

Should You be Paying Estimated Tax Payments?

What are estimated tax payments? Do I need to make estimated tax payments? How much should my estimated tax payments be? These are common questions an individual may ask their tax advisor. Below is a brief overview on this subject.

Individuals, including sole proprietors, partners, S corporation shareholders and taxpayers with significant investments and other earnings, generally must make estimated tax payments if they expect to owe tax of \$1,000 or more when their return is filed. Corporations generally must make estimated tax payments if they expect to owe tax of \$500 or more when their return is filed. Individuals typically do not have to pay estimated tax for the current year if they had no tax liability in the prior year and filed a tax return. If a taxpayer doesn't pay enough tax through withholding and quarterly estimated tax payments, they may be charged a penalty and interest. They also may be charged a penalty if estimated tax payments are late, even if the taxpayer is due a refund when they file their tax return. However, generally paying quarterly estimated taxes will lessen or even eliminate any penalties and interest.

Individual taxpayers, normally use Form 1040-ES, Estimated Tax for Individuals, to figure estimated tax and pay their tax. To calculate estimated tax, individuals must estimate their expected adjusted gross income, taxable income, taxes, deductions, and credits for the year. When figuring estimated taxes for the current year, taxpayers will often find it helpful to use income, deductions, and credits from the prior year as a starting point and modify for the current year. Since this is an estimate, you should use your best judgment in order to minimize interest and penalties. Corporations generally use Form 1120-W, Estimated Tax for Corporations, to figure estimated tax.

For individual estimated tax purposes, the payments are paid in periods, April, June, September, and January. Some taxpayers may find it easier to pay estimated taxes weekly, bi-weekly, monthly, or even in one lump sum on April 15th. Alternative payment periods are allowed if enough tax is paid in by the end of the quarter. So, how much you should pay depends on your situation. The safest option for individuals to avoid an underpayment penalty is to aim for "100 percent of your previous year's taxes." If your previous year's adjusted gross income was more than \$150,000 (or \$75,000 for those who are married and filing separate returns), you must pay in 110 percent of your previous year's taxes to satisfy the "safe-harbor" requirement evenly over the four installments. If you satisfy either test, you won't have to pay an estimated tax penalty, no matter how much tax you owe with your tax return on April 15 of the following year.

If you expect your income this year to be less than last year and you don't want to pay more taxes than you think you will owe at year end, you can choose to pay 90 percent of your estimated current year tax bill. If the total of your estimated payments and withholding add up to less than 90 percent of what you owe, you may face an underpayment penalty. So, you may want to avoid cutting your payments too close to the 90 percent mark to give yourself a little safety net.

Using an electronic payment option available on www.irs.gov/payments is the easiest way for individuals, small businesses, self-employed individuals, and gig workers to pay federal taxes. It is fast, easy, and secure. Taxpayers can use the Electronic Federal Tax Payment System (EFTPS) for all their federal tax payments, including federal tax deposits, installment agreement payments, and estimated tax payments. In addition, by using the EFTPS, taxpayers can access a history of their payments, so they know how much and when the payments were made. Alternatively, Individual taxpayers can create an Internal Revenue Service online account to make their estimated tax payments. Using their account, taxpayers can see their payment history, any pending payments, and other useful tax information. Individual taxpayers can also make an estimated tax payment by using IRS Direct Pay. Individual and Business taxpayers can also make an estimated tax payment by using debit, credit card, or digital wallet. The 2022 Form 1040-ES can help taxpayers estimate their quarterly tax payment. While electronic filing is strongly encouraged, taxpayers may also send estimated tax payments with Form 1040-ES by mail. Corporations must deposit payments using EFTPS. Additional information is available in Publication 542, Corporations.

If you have tax related questions or issues, please feel free to contact our firm to speak with a tax professional.