary to satisfy Taxpayer's estimated taxes for Year 10.

Taxpayer claims that interest on the deficiencies for Year 1 and Year 5 should not accrue during periods in which Taxpayer was overpaid for subsequent tax years (i.e., during various periods during which Taxpayer was in an “overpayment posture”).

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.

In Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. In Avon, the taxpayer elected to credit its 1967 overpayment to its 1968 estimated tax liability. Subsequent to the transfer of the overpayment a deficiency was determined for 1967. Once the credit elect was used to pay the succeeding year’s estimated tax, the prior year’s tax became unpaid for purposes of section 6601(a), and deficiency interest began to run. Prior to that date the government had the use of the funds with respect to the prior year’s tax, and no interest was payable on the overpayment that was the subject of the taxpayer’s election.

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 its 1983 overpayment to its 1984 estimated tax liability but did not indicate the installment to which the Service should credit the overpayment. 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. 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 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 Sequa Corp. v. United States, 99-1 U.S.T.C. (CCH) P50,379 (S.D.N.Y. June 10, 1998), the taxpayer elected to credit its 1990 overpayment to its 1991 estimated tax liability. Subsequent to the transfer of the overpayment a deficiency was determined for 1990. The court held that, if a taxpayer elects to apply an overpayment to its estimated taxes for the following year, and later discovers that it has overstated its overpayment (which creates a deficiency), interest on the

deficiency begins to run, not on the date of the election, but on the date on which such funds were actually so applied. The court concluded that since the taxpayer's 1990 credit elect was never needed to satisfy its 1991 taxes, the Service had use of the credit elect funds to offset the 1990 deficiency until March 15, 1992.

In Rev. Rul. 99-40, 1990-40 I.R.B. 441, which modified and superseded Rev. Rul. 88-98, 1988-2 C.B. 356, the Service reconsidered the manner in which interest on a subsequently determined deficiency is computed in light of May Department Stores decision. 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 sections 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.

In this case, Taxpayer reported overpayments for Year 1 and Year 5 and requested that those overpayments be credited to its estimated taxes for the succeeding tax years. Subsequent to the transfer of the overpayments, deficiencies were determined for Year 1 and Year 5. Taxpayer paid its Year 1 deficiency on Date a and its Year 5 deficiency on Date b. Section 6601(a) provides for deficiency interest from the date the tax is due to the date the tax is paid. According to Rev. Rul. 99-40, 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. Prior to the crediting of the overpayment, the government had the use of the funds from the prior year's tax and no interest is payable. In Taxpayer's situation, the credit was not needed to satisfy any estimated tax liability for Year 2 and Year 6. Accordingly, Taxpayer's Year 1 and Year 5 taxes became both due and unpaid when Taxpayer's Year 1 and Year 5 overpayments were credited to Taxpayer's Year 2 and Year 6 income tax liability on April 15th of Year 3 and Year 7, which are the due dates of the income tax returns for Year 2 and Year 6, respectively. Once the overpayments were credited to Taxpayer's Year 2 and Year 6 income tax the overpayments ceased to be overpayments for Year 1 and Year 5 and the Government no longer had the use of Taxpayer's funds for Year 1 and Year 5.

Taxpayer claims that interest on its Year 1 and Year 5 deficiencies should not accrue during periods in which it was overpaid for tax years subsequent to Years 1 and 5 when, according to Taxpayer, it was in an "overpayment posture." Taxpayer claims to have been in an "overpayment posture" for the Periods A, B, and C. The fact that Taxpayer had overpayments for subsequent tax years does not change the fact that the Government no longer had the use of Taxpayer's Year 1 and Year 5

funds once the overpayments were credited to its Year 2 and Year 6 income tax liability on the due date of the returns for those years.

Overpayments for tax years other than the year for which an underpayment is subsequently determined may be taken into consideration for interest computations in limited circumstances.

Section 6402 grants the Service the authority to make credits or refunds. Section 6402(a) provides that, in the case of an overpayment, the Secretary may credit the amount of such overpayment against any tax liability and shall, subject to certain subsections not relevant here, refund any balance.

Section 6601(f) provides that if any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed under section 6601 on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

In order to receive the benefit of section 6601(f), there must be the crediting of an overpayment under section 6402(a). See Northern States Power Co. v. United States, 73 F.3d 764 (8th Cir. 1996). The court held that section 6402(a) only applied to “outstanding liabilities.” The court concluded that because the taxpayer paid its liabilities, the taxpayer did not have any “outstanding liabilities” against which to credit taxpayer’s overpayments, and, therefore, the taxpayer could not benefit from section 6601(f).

In this case, Taxpayer had deficiencies for Year 1 and Year 5 and overpayments for Year 6, Year 8, and Year 9. Taxpayer paid its Year 1 deficiency on Date a and its Year 5 deficiency on Date b. In order to receive the benefit of section 6601(f), there must be the crediting of an overpayment under section 6402(a). To credit an overpayment under section 6402(a), there must be an “outstanding liability.” Since Taxpayer paid its liabilities for Year 1 and Year 5 there are no “outstanding liabilities” against which to credit taxpayer’s overpayments. Therefore, there can be no crediting of an overpayment under section 6402(a) and Taxpayer cannot benefit from section 6601(f). In addition, even if Taxpayer did have outstanding liabilities, Taxpayer’s overpayments for Year 6, Year 8, and Year 9 are considered payments for the succeeding tax years and cannot be used as a credit against a later determined deficiency. See Rev. Rul. 77-339, 1977-2 C.B. 475.

Section 6621(d) provides that to the extent, for any period, interest is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by title 26, the net rate of interest under section 6621 on such amounts shall be zero for such period. In order to obtain the benefit of section 6621(d), the taxpayer must have a period during which interest on an overpayment and underpayment overlap. However,

when a taxpayer makes an election to apply an overpayment to its succeeding year's estimated tax, no interest is allowable on the overpayment. See Treas. Reg. section 301.6402-3(a)(5) and Treas. Reg. section 301.6611-1(h)(2)(vii). Accordingly, section 6621(d) does not apply in any case in which the overpayment is applied to the succeeding year's estimated taxes.

In this case, Taxpayer elected to apply its Year 6, Year 8, and Year 9 overpayments to its Year 7, Year 9, and Year 10 estimated taxes. Since Taxpayer elected to credit its overpayments against its estimated taxes, Taxpayer is not entitled to interest on its overpayments under Treas. Reg. section 301.6402-3(a)(5) and Treas. Reg. section 301.6611-1(h)(2)(vii). Therefore, Periods A, B, and C are not periods during which interest overlaps on an overpayment and underpayment. Accordingly, section 6621(d) does not apply.

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Please call our office at (202) 622-4910, if you have any further questions.