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KPMG report: Strategy for minimizing late deposit penalties, avoiding IRS trap

Code section 6656 provides that in the case of any failure to deposit taxes by the date prescribed, a penalty will be imposed on the amount of the underpayment. The “failure to deposit penalty” ranges from 2% to 15% of the underpayment, depending on the number of days the deposit is late.

The IRS will generally follow Rev. Proc. 90-58, which applies deposits in “date-made order against deposit liabilities in due-date order.” In theory, this approach minimizes the number of days each deposit might be considered late. However, in reality, if a taxpayer misses a single deposit early in a quarterly payroll period, but makes all succeeding deposits on a timely basis, the IRS’s method can cause timely deposits to be reallocated against an earlier unpaid liability. When this happens, the later timely deposits appear to be untimely, generating failure-to-deposit penalties on multiple liabilities—rather than on the single liability for which the deposit was missed.

Fortunately, section 6656(e) allows taxpayers who receive a failure-to-deposit penalty notice to designate deposits against specific liabilities, which can reduce failure to deposit penalties significantly.

The following example helps to illustrate this point.

Deposit Date-Made Order Against Deposit Liabilities in Due-Date Order					
Liability Amount	Deposit Due Date	Deposit Date	Days Late	Penalty Rate	Penalty
\$ 100.00	2/1/2016	2/25/2016	24	10%	\$ 10.00
\$ 100.00	2/25/2016	3/15/2016	19	10%	\$ 10.00
\$ 100.00	3/15/2016	3/20/2016	5	2%	\$ 2.00
Total Penalty					\$ 22.00
Deposits Designated to Specific Liabilities					
Amount	Deposit Due Date	Deposit Date	Days Late	Penalty Rate	Penalty
\$ 100.00	2/1/2016	3/20/2016	48	10%	\$ 10.00
\$ 100.00	2/25/2016	2/25/2016	0	0%	\$ -
\$ 100.00	3/15/2016	3/15/2016	0	0%	\$ -
Total Penalty					\$ 10.00

It is important to note that a taxpayer that wishes to request a deposit redesignation under section 6656(e) must make such a request **within 90 days of the penalty notice date**. Failure to redesignate deposits may result in a taxpayer facing a substantially larger penalty amount, with a request for waiver based on reasonable cause as the only avenue for relief.

KPMG observation

Taxpayers receiving an IRS notice assessing a failure-to-deposit penalty need to consider how to redesignate the deposits. KPMG's Complex Interest Services group has experience in guiding taxpayers how to redesignate deposits in a taxpayer-favorable manner, and can assist with computational and refund claim preparation.

For more information, contact a tax professional with KPMG's Complex Interest Services group:

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