



Understanding Estimated Taxes

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Keep the IRS away. If you're self-employed, an entrepreneur or a small business owner, then it's important for you to understand how estimated taxes work and make sure you are compliant with the tax code.

Even though none of us likes paying them, estimated taxes are a good way to cover your tax liability quarter-to-quarter.

ESTIMATED TAXES... WHAT'S THAT?

"Estimated taxes" are... well... estimated. They're based on the income you expect to receive throughout the year.

Since the payments that you are receiving (income from sales, services, etc) are coming to you before taxes are taken out, as opposed to being taken out of your paycheck (think employee's paycheck where the employer withholds the taxes), you are required to estimate your income for the year and pay taxes on that amount.

WHO IS SUBJECT TO MAKING ESTIMATED TAX PAYMENTS?

Everyone, but the process is a little different.

Employees accomplish this through their employer withholding taxes from their paycheck. However, they could be required to submit estimated payments if the amounts being withheld aren't enough. A typical example would be someone who receives a W2 but also has investments and/or rental income or even a side hustle.

Generally, you'll have to make estimated payments if:



- You expect to owe at least \$1,000 (this is after accounting for withholding and refundable credits)
- Your withholding and refundable credits cover less than 90% of this year's tax liability or 100% of the previous year's liability (whichever is smaller)

CALCULATING ESTIMATED TAXES

Now for the fun part... maybe?

The truth is, there's no exact science and there's a variety of ways to get this done.

The easy way?

Set aside 30-35% of your net income and pay that quarterly. It's not very accurate but it can get the job done in a pinch.

IS THERE A WAY TO BE MORE ACCURATE?

Yes. Estimate your total tax liability.

To do this you will first need to calculate your taxable income. This includes any wages, interest, dividends, investment income (real estate included), and business income. If you aren't sure you can use the amounts from the previous year, but keep in mind that those numbers may not necessarily reflect the current year's income.

Next, use the tables provided by the IRS to calculate your tax based on your filing status. <https://www.irs.gov/pub/irs-pdf/p15t.pdf>

Once you have estimated your entire tax liability for the year (don't forget to include self-employment tax, income tax, investment income tax, etc.), divide that number by four to determine how much to pay each quarter.



WHEN ARE ESTIMATED TAXES DUE?

Despite being “quarterly” tax payments, you’ll notice they don’t line up with our regular calendar quarters.

For 2024, estimated quarterly tax payments are due:

- Q1 - April 15
- Q2 - June 17
- Q3 - September 16
- Q4 - December 15 (C-Corps only) January 15 for everyone else

Also, please note that these aren’t the only dates you can pay. I guarantee the IRS will gladly take your money any day of the year. We recommend making monthly arrangements to those that find it difficult to set funds aside for the quarterly payment.

Remember, it’s all about what works best for you. A surprise bill at tax time is never fun.

HOW TO MAKE ESTIMATED TAX PAYMENTS?

Luckily, the IRS makes it easy to make estimated payments.

For individuals:

- Fill out form 1040-ES and mail it with a check to the nearest IRS office
- Pay online or by phone via the IRS Payment Gateway (<https://www.irs.gov/payments>)

Corporations must pay using the EFTPS system

WHAT HAPPENS IF YOU DECIDE NOT TO PAY?

You may be subject to penalties.



If you want to avoid the penalties, pay the smaller of 90% of this year's tax liability, or 100% of the prior year's tax (110% if AGI is above \$150K).

The second option (100% of prior-year tax) is known as the "safe harbor rule". What this means is that even if your income is twice as much as it was last year, you will avoid penalties as long as you pay 100% of the prior year's tax (even if 100% of the prior year's tax is only 50% of the current year tax).

However, please be aware that you will still be responsible for the additional tax payments.

CONCLUSION

You may not have to pay taxes on your income until April, but you will still need to make estimated tax payments throughout the year.

If you are a freelancer or self-employed individual, it is important that you stay compliant with IRS regulations so that they don't get suspicious of your business practices and penalize you for noncompliance.

We can help! Reach out if you want our team of experts to guide you through how best to calculate and send in these payments this year without breaking any rules.