

Individual estimated tax

The following is an explanation of why it is necessary for you to make estimated tax payments and the applicable rules for paying the minimum amount of estimated tax without triggering the penalty for underpayment of estimated tax.

Individuals must pay 25% of a "required annual payment" by Apr. 15, June 15, Sept. 15, and Jan. 15, to avoid an underpayment penalty. (When that date falls on a weekend or holiday, the payment is due on the next business day.) The required annual payment for most individuals is the lower of 90% of the tax shown on the current year's return or 100% of the tax shown on the return for the previous year. Certain high-income individuals must meet a more rigorous requirement. If the adjusted gross income on your previous year's return is over \$150,000 (over \$75,000 if you are married filing separately), you must pay the lower of 90% of the tax shown on the current year's return or 110% of the tax shown on the return for the previous year.

Most people who receive the bulk of their income in the form of wages satisfy these payment requirements through the tax withheld by their employer from their paycheck.

If you fail to make the required payments, you may be subject to an underpayment penalty. The penalty equals the product of the interest rate charged by IRS on deficiencies, times the amount of the underpayment for the period of the underpayment. The penalty is avoided if you meet certain specified exceptions or waivers, described below.

Most individuals make estimated tax payments in four installments. In other words, we determine the required annual payment, then divide that number by four and make four equal payments by the due dates. But you may be able to make smaller payments under the annualized income method. This method is useful to people whose income flow is not uniform over the year, perhaps because of a seasonal business. For example, if your income comes exclusively from a business that you operate in a resort area during June, July, and Aug., no estimated payment is required before Sept. 15. You may also want to use the annualized income method if a significant portion of your income comes from capital gains on the sale of securities which you sell at various times during the year.

The underpayment penalty doesn't apply to you:

- (1) if the amount of tax you put down on your return is less than \$1,000 after subtracting withholding tax paid;
- (2) if you were a U.S. citizen or resident for the entire preceding year, that year was 12 months, and you had no tax liability for that year;
- (3) if you are a farmer or fisherman and pay your entire estimated tax by Jan. 15 of the following year, or pay your entire estimated tax by Mar. 1 of the following year and also file your tax return by that date; or
- (4) for the fourth (Jan. 15) installment, if you aren't a farmer or fisherman, file your return by Jan. 31 of the following year, and pay your tax in full.

In addition, IRS may waive the penalty if the failure was due to casualty, disaster, or other unusual circumstances and it would be inequitable or against good conscience to impose the penalty. The penalty can also be waived for reasonable cause during the first two years after you retire (after reaching age 62) or become disabled.