

## Estimated Tax Payments, underpayment penalties and extensions.

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. For estimated tax payments for the tax year 2003 and later tax years, 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 your last year's tax or 110% of your current tax. For 2007, you must pay 90% of your 2006 or 110% of 2007's tax.

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, the 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.

Filing an extension does not relieve the underpayment penalties. The extension relates to filing your tax return, not the payment of the tax. If you file an extension, and file your tax return after April 15<sup>th</sup> and a tax is due with the return, you will be subject to late payment penalties as well.

It may seem non-sensible, but underpayment penalties can be imposed even if you receive a refund. For example, let's suppose you sell a rental property or stock and have a capital gain in February 2006. Then, either by January 15, 2007 or even with your extension on April 15, 2007, you make an estimated payment. Next, you file your tax return on June 15, 2007 and claim a refund as your estimated payment exceeded the tax due. The IRS may reduce your refund for underpayment penalties and interest as your estimated payment was due on March 15, 2006.