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[Third Party Communication:

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From: [REDACTED]

Sent: Thursday, January 16, 2014 9:25:56 AM

To: [REDACTED]

Cc: [REDACTED]

Bcc:

Subject: IRC 6656(a) Failure to Deposit Penalty -

We have reviewed the taxpayer's submission regarding its alleged "reasonable cause" defense to the section 6656(a) penalty for its failure to timely deposit employment taxes owing as a result of the exercise of nonqualified stock options. We agree with your conclusion that the taxpayer does not come within the reasonable cause exception to the penalty, and the notice of penalty adjustment should be issued.

The Service will generally assert the section 6656(a) penalty unless the taxpayer can demonstrate that the failure to make timely deposit of employment taxes is due to "reasonable cause and not due to willful neglect." I.R.C. Section 6656(a). The taxpayer's claim to the reasonable cause defense in this case rests primarily upon its reliance on a third-party payroll processing company to make the deposits, as well as its history of timely payment of other required deposits. The taxpayer corrected the late deposits relating to the stock-based compensation immediately upon discovering the problem by instituting new procedures. These actions may amount to the exercise of ordinary business care that the reasonable cause defense requires and to the absence of "willful neglect." The reasonable cause defense, however, also requires the taxpayer to demonstrate that despite its exercise of ordinary business care and prudence, it was "rendered unable to meet its responsibilities." Valen Manufacturing Company v. United States, 90 F.3d 1190, 1193 (6th Cir. 1996). We agree with your conclusion that the taxpayer's reliance on a faulty system that led to the untimely deposits did not render it unable to meet its filing responsibilities and it is liable for the section 6656 penalty for all relevant periods. See United States v. Boyle, 469 U.S. 241 (1985) (reliance on attorney to prepare and file tax return not "reasonable cause" for late filing penalty.)

You also requested advice concerning the "first time abate" (FTA) administrative waiver that the IRS may use to relieve a taxpayer of a penalty for a single period if it has a record of prior compliance. See IRM 20.1.1.3.6.1, *First Time Abate*. We agree that the IRM indicates that the FTA procedure may apply to failure to deposit penalties if all criteria are met. We understand that the examining agent has coordinated with you in

considering the first time abatement process for _____, and found that it does not apply. We note that the taxpayer did not request a waiver under the FTA procedures.

You asked, as a general matter, whether the FTA process may be used where the penalty has not been assessed, but rather is being considered for a taxpayer under examination. Because the FTA is granted as a matter of administrative grace, and not a result of any statutory authority, this question is not a legal issue, but rather is an IRS management policy decision. In our view, however, it would be a waste of resources for the penalty to have to be assessed, and then protested, and then abated, if the FTA was appropriate. We understand that the Service permits taxpayers to re-designate deposits under section 6656(e)(2) for periods to which deposits are applied while a case is under examination and prior to the issuance of a notice of assessment of penalty. It would be analogous to allow a taxpayer to raise the FTA issue and have the issue resolved while the case is under examination and prior to assessment and we therefore recommend that the FTA be considered for waiver before assessment of failure to deposit penalties.

You also asked about whether the FTA should apply to the earliest tax period or whether it can apply to the period with the largest penalty. Again, because the FTA is not made pursuant to a statutory requirement, in our view it would be within the Service's discretion to grant the FTA for the single period with the largest penalty liability. Under the current procedures set forth in the IRM, however, the FTA must be made for the earliest tax period. Therefore, unless and until the Service makes a policy decision to change its FTA procedures, the IRM must be followed.

Please do not hesitate to contact me if you have any further questions in this matter.