



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)

SUBJECT: Deficiency Interest

This Field Service Advice responds to your memorandum dated August 13, 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 Corp = Authorized representative:

Year 1 = \$a =
Year 2 = \$b =

ISSUE

At what date does interest start running on a deficiency in tax, where X originally reported an overpayment on its return, elected to have the overpayment credited

against its estimated tax liability for the next succeeding year, but paid all required quarterly installments of estimated tax without resort to the credit elect.

CONCLUSION

To the extent the credit elect is not used to satisfy estimated taxes, interest on the deficiency corresponding in amount to the unused credit elect, does not start running until the unextended due date of the succeeding year's income tax return.

FACTS

X timely filed its tax return for Year 1, on the extended due date, September 15, Year 2. The Year 1 return reflected an overpayment of \$a, which X elected to apply to its Year 2 estimated tax liability. Upon audit, the Service determined that X had a deficiency of \$b for Year 1, which was greater than the amount of the credit elect.

In computing interest on the deficiency amount corresponding to the credit elect, X claims interest should run from the date the credit was used to satisfy any shortfalls in X's estimated taxes for Year 2. And since no amount of the credit was used to satisfy X's estimated tax liabilities—X fully paid all quarterly installments of estimated tax for Year 2 without resort to the credit elect,¹ interest should run on the subsequently determined deficiency corresponding in amount to the credit elect, from the unextended due date of the Year 2 return. We agree.

LAW AND ANALYSIS

In general, deficiency interest under Code section 6601(a) can be charged only when the tax is both due and unpaid. Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978). When an amount originally paid with respect to one tax (here, X's income taxes for Year 1) is subsequently credited against a different obligation (X's estimated tax liabilities for Year 2), the date that interest starts running under section 6601 is the point at which the Government loses the use of the money in question as a payment of the original year's tax. In a credit situation, this occurs when the credit is effective as payment of the next year's estimated tax, even when that point precedes the credit election. Rev. Rul. 88-98, 1988-2 C.B. 356, modified and superseded by Rev. Rul. 99-40, 1999-40 I.R.B. 441; 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, 1984-1 C.B. 254. However, where other funds are available to fully pay the estimated tax, the credit would not be effective as a payment of estimated tax under the use-of-money principles enunciated in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996),

¹ These facts are based on X's transcript of account and

acq. AOD CC-1997-008 (Aug. 4, 1997), and Sequa Corporation v. United States, 99-1 U.S.T.C. (CCH) ¶ 50,379 (S.D.N.Y. June 10, 1998). These cases hold that the credit elect may not be used as a payment of estimated tax installments due prior to, or even after, the date of the election, where those taxes are fully paid without application of the credit.

In May Department Stores, the taxpayer reported overpayments on its timely filed 1983 and 1984 returns and elected to have the overpayments applied to the following years' estimated tax liabilities, but did not designate which quarterly installments against which the credit elect should be applied. In accordance with Rev. Rul. 84-58, 1984-1 C.B. 254, the Service applied the credit elect to the following years' first quarterly installment, even though the taxpayer had made sufficient estimated tax payments for its first and second installments without application of the credit elect.² On audit, the Service determined deficiencies in tax for the 1983 and 1984 years in amounts less than the credit elects, and computed deficiency interest from the due dates of the first installments of estimated tax for each year. The Court of Federal Claims held no interest was owed on the deficiency until the due dates of the third estimated tax installments, because the credit elects were not needed to cover estimated tax payments, and were available to offset the deficiencies, until those third installments.

Sequa holds 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. Relying on the fact that Sequa's payment of its first quarterly installment of 1991 estimated taxes was more than enough to satisfy its total 1991 estimated tax liability, and the 1990 credit elect was never needed to pay 1991 taxes—estimated or actual—the district court concluded that the Service had use of the credit elect funds to offset the 1990 deficiency until March 15, 1992.

In light of May Department Stores, the Service has reconsidered the manner in which deficiency interest is computed under section 6601(a), when taxpayer makes an election to credit the overpayment to the succeeding year's estimated taxes. When such election is made, 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 Code sections 6654 and 6655. Rev. Rul. 99-40, 1999-40 I.R.B. 441. Thus, the Service will

² In Revenue Ruling 84-58, the Service held that, for returns filed after December 31, 1983, when a taxpayer elects to have an overpayment of income tax credited against its estimated tax for the next succeeding year, such overpayment arising on or before the due date of the return will be applied against the first installment of estimated tax for the next succeeding year unless the taxpayer requests that it be applied to a later installment.

accrue interest on a subsequently determined deficiency from the date the credit elect is applied to the succeeding year's estimated taxes to the extent the credit elect is equal to or less than the deficiency amount. In all situations, the estimated tax rules in effect for the tax year in which the credit is used will determine the amount of estimated taxes due, and thus, the amount of the credit needed to satisfy the quarterly installments.³

Rev. Rul. 99-40 does not address the situation where the credit elect is not needed to satisfy any installment of estimated tax in the succeeding year. However, "such amount shall be considered as a payment of the income tax for the succeeding taxable year," pursuant to Code section 6513(d), and for purposes of limitations on credits or refunds, "shall be deemed to have been paid on the last day prescribed for filing the return ... for such taxable year ... determined without regard to any extension of time for filing ...," under Code section 6513(b)(2). Since the unextended due date of the succeeding year's return is the date the credit is effective as a payment of the succeeding year's income taxes, for purposes of claiming a refund or credit for that year, the Government should also be treated as having lost the use of that money as a payment of the original year's tax at that point in time. Accordingly, where no part of the credit is used to satisfy estimated taxes, the original year's tax would become due and unpaid as of the unextended due date of the succeeding year's return, and on that date, interest would start running under section 6601. Here, because the entire credit elect was not needed to pay estimated taxes, it is deemed a payment of income taxes for Year 2 as of the unextended due date for the Year 2 return. The Year 1 deficiency corresponding to the amount of the unused credit elect started running interest as of the unextended due date of the Year 2 income tax return.

By: _____
 GEORGE E. BOWDEN
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 Assistant Chief Counsel (Field Service)

³ Where a taxpayer splits the credit elect between installments of estimated tax, the estimated tax rules allow the credit elect to be applied as needed to satisfy all or part of the amount payable on the quarterly installment due date. When a credit elect is split among various installments the taxpayer will use money ultimately belonging to the Government at differing times to satisfy estimated tax liabilities. Accordingly, we conclude that deficiency interest computations that take into account the manner in which the credit elect was split among installments of estimated tax are consistent with both May Department Stores and Avon Products, Inc. v. United States. See Notice N(35)000-168, issued November 9, 1999.