



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

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 4, 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 = Year 1 =
- Year 2 =
- Year 3 =
- \$a =
- \$b =
- X's Representative = \$c =
- \$d =
- \$e =
- \$f =
- \$g =
- \$h =

\$i =

\$j =

\$k =

\$l =

\$m =

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 for such year and elected to have the overpayment applied 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 represents an excessive credit taken by X, deficiency interest will be assessed as of the dates the purported overpayment is applied to the succeeding year's estimated taxes, or the original due date of the succeeding year's income tax return if the overpayment is not needed to satisfy specific installments of estimated taxes.

FACTS:

X's fiscal Year 1 ended September 30, Year 1. In December of that year, X filed a Form 7004 extending the filing date for its return from December 15, Year 1, to June 15, Year 2. X estimated its tax liability at \$a and timely paid that amount in installments by December 15, Year 1. X filed its Year 1 return on June 15, Year 2, reporting a lesser liability of \$b, and hence an overpayment of \$c.¹ On its return, X elected to have the overpayment applied against its Year 2 estimated tax liability, but did not attach a statement specifying to which installment the Service should apply the Year 1 overpayment.² The Service, in accordance with Rev. Rul. 84-58, 1984-1 C.B. 254, retroactively applied X's reported overpayment against its first installment of Year 2 estimated taxes, which were due to be paid by January 15, Year 2.

¹ In calculating its overpayment, X included also a refundable credit.

² On the Form 2220 (Underpayment of Estimated Tax by Corporation) that X filed with respect to its estimated tax liability for Year 2, X indicated that it had applied the overpayment as a credit against its first installment of estimated tax for Year 2.

Upon audit of the Year 1 return, the Service determined that X had a deficiency of \$d, which was greater than the overpayment X had reported. In computing the amount of interest due on the Year 1 deficiency, the Service appears to have run interest on the entire deficiency as of the due date of the Year 1 tax, December 15, Year 1.³ X claims it is liable for interest on the difference between the deficiency amount and the purported overpayment from December 15, Year 1. The deficiency equivalent to the return overpayment should run interest from the dates the return overpayment was used to satisfy shortfalls in Year 2 estimated taxes. Thus, since X fully paid the first installment of Year 2 estimated taxes without applying any portion of the Year 1 overpayment, and underpaid the second and third installments, by \$e and \$f, respectively, X claims deficiency interest should run on these amounts as of the due dates of the second and third installments. In all events, X uses the date it filed the Year 1 return making the credit election, as the latest date interest begins to run on the Year 1 deficiency. [REDACTED]

Year 2. The same scenario occurred for Year 2. X filed its Year 2 return on June 15, Year 3, reporting a tax liability of \$g, total payments of \$h, and an overpayment of \$i. X elected to have the overpayment credited against its Year 3 estimated tax liability, but did not designate the specific installment to which the overpayment should be applied. The Service retroactively applied the overpayment to taxpayer's first installment of estimated taxes for Year 3, due to be paid by January 15, Year 3.

Upon audit, the Service determined a deficiency of \$j for Year 2. This amount was greater than the overpayment of \$i X had reported on its return. X claims interest should be charged on the amount of the deficiency represented by the return overpayment, starting June 15, Year 3.⁴ X made estimated tax payments sufficient to cover the first three installments of estimated tax, due January 15, March 15, and June 15, Year 3, without applying any portion of the return overpayment. However, a shortfall in estimated tax payments occurred for the fourth installment, due September 15, Year 3.

³ Typically, in situations where the taxpayer has not specified the installment of estimated taxes to which its return overpayment is to be applied, the Service will run interest on the amount of the deficiency represented by the return overpayment, starting at the due date of the first installment of estimated taxes.

⁴ X does not dispute that it is liable for interest on the difference between the deficiency amount and the purported overpayment from December 15, Year 2.

Year 3. X reported an overpayment of \$k, and elected to apply a lesser amount, \$l, to Year 4's estimated taxes.⁵ X did not designate the specific installment to which the overpayment should be applied. On audit, the Service determined a deficiency in tax for Year 3 in the amount of \$m, which was less than the overpayment X had reported on its return. The Service computed deficiency interest from the due date of the Year 3 return, December 15, Year 3. X claims deficiency interest should run starting June 15, Year 4. X did not make sufficient payments of estimated taxes to fully satisfy the third and fourth installments, which were due June 15, and September 15, Year 4.

LAW AND ANALYSIS:

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.⁶ 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 § 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 credit the overpayment. 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 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 the Service's application of taxpayer's 1983

⁵ The difference was refunded to X.

⁶ 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.”

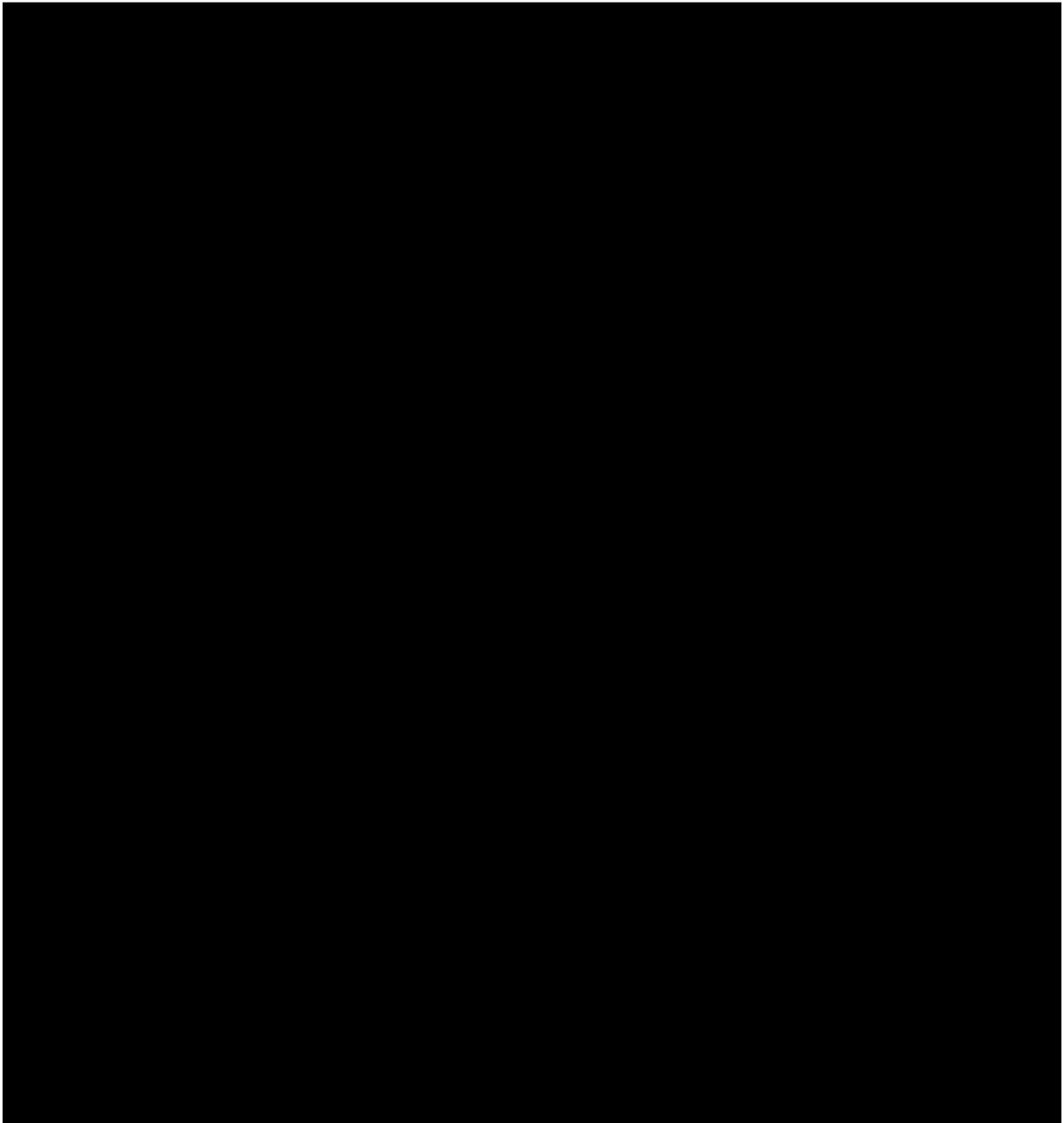
overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

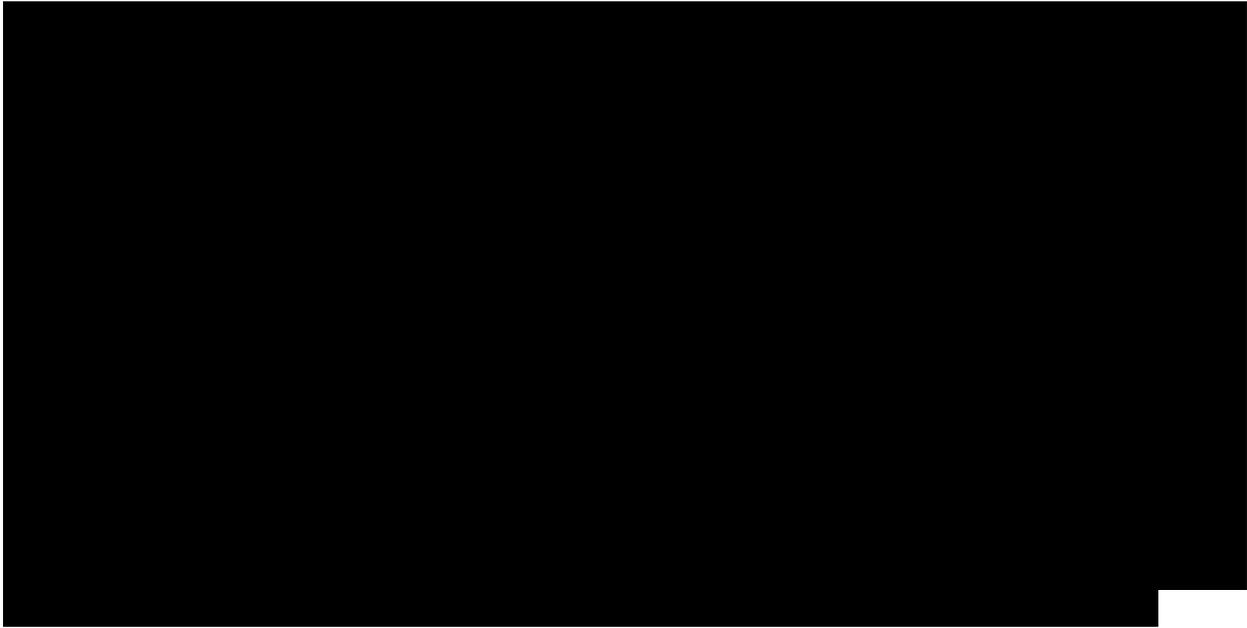
In light of the May Department Stores decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under § 6601(a), when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When such election is made, the overpayment 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 §§ 6654 and 6655. The Service will assess interest on a subsequently determined deficiency for the overpayment year from the date or dates that the overpayment 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 elect is used determine the amount of estimated taxes due, and thus, the amount of the overpayment needed to satisfy the installments of estimated tax. The unused balance of the overpayment is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

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 had 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 § 6402(b); Treasury Reg. § 301.6402-3(a)(5) & § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356.

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment would be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with § 6402(b), 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 of such overpayment shall be allowed for the taxable year in which the overpayment arises. See also § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on that 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 overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under § 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 must be treated as a payment against the next year's tax with an effective date no later than the due date of the next year's return.





Please call if you have any further questions.

By: _____
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