Interest Calculations When Netting Overpayment And Underpayments

BACKGROUND

In the course of a business tax audit (e.g., General Corporation Tax, Unincorporated Business Tax or Banking Corporation Tax), the auditor and the taxpayer may agree that there has been an overpayment for one tax period and a deficiency in the same tax for another tax period within the same audit period. In this situation, the Department, but not the taxpayer, has the option of applying the overpayment in full or partial satisfaction of the deficiency and of assessing or refunding any resulting balance. The Department can choose to issue the refund and to separately assess the deficiency; there is no obligation to net the overpayment and the deficiency. However, because it may take time before the deficiency can be finally assessed and collected, netting is often preferable for practical reasons.

Outside the audit context, a taxpayer complying with its obligation to report federal or State changes may report an overpayment for one tax period and a deficiency for another tax period. The taxpayer does not have the option to net the overpayment and deficiency although taxpayers often attempt to do so. While the reporting of the deficiency can represent a self assessment unless the taxpayer indicates its objection, the initial reporting of the overpayment by the taxpayer represents a refund claim subject to processing and confirmation. Once the overpayment and deficiency reported are confirmed by the Department, the Department may net the overpayment against the deficiency but this is not mandatory.

In both of these netting situations, the calculation of interest on the overpayment and the deficiency is an issue. Interest accrues on an underpayment from the due date of the return until paid. Administrative Code ''11-526(a) and 11-675.1. Interest accrues on an overpayment from the overpayment date (the later of the due date of the return or the date the tax was paid) until the due date of the amount against which it is credited or a date not more than 30 days prior to the date of the refund check if not credited. Code ''11-528(a) and 11-679.1. For tax years beginning after 1989, interest does not accrue on overpayments prior to the filing of a refund claim. Code ''11-528(a)(3) and 11-679.1(c). The Commissioner is authorized to adopt rules mitigating this provision under certain circumstances if it would result in a taxpayer being assessed interest on a deficiency while being denied interest on an overpayment. Code ''11-528(a)(4) and 11-678.1(d). Finally, Code sections 11-524(k) and 11-675.11 provide that where a tax liability is satisfied by crediting an overpayment, interest will not accrue on the liability for any period during which interest would have been allowed on the overpayment had it not been applied against the liability.

A related interest calculation issue exists where a taxpayer files a business tax return reporting an overpayment which the taxpayer elects to credit against estimated tax payments due for a subsequent period. Administrative Code ''11-677.2 and 11-526(b). If a taxpayer makes such an election and an audit results in an adjustment to the taxable income for the first period reducing or eliminating the reported overpayment, the taxpayer's election to credit the

reported overpayment will result in a deficiency for the first period. In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), the Court of Claims addressed this issue at the federal level. The court concluded that the reported overpayment continued to exist as a payment for the earlier year and did not become a payment for the later year until the time that the taxpayer actually made the election, even where the estimated tax due date preceded the date of the election.[1] As a result, any deficiency created as a result of the crediting of the reported overpayment did not begin to accrue interest until the election was made, not on the due date for the estimated tax payment. The State Tax Appeals Tribunal reached a similar result in Matter of Unicorp American Corporation, DTA No. 811873 (December 28, 1995). As a decision of the State Tax Appeals Tribunal, that decision represents binding precedent on the Department.

SCOPE

This Statement of Audit Procedure provides guidance to auditors in calculating interest where the Department chooses to credit, or net, an overpayment for a tax period against a deficiency for the same tax for another tax period within the same audit period based on the authorities cited above. This SAP assumes that both the overpayment and the deficiency have been finally determined by the Department. This SAP also advises auditors that the Department will follow the results in Matter of Unicorp. While the authorities cited above relate solely to the business taxes and while interest does not accrue on overpayments of excise taxes, this Statement of Audit Procedure applies, to the extent relevant, where the Department chooses to credit overpayments of excise taxes against underpayments of the same taxes.

PROCEDURE

a. Overpayment Precedes Deficiency. If an overpayment exists for year 1 as of the due date of the return for year 1 without extensions, and is credited against a deficiency for year 2, no interest accrues on the deficiency for year 2 except to the extent it exceeds the amount of the overpayment from year 1. The result is the same regardless of when the account entries are made crediting the overpayment because the offset is deemed to take place as of the date the deficiency first arose, i.e., the due date of the return for year 2. If the overpayment does not fully offset the deficiency, any remaining deficiency accrues interest according to the usual rules. If a refund for year 1 was claimed on the year 1 return, the overpayment would accrue interest from the date of the claim until the due date for the year 2 return, which is the date when the overpayment is credited. If the overpayment exceeded the deficiency, interest would continue to accrue on the balance. If no refund claim is filed, no interest accrues on the overpayment.

b. Deficiency Precedes Overpayment. If a deficiency exists for year 1 as of the due date of the return for year 1 without extensions, and an overpayment for year 2 is credited against that deficiency, the year 1 deficiency accrues interest until the date the overpayment arises,

[1] This could be the case where the return reporting the overpayment is filed on an extension after the due date for the estimated taxes for the subsequent period. For example, the 1992 return could be filed with extensions on October 15, 1993 electing to credit the reported overpayment to the estimated tax payment due March 15, 1993.

generally the due date of the year 2 return unless the year 2 tax was paid later. If the deficiency exceeds the overpayment, the portion of the deficiency not satisfied will continue to accrue interest until paid. If the overpayment exceeds the deficiency, interest will begin to accrue on the remaining balance of the overpayment on the later of the date the overpayment arises or the date a refund claim is filed.

c. Deficiency and Overpayment for Same Tax Period. A deficiency is defined as the excess of the tax due over (i) amounts shown as tax due on the return, (ii) amounts previously assessed as deficiencies, and (iii) amounts previously credited or refunded. An overpayment is the excess of the tax paid for a tax period over the tax due. Because the definition of a deficiency does not take into account payments or prepayments of tax, a deficiency can exist for a tax period while there is in fact an overpayment for that same period. However, interest only accrues on the amount of any deficiency in excess of amounts of tax paid. If a return reports an overpayment and if the actual tax due for that year exceeds the tax shown as due, there may be no overpayment in fact or the actual overpayment may be less than originally reported. If the taxpayer elected to credit the reported overpayment toward tax payments due for a later period, that amount is treated as a payment of tax for the later period and ceases to be an overpayment for the earlier period as of the date that election is made. As a result, a deficiency may be created or increased as a result of that election. The Department will follow the results in <u>Matter of Unicorp</u> in these cases to the effect that interest on any deficiency created as a result of an election to credit a reported overpayment will not begin to accrue until the date the election is made, <u>i.e.</u>, the date the return making the election is filed.

EXAMPLES

<u>EXAMPLE A:</u> X is a calendar year taxpayer.

On 4/15/91 X filed its 1990 UBT return showing $100X tax due, $90X of estimated tax paid and remitting the $10X balance with the return.

On 4/15/92 X filed its 1991 UBT return showing $100X of tax due and $150 of estimated taxes paid in 1991 and claiming a refund for the $50X overpayment. No final decision is made by the Department on that claim prior to 1/1/95.

On 1/1/95 X timely filed form NYC-115 showing $10X additional tax due for 1990. X concedes the accuracy of the change but does not remit the $10x claiming $10X of the $50X 1991 overpayment as a credit. On 4/1/95, the Department finds the $50X overpayment to be correct and credits $10X of it against the $10X 1990 deficiency and refunds the balance.

RESULT: The 10X 1990 deficiency bears interest from 4/15/91 to 4/15/92, the date of the overpayment. The $40X remaining overpayment bears interest from 4/15/92 until 30 days prior to the date of the refund check.

<u>EXAMPLE B:</u> The facts are the same as in example A except the 1991 return is filed 10/15/92 with an extension.

RESULT: The results should be the same as in example A except that the $40X balance of the overpayment bears interest only from 10/15/92, the date the refund claim is filed.

<u>EXAMPLE C:</u> On 4/14/84 X, a calendar year taxpayer, filed an extension to 10/15/84 to file his UBT return and made an estimated payment of $100X.

On 10/15/84 X filed a return showing an overpayment for 1983 of $50X. X elected to credit the overpayment to the 1984 tax year. Upon audit, it is determined that there was no overpayment of $50x for 1983.

RESULT: The taxpayer will be charged interest from 10/15/84 on $50x because when the $50x was credited to the 1984 tax year, it created a deficiency for 1983 on that day.

<u>EXAMPLE D:</u> X is a calendar year taxpayer.

On 4/14/91 X filed its 1990 UBT return showing $100X of tax due and $150 of estimated taxes paid in 1990 and claiming a refund for the $50X overpayment.

On 4/15/92 X filed its 1991 UBT return showing $100X tax due, $90X of estimated tax paid and remitting the $10X balance with the return.

On 1/1/95 X timely files Form NYC-115 showing $10X additional tax due for 1991. X concedes the accuracy of the change but does not remit the $10X claiming $10X of the $50X 1990 overpayment as a credit. On 4/1/95, the Department finds the $50X overpayment to be correct and credits $10x of it against the $10X 1991 deficiency and refunds the balance.

RESULT: $10 x of the 1990 $50X overpayment bears interest from 4/15/91 until 4/15/92, the due date for the $10X deficiency against which the overpayment is credited. The remaining $40X overpayment bears interest from 4/15/91 until 30 days prior to the date of the refund check. The $10X deficiency does not bear interest because it is paid as of the date that it is due.