



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
CC:LM:MCT:DET

FROM: John J. McGreevy
Assistant to the Branch Chief
CC:PA:APJP:1

SUBJECT: Computation of Interest on Subsequently Determined
Deficiency

This Chief Counsel Advice responds to your memorandum dated December 19, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

X Corporation =
Y Corporation =
Z Corporation =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 7 =
Date a =

ISSUES

If an overpayment claimed on the consolidated return filed by the common parent of an affiliated group is credited to the group's succeeding year's estimated tax, and the group is subsequently merged with a new entity in the succeeding year, from what date will interest be assessed on a subsequently determined deficiency for the overpayment year, where the overpayment was credited against the liability of the new entity?

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CONCLUSION

Deficiency interest accrues from the due date of the new entity's consolidated return for the succeeding year.

FACTS

In September Year 2, X Corporation, a calendar year taxpayer, filed a consolidated Year 1 tax return as parent of its consolidated group. The consolidated return reflected an overpayment, which X Corporation elected to apply to the group's succeeding year tax liability pursuant to § 6402(b) of the Internal Revenue Code ("Code").

In Year 2, X Corporation and Y Corporation merged to form Z Corporation. Both X Corporation and Y Corporation became wholly owned subsidiaries of Z Corporation. The merger became effective Date a, with X Corporation retaining its Employer Identification Number ("EIN").

In September Year 3, Z Corporation, also a calendar year taxpayer, filed a return for the Year 2 tax year on behalf of the consolidated group under its own EIN. The Year 2 return reflected an overpayment which Z Corporation elected to partially apply towards its tax liability for Year 3. The Internal Revenue Service ("Service") refunded the balance. X Corporation was not required to file its own return for Year 2. Income tax returns filed by Z Corporation for Year 3 and Year 4 also reflect overpayments.

After the merger, the Service transferred X Corporation's estimated tax payments for Year 2 to Z Corporation's taxpayer account.

As a result of an examination of X Corporation, the Service determined a deficiency for the Year 1 tax year. The interest on this deficiency was calculated from April 15, Year 2, the date the overpayment was posted to X Corporation's account.

On August 18, Year 7, Z Corporation filed a claim for refund of the Year 1 deficiency interest. Citing May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), and Rev. Rul. 99-40, 1999-40 I.R.B. 441, Z Corporation contends that interest should begin March 15, Year 3, the due date of Z Corporation's Year 2 tax return.

LAW AND ANALYSIS

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Section 6402(a) of the Code provides that in the case of any overpayment, the Secretary may credit the amount of such overpayment against any federal tax liability of the person who made the overpayment.

Section 6402(b) authorizes the Service to prescribe regulations providing for the crediting against the estimated income tax for any taxable year of the amount determined by the taxpayer or the Secretary to be an overpayment of the income tax for the preceding taxable year.

Section 301.6402-3(a)(5) of the Regulations on Procedure and Administration provides that a taxpayer may elect to apply all of the overpayment shown by its return to its estimated tax for the succeeding tax year by so indicating on its return. No interest is allowed on the portion of the overpayment credited and the amount of the credit is applied as a payment on account of the estimated income tax for the year or the installments thereof. See also Treas. Reg. § 301.6611-1(h)(2)(vii).

Section 1501 of the Code provides that an affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. Section 1.1502-6(a) of the Income Tax Regulations states that, generally, the common parent corporation and each subsidiary which was a member of the group during any part of the consolidated return year shall be severally liable for the tax for such year.

Thus, in the case of a consolidated group of corporations, § 6402 permits the Service to credit an overpayment of one member of the group against the consolidated income tax liability of the group.

Section 6601(a) provides that if any amount of tax is not paid on or before the last date prescribed for payment, interest shall be paid on the amount from such date to the date paid. Section 6151(a) provides that the date prescribed for payment is the time fixed for filing the return, determined without regard to any extension of time for filing. Section 6601(b) provides that for determining interest on underpayments, the last date prescribed for payment is determined without regard to any extension of time for payment or filing.

According to Rev. Rul. 99-40, 1999-40 I.R.B. 441, when a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) 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 with respect to such year. When a taxpayer reports an overpayment on its income tax return, and the Service later determines a deficiency for that year, interest will be assessed on the portion of the deficiency that is less than or equal to the

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overpayment from the date on which the overpayment was applied to the succeeding year's estimated taxes. Interest will be assessed on any remaining portion of the deficiency from the original due date of the tax for the overpayment return year.

In Sequa Corporation v. United States, 99-1 U.S.T.C. (CCH) P50,379 (S.D.N.Y. 1998), the court held 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 on the date on which such funds were actually applied. Relying on the fact that Sequa's payment of its first quarterly installment of 1991 estimated tax liability 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.

X Corporation filed its Year 1 return in September Year 2 reflecting an overpayment, which it elected to credit to its tax liability for the succeeding year. As a member of the consolidated group for Year 2, X Corporation was severally liable for the group's Year 2 tax liabilities. The Year 1 overpayment was not applied towards any X Corporation Year 2 estimated tax liability. In addition, the overpayment was not applied to any Z Corporation Year 2 consolidated tax liability, estimated or actual, until it was applied to the Year 2 income tax liability on March 15, Year 3. Because the X Corporation deficiency was not unpaid until March 15, Year 3, deficiency interest does not accrue until March 15, Year 3, the due date of the Year 2 consolidated return

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call our office at (202) 622-4910 if you have any further questions.