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## **QUESTION PRESENTED**

What is the effective date of a credit of an overpayment to the current year's estimated tax where the credit arises from a credit-elect of an overpayment shown on a delinquent prior-year return?

## **CONCLUSION**

The FTB will follow IRS Revenue Ruling 99-40, IRC section 6513(b)(1) and (2), and IRS Internal Revenue Manual 20.2.4.3 (03-01-2002). As explained in TAM 99-1030, the credit-elect will be applied as needed to reduce the current year's estimated tax. This rule will apply even when the prior year return is not timely filed. The holdings of Legal Ruling 94-4 and TAM 99-1030, question 3, have been superseded and should no longer be followed.

## **FACTS**

According to the facts presented, a calendar year corporate taxpayer elects to have the overpayment shown on its late filed California income tax return for Year 1 (e.g., extended due date is September 15, Year 2, and the return is filed December 15, Year 2) applied as a credit-elect for its Year 2. The entire overpayment is attributable to prepaid credits (payments made before the due date of the return). Taxpayer files a timely Year 2 return, claiming the credit-elect from Year 1 as a prepayment.

## **APPLICABLE LAW**

Revenue and Taxation Code section 19362 (renumbered from § 19064 effective 1/1/94) provides:

The Franchise Tax Board is authorized to prescribe regulations providing for the crediting against the estimated tax for any taxable year of the amount

determined by the taxpayer or the Franchise Tax Board to be an overpayment of the tax for a preceding taxable year.

(This section is based on and substantially similar to Internal Revenue Code section 6402(b).)

Revenue and Taxation Code section 19002(e) (renumbered from § 18551.1(e) effective 1/1/94) provides:

(e) If any overpayment of income tax is claimed as a credit against estimated tax for the succeeding taxable year, that amount shall be considered as a payment of estimated tax in accordance with Section 19007, for the succeeding taxable year, and no claim for credit or refund of the overpayment shall be allowed for the taxable year in which the overpayment arises.

(This subdivision is based on, and substantially similar to, Internal Revenue Code § 6513(d).)

Legal Ruling 94-4, March 23, 1994, held that the effective date of a credit-elect shown on a timely-filed return was the first estimated due date for the subsequent year, and the effective date of a credit-elect shown on a delinquent return was the filing date of the delinquent return. The State Board of Equalization came to the same conclusion in *Appeal of Capitol Architectural Products Co.* (96-SBE-021), decided on December 4, 1996. These holdings were supported by the IRS Revenue Rulings 88-97 and 88-98 and *Avon Products v. United States* (1978) 588 F.2d 342.

As explained in TAM 99-1030, in Revenue Ruling 99-40, 1999-40 IRB. 441, the IRS modified its position on credit-elect application, modifying Rev. Rul. 88-98 and allowing a retrospective determination of the application of the credit-elect to the latest estimated tax installment necessary to avoid an estimated tax penalty for the subsequent year.

As the Franchise Tax Board has not issued regulations under these sections and the Revenue and Taxation Code is in substantial conformity with the Internal Revenue Code, the Franchise Tax Board will follow federal regulations, procedures, rulings and decisions. (See FTB Notice 89-277, Taxpayers' Bill of Rights, Franchise Tax Board Chief Counsel Rulings Guidelines, Section H.)

The IRS Internal Revenue Manual 20.2.4.3 (03-01-2002), Availability Dates for Overpayments, indicates in item 1 that prepaid credits are deemed paid as of the due date of the return, whether the return is timely filed or not.

## ANALYSIS AND DISCUSSION

In IRS Revenue Ruling 99-40, the IRS did not specifically indicate how credit-elects shown on a delinquent return should be applied to the subsequent year's estimated tax payments. IRS Internal Revenue Manual 20.2.4.3 (03-01-2002), holds that prepaid credits are deemed paid as of the due date of the return, determined without regard to any extension of time to file, whether the return is timely or late filed. (See IRS Revenue Ruling 99-40, I.R.C. § 6513(b)(1) and (2).)

The credit-elect shown on a delinquent return is available for crediting to the subsequent year return as of the return original due date of that delinquent return.<sup>1</sup> Under 99-40, the credit-elect applies to each estimate for the subsequent year as needed to minimize the estimated tax penalty, but in no case later than the original due date of the subsequent year's return.

### Tax Counsel

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<sup>1</sup> The delinquent return must still be filed within the applicable statute of limitations. If the return is filed after the statute of limitations has expired, no credit or refund of withholding or estimated tax is allowed. (See § 19006; *Commissioner v. Lundy* (1996) 516 U.S. 235; and *Baral v. U.S.* (2000) 528 U.S. 431.)