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: Claim for refund of deficiency interest; Accrual of overpayment interest

This Field Service Advice responds to your memorandum dated October 15, 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 =	$a =	$g =
Year 2 =	$b =	$h =
Year 3 =	$c =	$i =
Year 4 =	$d =	$j =
	$e =	$k =
	$f =	

ISSUES

1. At what date does interest begin to run on an underpayment, 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 taxable year, but the Service subsequently determined a deficiency in tax for the taxable year of the purported overpayment.

2. Where the Service offsets an overpayment in Year 3 against an underpayment for Year 4, whether the taxpayer is entitled to overpayment interest under section6611 from the return due date of the underpayment, against which the overpayment is credited, to the later date that the underpayment actually arose and the offset was effective.

CONCLUSIONS

1. Interest runs on any portion of the subsequently determined deficiency which exceeds the overpayment from the original due date of the tax. Interest runs on that portion of the deficiency less than or equal to the overpayment from the date the overpayment is credited to the succeeding year's estimated taxes, or the original due date of the succeeding year's income tax return to the extent the overpayment is not needed to satisfy specific installments of estimated tax.

2. The statutory terms of section 6611 should not be construed to allow the taxpayer overpayment interest up until the date the underpayment actually arose and the offset was effective. Overpayment interest runs only to the due date of the income tax return for the year in which the overpayment is applied, not the actual date the underpayment arose.

FACTS

For Year 1, there was an overpayment of $a upon the filing of the return. The taxpayer elected to apply this overpayment to its Year 2 tax liability. The Year 1 return was filed on September 15, Year 2 and there was no designation as to which Year 2 estimated tax payment the overpayment should be applied. The Service credited the entire overpayment to Year 2 as of the due date of the first estimated tax payment. However, only $b was used to satisfy a shortfall in the first quarter estimated payment of Year 2. The taxpayer contends in its claim that the balance of the overpayment, $c, is applied to Year 2 as of September 15, Year 2. In actuality, $b was used to satisfy a shortfall in the first quarter estimated payment and $d was applied to the third quarter estimated payment. The balance of $e was not needed for any other Year 2 estimated tax liability payment. A subsequent deficiency was determined for Year 1 in the amount of $f.

For Year 3, there was an overpayment of $g upon the filing of the return. The taxpayer elected to apply this overpayment to its Year 4 tax liability. The Year 3 return was filed on September 15, Year 4 and there was no designation as to which Year 4 estimated tax payment the overpayment should be applied. The Service credited the entire overpayment to the Year 4 tax year as of the due date of the first estimated tax payment. A subsequent deficiency was determined for the Year 3 tax year in the amount of $h. The taxpayer contends in its claim that the overpayment is applied to Year 4 as of September 15, Year 4. In actuality, the overpayment was not needed for any of the Year 4 estimated tax liability payments, because all of the estimated tax payments for Year 4 were paid in full with funds other than the credit elect from Year 3.

For Year 2, the audit resulted in an overpayment of $i. This overpayment was applied to Year 1 in the amount of $j and to Year 3 in the amount of $k. The Service computed interest on the overpayment applied to Year 3 from March 15, Year 3 to March 15, Year 4. The taxpayer contends that the overpayment interest on the portion of the overpayment applied to Year 3 should be computed to the date the credit elect from Year 3 was applied to the third installment of estimated tax for Year 4. The taxpayer's theory is that since $g, the original overpayment on the Year 4 return, was not effective as a payment of the Year 4 tax until September 15, Year 4, the overpayment interest for Year 2 on that amount should also run from March 15, Year 4 to September 15, Year 4.

LAW AND ANALYSIS

Issue 1

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 an 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 section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid.[1] 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.

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[1] Section 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."

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 section 6655 for 1984 for the first and second installments of estimated tax due for 1984. The court concluded the Services 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 Rev. Rul. 99-40, 1999-40 IRB 1, the Service has reconsidered the manner in which interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, 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 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 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 credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.[2]

For the deficiency in Year 1, a portion of the overpayment was applied to the third quarter of the succeeding year's estimated tax. Because the remaining portion of the return overpayment exceeded the subsequently determined deficiency, interest did not begin to run for the Year 1 deficiency on the third installment due date. A portion of the overpayment was also applied to the fourth installment of the succeeding year's estimated tax. As of the fourth installment date, the

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[2] Section 6513(d) provides that if any overpayment of income tax is, in accordance with section 6402(b), claimed as a credit against estimated tax for the succeeding taxable year, such amount shall be considered as a payment of the 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.

subsequently determined deficiency exceeded the remaining return overpayment, therefore interest begins to run on that portion of the deficiency in excess of the remaining return overpayment as of the due date of the fourth installment. Any overpayment not applied to the estimated tax payments for Year 2 should be applied to the income tax liabilities for Year 2 as of the unextended due date of that return. Thus, interest runs on the remaining portion of the deficiency from the unextended due date of the Year 2 return.

The deficiency in amount for Year 3 that is in excess of the overpayment reflected on the Year 3 return, should accrue deficiency interest from the original due date of the tax for Year 3. The return overpayment was not needed to satisfy any of the installments of estimated tax for Year 4, so the overpayment should be applied to the income tax liabilities for Year 4 as of the unextended due date of that return. Thus, interest runs on the remaining portion of the deficiency from the unextended due date of the Year 4 return.

Issue 2

"In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment . . . " Section 6402(a). See also, Treas. Reg. section 301.6402-1 ("Commissioner . . . may credit any overpayment of tax, including interest thereon, against any outstanding liability . . . "). Interest, however, is not recoverable on an obligation owed by the Government unless explicitly provided by statute or contract. Rosenman v. United States, 323 U.S. 658, 663 (1945). The taxpayer claims a right to interest under section 6611. Section 6611(b)(1) provides that "interest shall be allowed and paid . . . [i]n the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken." (emphasis added). Treasury Regulation section 301.6611-1(h)(2) provides that, in general, the term due date means "the last day fixed by law or regulations for the payment of the tax."

Section 6151(a) provides that "when a return of tax is required under this title or regulations, the person required to make such return shall . . . pay such tax at the time .. . fixed for filing the return (determined without regard to any extension of time for filing the return)." See also, Treas. Reg. section 1.6151-1(a). Section 6072 governs the time for filing income tax returns stating that " [r]eturns of corporations [required] under section 6012 . . . made on the basis of a fiscal year shall be filed on or before the 15th day of the third month following the close of the fiscal year." See also, Treas. Reg. section 1.6072-2(a). Thus, the last day fixed by law for the payment of income tax is the due date of the return (determined without regard to any extension of time).

For Year 3, the due date of the amount (here the underpayment for Year 4) against which the overpayment was credited, is the due date of the return for the year in which the taxes were underpaid. Overpayment interest runs only to the due date of the income tax return for the year in which the overpayment is applied, not the actual date the underpayment arose. Thus, overpayment interest runs until the unextended return due date for Year 4.

[redacted]

Please call if you have any further questions.

By: ______________________
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CC:DOM:FS