

Rev. Proc. 2001-58

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the failure-to-deposit penalty provisions of section 6656 of the Internal Revenue Code (Code), as amended by section 3304(c) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 742 (1998) (RRA). This revenue procedure describes how the Service will credit Federal tax deposits to determine whether a failure-to-deposit penalty under section 6656 should apply to deposit periods beginning after December 31, 2001. This revenue procedure applies only with respect to situations in which deposits have not been made in sufficient amounts to satisfy the cumulative deposit obligations as of at least one deposit due date.

SECTION 2. BACKGROUND

.01 Section 6656 of the Code provides that in the case of any failure by any person to deposit (as required by the Code or regulations) on the date prescribed any

amount of tax in a government depository, there will be imposed upon such person a penalty equal to the applicable percentage of the amount of the underpayment, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The applicable percentage ranges from 2 to 15 percent depending upon the lateness of the deposit.

.02 Rev. Proc. 90-58 (1990-2 C.B. 642) effective for deposit periods beginning after March 31, 1991, provided that the Service will apply deposits for a specified tax period in a date-made order against deposit liabilities in a due-date order. Thus, the Service applies a deposit first to satisfy the oldest past due deposit liability within the specified tax period. The Service applies other credits to the taxpayer's account, such as overpayments from previous tax periods, in a similar fashion. Rev. Proc. 91-52 (1991-2 C.B. 781) clarified and amplified the provisions relating to the application of other credits to taxpayer accounts.

.03 Under Rev. Proc. 90-58, the oldest deposit liability in the specified tax period is satisfied first, thus preventing the penalty rate on that liability from escalating. If, however, a depositor inadvertently missed a single deposit early in a specified tax period, multiple cascading penalties could result as payments that would otherwise be sufficient to satisfy current liabilities were applied to satisfy earlier shortfalls.

.04 Notice 98-14 (1998-1 C.B. 585) provided interim procedures that depositors may use to request abatement of the failure-to-deposit penalty imposed by section 6656 when the order in which the Service applies deposits against deposit liabilities, as set forth in Rev. Proc. 90-58, produces multiple failure-to-deposit penalties as a result of a single failure to deposit. Under that Notice, depositors that wish to request relief are instructed to call the toll-free number shown on the penalty notice. Notice 98-14 applies to return periods beginning after December 31, 1997.

.05 Section 3304(a) of RRA added subsection (e) to section 6656 of the Code, which permits a depositor receiving a penalty notice (with respect to any deposit of tax made for a specific tax return period) to designate, during the

90-day period beginning on the date of the penalty notice, the deposit period or periods within the specified tax period to which a deposit of tax shall apply. Section 3304(d)(1) of RRA provides that section 6656(e) is effective for Federal tax deposits required to be made after January 18, 1999 (180 days after the July 22, 1998, enactment of RRA).

.06 Rev. Proc. 99-10 (1999-1 C.B. 272) provided procedures for implementing section 6656(e) of the Code as added by RRA section 3304(a). In particular, Rev. Proc. 99-10 provided guidance on how a depositor may designate the application of its Federal tax deposits for a specified tax period to minimize the failure-to-deposit penalty under section 6656 with respect to deposits required to be made after January 18, 1999.

.07 Section 6656(e)(1) of the Code (as added by section 3304(a) of RRA) was amended by section 3304(c) of RRA to provide that a deposit shall be applied to the most recent period or periods within the specified tax period to which the deposit relates, unless the person making such deposit designates a different period or periods to which such deposit is to be applied. Section 3304(d)(2) of RRA provides that this amendment is effective for Federal tax deposits required to be made after December 31, 2001.

SECTION 3. SCOPE

This procedure will apply with respect to all taxes required to be deposited under section 6302 of the Code and underlying regulations that are reported on the following Internal Revenue Service forms:

Form 720, *Quarterly Federal Excise Tax Return*

Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*

Form 941, *Employer's Quarterly Federal Tax Return*

Form 943, *Employer's Annual Tax Return for Agricultural Employees*

Form 945, *Annual Return of Withheld Federal Income Tax*

Form CT-1, *Employer's Annual Railroad Retirement Tax Return*

SECTION 4. APPLICATION

.01 Except as otherwise provided in this revenue procedure, the Service will apply Federal tax deposits for deposit periods beginning after December 31, 2001, to the most recently ended deposit period or periods within the specified tax period to which the deposit relates and will apply any excess to deposit periods ending on or after the date of the deposit in period-ending-date order. The application of deposits to the most recently ended deposit period will, in some cases, prevent the cascading of penalties where a depositor either fails to make deposits or makes late deposits.

.02 Any depositor to whom the Service mails a penalty notice for a specified tax period beginning after December 31, 2001, may, within 90 days of the date of the penalty notice, contact the Service and designate the deposit period, or periods, within such specified tax period to which the deposit(s) of, or credit(s) against, the tax for the tax period are to be applied. The depositor may either call the toll-free number shown on the penalty notice or write (including a revised schedule of deposits) to the Accounts Management Unit at the address of the IRS's Account Management site shown on the penalty notice. The Service will adjust the penalty amount to reflect the revised schedule of deposits and notify the taxpayer of the adjustment in writing.

.03 Under certain circumstances, employers may deposit employment taxes under the "safe harbor" rule of section

31.6302-1(f) of the Employment Taxes and Collection of Income Tax at the Source Regulations. Under circumstances in which this rule applies, the Service considers a depositor to have satisfied its deposit obligations even if there is a shortfall in the amount of taxes required to be deposited for a deposit period. For purposes of this revenue procedure, a shortfall will be treated as a liability for a deposit period (the make-up period) ending immediately before the shortfall make-up date and after the end of any other deposit period ending before the shortfall make-up date. Thus, if a shortfall make-up date falls on the same date a deposit is due for another deposit period, the Service will apply a deposit made on the shortfall make-up date to the shortfall liability first. Any excess will then be applied to deposit periods other than the make-up period beginning with the most recently ended of such other periods. If a deposit is made before the shortfall make-up date but after the end of a deposit period for which the deposit obligation has not been satisfied, the Service will apply the deposit to the liability for that deposit period first before applying any excess to the shortfall. Similar rules apply with regard to withheld income taxes by agents withholding from nonresident aliens and foreign corporations under section 1.6302-2(a)(1)(ii) of the Income Tax Regulations. Under sections 40.6302(c)-1, 40.6302(c)-2, 40.6302(c)-3, and 40.6302(c)-4 of the Excise Tax Procedural Regulations, depositors of excise taxes reportable on Form 720 also are eligible to use certain safe harbor rules. Because the safe harbor underdeposits are satisfied by later payments, rather than later deposits, no spe-

cial rule regarding the application of deposits is needed with respect to satisfaction of the safe harbor underdeposits. The rule for employment taxes is illustrated in section 5.04 of this revenue procedure.

.04 Under section 31.6302-1(c)(3) of the regulations, a depositor that has accumulated \$100,000 or more of employment taxes must deposit those taxes by the close of the next banking day. For purposes of applying the rules of this revenue procedure, the deposit required by section 31.6302-1(c)(3) is treated as a liability for a deposit period ending on the day in which the depositor accumulates in excess of \$100,000 in employment taxes.

SECTION 5. EXAMPLES

.01 *Example 1—Elimination of Cascading Penalty for Insufficient Timely Deposit.*

The following employment tax example illustrates how the Service will apply deposits to the most recently ended deposit period. This ordering rule is similarly applicable to deposits under section 6302 of railroad retirement taxes, FUTA taxes, excise taxes, and income tax withheld from nonresident aliens and foreign corporations.

For the second calendar quarter of 2002, A, a semi-weekly employment tax depositor within the meaning of section 31.6302-1 of the regulations, accumulates the following employment tax deposit liabilities for its bi-weekly pay dates, and makes the following deposits on the deposit due dates:

Deposit Due Date	Required Deposit	Actual Deposit
04/17/02	\$ 8,000	\$ 6,000
05/01/02	\$ 6,000	\$ 6,000
05/15/02	\$ 5,000	\$ 5,000
05/30/02	\$ 7,000	\$ 7,000
06/12/02	\$ 8,000	\$ 7,000
06/26/02	\$ 9,000	\$ 9,000

During July 2002, A completes its Form 941 for the second quarter and discovers the April 17, 2002, and June 12, 2002, underdeposits. On July 31, 2002, the due date for the Form 941, A files the

Form 941 and deposits \$3,000. The Service applies the deposits actually made to the most recently ended deposit periods. The Service then mails a notice to A dated October 21, 2002, advising that A is

subject to the failure-to-deposit penalty in the amount of \$300. The penalty is calculated as follows:

Deposit Due Date	Underdeposits	Days Late	Penalty Rate	Penalty Amount
04/17/02	\$ 2,000	105	10%	\$ 200
05/01/02	\$ 0	0	N/A	\$ 0
05/15/02	\$ 0	0	N/A	\$ 0
05/30/02	\$ 0	0	N/A	\$ 0
06/12/02	\$ 1,000	49	10%	\$ 100
06/26/02	\$ 0	0	N/A	\$ 0
TOTAL				\$ 300

A would have 90 days from October 21, 2002, in which to call the toll-free number on the notice, or write the Accounts Management Unit at the appropriate IRS Service Center, and designate the deposit period, or periods, within the specified tax period to which the deposits are to be applied. In this case, however, the manner in which the Service applied the deposits avoids cascading penalties and minimizes the failure-to-deposit penalty for the quarter.

.02 Example 2—Cascading Penalty Under Section 6656(e).

This example will show how the application of deposits to the most recently ended deposit period will not always eliminate cascading penalties. For the second calendar quarter of 2002, B, a monthly employment tax depositor within the meaning of section 31.6302-1 of the regulations, pays its employees on the first of every month. Instead of waiting until the 15th day of the following month to make its deposits, B normally makes deposits on the 25th (or next banking day thereafter) of each month in which the liability is incurred. B pays its employees on April 1, 2002. For some reason, B fails

to make the deposit on April 25, 2002. For May, B pays its employees on May 1, 2002. On May 28, 2002 (the first banking day after Saturday, May 25, 2002), unaware of the underdeposit for April, B makes a deposit to cover its May liability. The Service applies this deposit to the most recently ended deposit period, which in this case is April 2002, instead of the May 2002 liability as intended by B. This cycle of deposits continues until the end of the quarter. Instead of having a failure-to-deposit penalty only for April, B will be subject to a penalty for every month in the quarter. B can, however, minimize cascading penalties and reduce the penalty amount by timely following the procedures in section 4.02 of this revenue procedure and designating May and June as the deposit periods to which the deposits are to be applied.

.03 Example 3—Elimination of Cascading Penalty for Late Deposits.

This example will show how the application of deposits to the most recently ended deposit period or periods will affect the calculation of the failure-to-deposit penalty in situations where the depositor is late in making some or all of

its deposits. For the second calendar quarter of 2002, C, a semi-weekly employment tax depositor, pays its employees every Friday. C accumulates \$10,000 in employment tax deposit liability for each of its weekly pay dates.

The table below shows the deposit period ending date and due date for C's deposits. It also shows the date of each deposit and the deposit period to which it is applied under section 6656(e) of the Code. The table shows how, under section 6656(e) and this revenue procedure, the Service applies C's deposits to the most recently ended deposit period. Accordingly, under section 6656(e), the Service applies C's deposit of April 22, 2002, and subsequent deposits through June 24, 2002, to deposit liabilities for periods which have ended, but for which the due dates have not occurred. Applying deposits in this manner, C's deposit liability for the period ending April 12, 2002, is not satisfied until C makes its deposit of June 26, 2002. Nonetheless, applying the deposits to the most recently ended deposit period avoids cascading penalties and minimizes the failure-to-deposit penalty for the quarter.

Deposit Period Ending Date	Due Date of Deposit	Date of Deposit that Service Applies to Deposit Period and Applicable Penalty under Section 6656(e)	
04/05/02	04/10/02	04/10/02	\$ 0
04/12/02	04/17/02	06/26/02	\$ 1,000
04/19/02	04/24/02	04/22/02	\$ 0
04/26/02	05/01/02	04/29/02	\$ 0
05/03/02	05/08/02	05/06/02	\$ 0
05/10/02	05/15/02	05/13/02	\$ 0
05/17/02	05/22/02	05/20/02	\$ 0
05/24/02	05/30/02	05/27/02	\$ 0
05/31/02	06/05/02	06/03/02	\$ 0
06/07/02	06/12/02	06/10/02	\$ 0
06/14/02	06/19/02	06/17/02	\$ 0

Deposit Period Ending Date	Due Date of Deposit	Date of Deposit that Service Applies to Deposit Period and Applicable Penalty under Section 6656(e)	
06/21/02	06/26/02	06/24/02	\$ 0
06/28/02	07/03/02	07/03/02	\$ 0
TOTAL	PENALTY		\$ 1,000

.04 Example 4—Safe Harbor Deposits.

(1) *Facts.* This example will show how the application of employment tax deposits to the most recently ended deposit period or periods will be accomplished in situations where the depositor is also making a deposit by the shortfall make-up date in order to qualify for the safe harbor in section 31.6302-1(f) of the regulations. For the second calendar quarter of 2002, D, a semi-weekly employment tax depositor, pays its employees every Friday. D accumulates \$10,000 in employment tax deposit liability for each of its weekly pay dates. D makes timely deposits of employment taxes in the amount of \$9,800 on April 10, 17, and 24, 2002. Under section 31.6302-1(f), D must make a deposit of \$600 by the shortfall make-up date, May 15, 2002. D also must make a deposit of employment taxes for the deposit period May 8-10, 2002, on or before May 15, 2002.

(2) *Deposit made on shortfall make-up date.* D deposits \$9,800 on May 1 and May 8, 2002, and \$10,200 on May 15, 2002. The May 1 deposit is applied to the deposit period April 24-26, 2002, and the May 8 deposit is applied to the deposit period May 1-3, 2002. Because the May 15 deposit is made on the shortfall make-up date, under section 4.03 of this revenue procedure, the Service first applies \$600 to the shortfall liability for April. Accordingly, D has satisfied section 31.6302-1(f) of the regulations for the three deposits in April and owes no penalty with respect to those deposits. The Service applies the remaining \$9,600 to the deposit period ending May 10, 2002, leaving an underdeposit of \$400. As this amount is greater than 2 percent of the deposit liability, D will not satisfy section 31.6302-1(f), and will be subject to the failure-to-deposit penalty. The amount of the penalty will depend on when D satisfies the underdeposit.

(3) *Deposit made prior to shortfall make-up date.* Instead of making the

deposit on May 15, 2002, as in (2) above, D makes the \$10,200 deposit on May 14, 2002. Because the deposit is made prior to the shortfall make-up date, under section 4.03 of this revenue procedure, the Service first applies \$10,000 to the deposit liability for the deposit period ending May 10, 2002. This liability is fully satisfied. The Service applies the remaining \$200 to satisfy the remainder of the deposit liability for the deposit period ending May 3, 2002. D will not satisfy section 31.6302-1(f) of the regulations for the three deposits in April, and will be subject to the failure-to-deposit penalty. The amount of the penalty will depend on when D satisfies the underdeposits.

(4) *Designation.* In either situation described in this example, D may timely contact the Service under the procedures in section 4.02 of this revenue procedure and designate the deposit periods (including the make-up period) to which the deposits are to be applied.

.05 Example 5—Deposits Made Under the One-Day Rule.

This example will show how the application of deposits to the most recently ended deposit period or periods will be accomplished in situations where the depositor becomes subject to the one-day rule of section 31.6302-1(c)(3) of the regulations. For the second calendar quarter of 2002, E, a semi-weekly employment tax depositor, makes a timely deposit of employment taxes on April 10, 2002, for the deposit period April 3, 2002, through April 5, 2002. On Monday, April 8, 2002, E accumulates \$110,000 in employment taxes with respect to wages paid on that date. Under section 31.6302-1(c)(3), E deposits those taxes by the end of the next business day, April 9, 2002. Under this revenue procedure, the deposit required by section 31.6302-1(c)(3) is treated as a liability for a deposit period ending on the day in which E accumulates in excess of \$100,000 in employ-

ment taxes. Accordingly, the Service applies E's deposit on April 9, 2002, to the one-day deposit liability for the deposit period ending April 8, 2002. E's deposit on April 10, 2002, is then applied to the liability for the deposit period ending April 5, 2002.

SECTION 6. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 99-10 is obsoleted with respect to federal tax deposit periods beginning after December 31, 2001. Rev. Proc. 99-10 continues to apply to deposits that are required to be made after January 18, 1999, and relate to deposit periods ending on and before December 31, 2001.

.02 Notice 98-14 continues to apply to deposits required to be made on or before January 18, 1999, with respect to return periods beginning after December 31, 1997.

.03 Rev. Proc. 90-58 and Rev. Proc. 91-52 are obsoleted.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for federal tax deposit periods beginning after December 31, 2001.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles A. Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue procedure, contact Charles A. Hall at (202) 622-4940 (not a toll-free call).