Office of Chief Counsel
Internal Revenue Service

memorandum

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date: February 14, 2002

to: Compliance Division
Attn: [redacted], Team Co-ordinator (LMSB)
[redacted]

from: Associate Area Counsel (LMSB), Chicago

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subject: [redacted]
Interest Calculation on Estimated Tax Payments for [redacted]

EIN: [redacted]

This memorandum responds to your request for advice dated January 24, 2002. In your memo you ask about the proper method of calculating interest on a tax overpayment and how to net that interest against the interest imposed on the taxpayer for prior years' deficiencies. In our opinion, no interest was earned on the overpayment and, consequently, the question of netting interest does not arise.

We do not believe that this memorandum concerns an issue that requires coordination with an industry counsel.

This memorandum should not be cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

Facts

[redacted] Company (the taxpayer) made quarterly estimated payments of income tax to the Service for the year [redacted]. These payments were made on the 15th day of March, June, September, and December of [redacted].

The Service examined the taxpayer's [redacted] and [redacted] returns during [redacted]. At some point during [redacted] it became clear to the taxpayer that it had incurred substantial deficiencies for [redacted] and [redacted] and that its estimated payments for [redacted] were far larger than the tax that would actually be incurred for that year. Consequently, on [redacted], the taxpayer asked the Service in writing to transfer $[redacted] of the estimated payments for [redacted] to pay the deficiencies for [redacted] and [redacted]. Specifically, the taxpayer asked that $[redacted] of its payment on June 15, [redacted], $[redacted] of its payment on September 15, [redacted], and $[redacted] of its payment on December 15, [redacted] be applied to the [redacted] and [redacted] deficiencies.

In response to this request, the Service transferred $[redacted] from the taxpayer's [redacted] account to its [redacted] and [redacted] accounts, effective as of December 15, [redacted]. The taxpayer, upon hearing of this treatment, requested that the transfers be deemed to have been made from the [redacted] account to the [redacted] and [redacted] accounts as of June 15, [redacted], September 15, [redacted] and December 15, [redacted], in the amounts specified in its [redacted] request.

Issues

What is the proper interest computation on the overpayment and on the deficiencies when the taxpayer, on [redacted] requested that its excess estimated tax payments for [redacted] be applied to prior year deficiencies, the taxpayer having also requested that the amounts be deemed transferred as of the dates the estimated tax payments were made to the Service, i.e., June 15, September 15, and December 15, [redacted]?

Law

I.R.C. § 6601(a) states:

> If any amount of tax imposed by this title . . . is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section 6621 shall be paid for the period from such last date to the date paid.

I.R.C. § 6611(a) states:

> Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.

I.R.C. § 6611(e) states:

If any overpayment of tax imposed by this title is refunded within 45 days after the last day prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in the case of a return filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under subsection (a) on such overpayment.

I.R.C. § 6621(d) states:

To the extent that, 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 this title, the net rate of interest under this section on such amounts shall be zero for such period.

I.R.C. § 6425(a) states:

A corporation may, after the close of the taxable year and on or before the 15th day of the third month thereafter, and before the day on which it files a return for such taxable year, file an application for an adjustment of an overpayment by it of estimated income tax for such taxable year. An application under this subsection shall not constitute a claim for credit or refund.

I.R.C. § 6425(b)(4) states:

For purposes of this title (other than section 6655), any adjustment under this section shall be treated as a reduction, in the estimated income tax paid, made on the day the credit is allowed or the refund is paid.

Treas. Reg. § 1.6425-3(e) and (f) state:

(e) If the Internal Revenue Service allows the adjustment, it may first credit the amount of the adjustment against any liability in respect of an internal revenue tax on the part of the corporation which is due and payable on the date of the allowance of the adjustment before making payment of the balance to the corporation. . . .

> (f) For purposes of all sections of the Code except section 6655, relating to additions to tax for failure to pay estimated income tax, any adjustment under section 6425 is to be treated as a reduction of prior estimated tax payments as of the date the credit is allowed or the refund is paid. . . .

Analysis

Under I.R.C. § 6601(a), a taxpayer is obliged to pay interest to the Service on its underpayments of tax. The interest rate is specified in I.R.C. § 6621(a)(2). Under I.R.C. § 6611(a), a taxpayer is entitled to receive interest from the Service on overpayments of tax. The interest rate is specified in I.R.C. § 6621(a)(1).

In general, the interest rate that a corporate taxpayer must pay to the Service on tax underpayments is greater than the interest rate that the taxpayer is entitled to receive from the Service on tax overpayments. See I.R.C. § 6621(a). Consequently, in the absence of the "interest netting" provisions of I.R.C. § 6621(d), if a corporate taxpayer had simultaneous equal overpayment and underpayment obligations the two principal amounts would cancel each other, but the interest amounts would not cancel each other-- the taxpayer would owe more interest than it earned. The interest netting provisions are designed to alleviate this situation.

The interest netting rules come into play when a taxpayer has underpaid his tax and overpaid his tax at the same time. These countervailing obligations usually arise from two or more different tax years. I.R.C. § 6621(d) provides that, to the extent that for any time period interest is payable under subchapter A (i.e., interest incurred by the taxpayer on deficiencies under I.R.C. §§ 6601 to 6602) and allowable under subchapter B (i.e., interest payable by the Service on overpayments under I.R.C. § 6611) on equivalent underpayments and overpayments by the same taxpayer, the net rate of interest under § 6621 on the amount of the overlap is zero for such period.

In the present case, the taxpayer argues that the Service should apply interest netting rules to its "overpayment" of taxes for [redacted] and its deficiencies for [redacted] and [redacted] The taxpayer argues that the shift of funds from its estimated tax payments for [redacted] should be deemed to have occurred in specified amounts as of June 15, September 15, and December 15, [redacted]

The taxpayer's argument is flawed for two reasons: First, no interest was incurred on an "overpayment" in this case, so there is no overpayment interest to net against the interest incurred on the deficiency. Second, the taxpayer's re-assignment of excess estimated tax payments to the deficiencies cannot be made retroactively.

It is perfectly clear that the law does not require or allow the payment of interest on estimated tax payments. If the excess estimated payments result in a refund, the Service is obliged to pay interest on the refund, but only if the Service pays that refund more than 45 days after the due date of the return (or 45 days after the actual date of filing, whichever is later). See I.R.C. § 6611(e). Taxpayers do not earn interest on their estimated tax payments (no matter how greatly in excess of their tax liabilities) before filing a return.

Because a taxpayer does not earn interest on estimated tax payments, there is no interest payable by the government in this case to net against the interest that the taxpayer incurred on its deficiencies. According to Rev. Proc. 2000-26, 2000-1 C.B. 1257, it was the intent of Congress in enacting I.R.C. § 6621(d) that the Service make all reasonable efforts to offset overpayment and underpayment liabilities "in situations in which interest is both payable and allowable by the same taxpayer." In the present case there is no overpayment interest earned (i.e., no interest "allowable" by the government to this taxpayer) on estimated tax payments for [redacted] and therefore I.R.C. § 6621(d) has no application.

If a corporate taxpayer realizes that it has paid estimated taxes in excess of the amount of tax actually incurred, the taxpayer has the option of requesting the Service to refund such excess or credit it to other years. See I.R.C. § 6425. In the case of a tax year ending on December 31, a request for the refund or credit of excess estimated tax payments must be filed between January 1 and March 15 of the year following the year of payment. See I.R.C. § 6425(a)(1). Generally, the Service must act on such a request within 45 days. See I.R.C. § 6425(b). If a refund is payable as a result of such a request, the Service may (with or without the consent of the taxpayer) credit such amount to any deficiency owed by the taxpayer rather than issue a refund. See Treas. Reg. § 1.6425-3(e). We know of no authority, however, which allows a taxpayer to retroactively transfer its estimated tax payments for one year to pay its deficiencies for another. On the contrary, under I.R.C. § 6425(b)(4) and Treas. Reg. 1.6425-3(f), the crediting of excess estimated tax for one year to pay the deficiency for another year is deemed to be done "as of the date the credit is allowed," not as of the date the

payment was made. Obviously, a credit can be allowed only after the taxpayer has filed its request for a credit or refund and not during the year of the estimated tax payment.

If the taxpayer on June 15, September 15, and December 15, [redacted] had made smaller estimated tax payments than it actually made, and if it had used the money thus saved to make payments on those dates on its deficiencies for [redacted] and [redacted], the taxpayer would have reduced the interest it incurred on those deficiencies, even though the total amount of money received by the government on those dates from that taxpayer would be unchanged. Unfortunately for the taxpayer, it did not designate as payments on its deficiencies any of the amounts it paid the Service when it made those payments on June 15, September 15, and December 15, [redacted]. It cannot shift those funds in [redacted] of [redacted] and expect to be treated (for interest purposes) as if it had made such payments on the deficiencies during the previous year.

The Service appears to have erred in this case in being too generous. According to the transcript, the Service credited the excess estimated tax payments for [redacted] to the deficiencies for [redacted] and [redacted] as of December 15, [redacted]. The taxpayer, however, filed its request to shift such funds on [redacted] In no case should the Service have credited the payments from one year's account to another before that date. We therefore recommend that the interest incurred by the taxpayer on its deficiencies for [redacted] and [redacted] be recomputed based on the assumption that the funds were shifted as of the date the transcript indicates that such funds were actually credited to the deficiencies (but not later than 45 days after [redacted]).

Conclusion

We conclude that the interest netting rules of I.R.C. § 6421(d) do not apply because no interest is payable by the government on estimated tax payments, unless and until those payments become overdue refunds, which is not the case here. The taxpayer cannot reduce the interest it incurs on deficiencies by retroactively shifting excess estimated tax payments to a deficiency year. The Service erred in deeming such shifts to have been made on December 15, [redacted] when the credit was not requested until [redacted].

Of course, this advice depends on the facts which you have presented and we caution you not to apply this advice to other taxpayers. If you have any questions or need further advice, please contact J. Paul Knap at 414-297-4246.

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