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

OFFICE OF
CHIEF COUNSEL

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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

This Field Service Advice responds to your memorandum dated
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 =	$i =
Year 2 =	$b =	$j =
Year 3 =	$c =	$k =
Year 4 =	$d =	$l =
Year 5 =	$e =	$m =
Year 6 =	$f =	$n =
Year 7 =	$g =	
Year 8 =	$h =	

ISSUE:

At what date does interest begin to run on an underpayment of tax, 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.

CONCLUSION:

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.

FACTS:

X timely filed its tax returns for the years ended August 31, Year 1, and August 31, Year 3, on the extended due dates of May 15, Year 2, and May 15, Year 4, respectively. The Year 1 and Year 3 returns each reflected overpayments of $a. On April 10, Year 7, the Service determined deficiencies for Year 1 and Year 3 each in the amount of $b (greater than the $a reported as overpayment on the return). With respect to estimated tax payments for Year 2, the entire $a of the excessive credit elect for Year 1 was used to satisfy estimated tax payments for the fourth quarterly installment. With respect to estimated tax payments for Year 4, only $c of the excessive credit elect for Year 3 was used to satisfy estimated tax payments for the fourth quarterly installment.

X timely filed its tax returns for the years ended August 31, Year 4 and August 31, Year 6, on the extended due dates of May 15, Year 5, and May 15, Year 7, respectively. The Year 4 and Year 6 returns reflected overpayments of $d and $e, respectively. On February, 3, Year 8, the Service determined deficiencies for Year 4 in the amount of $f (less than the reported return overpayment) and for Year 6 in the amount of $g (less than the reported return overpayment). With respect to estimated tax payments for Year 5, only $h of the excessive credit elect for Year 4 was used to satisfy estimated tax payments for the fourth quarterly installment. With respect to estimated tax payments for Year 7, only $i was used to satisfy estimated tax payments for the third quarterly installment and only $j was used to satisfy estimated tax payments for the fourth quarterly installment.

X elected to apply the overpayment in each of the above taxable years to the corresponding subsequent taxable year's estimated taxes. However, X failed to specify a particular tax installment to which the overpayment was to be applied, and the Service applied it to the first estimated-tax installment for each subsequent taxable year, i.e., the installment due on December 15 of Year 1, Year 3, Year 4, and Year 6.

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 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 § 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 § 6601(a), and thus when deficiency interest begins to run.

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 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 the 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

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[1] 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."

the succeeding year's estimated taxes. When such an 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(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]

Finally, § 6621(d) does not support the taxpayer's position regarding interest netting. The net interest rate of zero authorized by § 6621(d) applies to the extent that, for any period, interest is payable under § 6601 and allowable under § 6611 on equivalent underpayments and overpayments by the same taxpayer. The mechanics of the computation require that the interest on the overpayment and the interest on the underpayment be netted to arrive at net interest of zero for any period during which the overpayment and the underpayment overlap. However, when a taxpayer makes an election to apply an overpayment shown on the return to the succeeding year's estimated tax, 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). Accordingly, § 6621(d) does not apply in any case in which the overpayment is applied to the succeeding year's estimated taxes, since no interest is allowable on the overpayment in that situation.

In sum, the deficiency amount for Year 1 that is in excess of the overpayment reflected on the Year 1 return, should accrue deficiency interest from the original due date of the tax for Year 1. Interest begins to run on the portion of the deficiency that is less than or equal to the overpayment, as of the date on which the overpayment is applied to succeeding year's estimated taxes, i.e., the due date of the fourth installment.

For the deficiency in Year 3, interest begins to run on the portion of the deficiency in excess of the overpayment reflected on the Year 3 return from the original due

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[2] § 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 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.

date of the tax for Year 3. Interest begins to run on the portion of the deficiency that is less than or equal to the overpayment, as of the date on which the overpayment is applied to the succeeding year's estimated taxes, i.e, the due date of the fourth installment. However, in Year 3 the return overpayment is not needed to fully satisfy the installments of estimated tax for Year 4, so the remaining 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.

For the deficiency in Year 6 a portion of the overpayment was applied to the third installment 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 6 deficiency on the third installment due date. For the deficiencies in Year 4 and Year 6, a portion of the overpayment was applied to the fourth installment 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 either Year 4 or Year 6 on the fourth installment due date. The remaining overpayment should be applied to the income tax liabilities for Year 5 and Year 7 as of the unextended due date of those returns. Thus, interest runs on the entire amount of the deficiencies for Year 4 and Year 6, on the unextended due dates of the succeeding year's tax returns.

SUMMARY OF CONCLUSION

	Deficiency Amount	Date Interest Begins to Run
Year 1	$k[3]	November 15, Year 1
	$a[4]	August 15, Year 2Year 3
	$k[5]	November 15, Year 3
	$c[6]	August 15, Year 4

[3] Deficiency ($b) in excess of the overpayment ($a) runs from original due date of the tax for Year 1.

[4] Portion of the deficiency equal to or less than overpayment amount runs from date overpayment applied to fourth installment of Year 2 estimated taxes.

[5] Deficiency ($b) in excess of the overpayment ($a) runs from original due date of the tax for Year 3.

[6] Portion of the deficiency equal to or less than overpayment amount runs from date overpayment applied to fourth installment of Year 4 estimated tax.

	$l[7]	November 15, Year 4
Year 4	$f[8]	November 15, Year 5
Year 6	$g[9]	November 15, Year 7

If you have any further questions or comments, please call the branch telephone number.

By: ____________________
GEORGE E. BOWDEN
Technical Assistant
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[7] Overpayment not needed to fully satisfy installments of estimated tax in Year 4, so remaining overpayment applied to Year 4 income tax as of unextended due date of that return and interest runs on remaining portion of deficiency ($a - $c).

[8] Overpayment applied to fourth installment in the amount of $h, but the remaining portion of the overpayment ($m) exceeds the deficiency ($f), so interest on the deficiency does not begin to run on the fourth installment due date.

[9] Overpayment applied to third installment in the amount of $i and the fourth installment in the amount of $j, but the remaining portion of the overpayment ($n) exceeds the deficiency ($g), so interest on the deficiency does not begin to run on the fourth installment due date.