Estimated Tax and Self-Employment Tax

8535. Who must pay the estimated tax and are penalties imposed for underpayment of the tax?

Subject to the potential imposition of penalties, any taxpayer who expects to owe tax of $1,000 or more is required to make estimated tax payments.[[1]](#endnote-1) In other words, a taxpayer should project the current year’s taxable income, tax and credits based on expected income, deductions, etc. Based on “a pay as you go” method, estimated tax payments are payable periodically throughout the year. For this purpose, tax liability includes regular income tax, alternative minimum tax as well as self-employment tax (Social Security and Medicare tax).[[2]](#endnote-2)

For self-employed taxpayers, the requirement to make estimated payments is more problematic than for employees. Unlike employees, no part of a self-employed individual’s compensation is withheld by the payor and paid over to the IRS for taxes. Moreover, in addition to regular income tax, these taxpayers are required to pay the full 15.3% of the Social Security and Medicare tax. For this reason, a self-employed with even a modest amount of income who may owe little or no income tax, may, nonetheless have a significant Social Security and Medicare tax liability.

However, even employed individuals who are subject to withholding should consider making estimated payments under the following circumstances:

* The amount being withheld by the employer is insufficient.
* The taxpayer has a significant amount of other income such as dividends, interest, alimony, rent, etc. that is not subject to withholding.

On the other hand, an individual need not make estimated payments if all three of the following conditions are met:

* The individual had no tax liability for the prior tax year.
* The individual was a U.S. citizen for the entire tax year.
* The prior tax year was a 12 month period.[[3]](#endnote-3)

Although estimated payments can be made at any time during the tax year, there is a “required annual payment” that is payable in “required installments” with specific due dates. For that purpose, the tax year is divided into four unequal quarters with the following due dates:

First Quarter January through March April 15th

Second Quarter April through June June 15th

Third Quarter June through August September 15th

Fourth Quarter September through December January 15th of following tax year[[4]](#endnote-4)

The “required annual payment” is a) 90% of the taxpayer’s expected tax liability for the tax year or b) 100% of the tax owing for the prior tax year (assuming the prior tax year spanned 12 months).[[5]](#endnote-5) However, if the taxpayer’s adjusted gross income exceeded $150,000 ($75,000 for filing married filing separately), the percentage in b), above is 110%.[[6]](#endnote-6)

If the taxpayer fails to make timely estimated installment payments, the taxpayer is subject to penalties. Although the taxpayer can compute the penalty on Form 2210, the IRS will compute the penalty if the taxpayer does not complete the form.

1. http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estimated-Taxes [↑](#endnote-ref-1)
2. IRC Sec. 6654(a). [↑](#endnote-ref-2)
3. http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estimated-Taxes [↑](#endnote-ref-3)
4. IRC Sec. 6654(c). [↑](#endnote-ref-4)
5. IRC Sec. 6654(d)(1)(A). [↑](#endnote-ref-5)
6. IRC Sec, 6654(d)(1)(C). [↑](#endnote-ref-6)