



WORKING TOWARD A BRIGHTER FINANCIAL FUTURE



ESTIMATED TAX PAYMENTS BASICS

WHAT ARE ESTIMATED TAX PAYMENTS?

Even though income taxes are due in April every year, you are required to prepay your taxes throughout the year. These prepayments are estimates and are reconciled when you file your tax return. You will receive a refund if you over paid or may still owe if you under paid. If you don't prepay your taxes throughout the year, you may owe additional penalties.

Estimated payments usually refer to payments made by you yourself rather than payments made automatically on your behalf such as withholding by an employer. Employers often automatically withhold and send tax payments on behalf of their employees; however, this is just based on information you provide and if you have additional income sources you may still need to make estimated payments yourself.

WHO NEEDS TO MAKE ESTIMATED TAX PAYMENTS?

Two of the most common groups who need to make estimated payments on their own are retirees and self-employed workers. If you are retired, you may need to make estimated payments on your own because retirement accounts and pensions often don't withhold enough to cover all the income tax owed.

SELF-EMPLOYED WORKERS

If you are self-employed or an independent contractor, you have no employer to automatically withhold to pay taxes for you and must make payments yourself. Self-employed workers must make estimated payments to cover both income taxes and self-employment taxes.

Self-employment taxes cover the Social Security and Medicare payroll taxes. In an employer/employee situation, both pay half of the taxes, and it is withheld from paychecks automatically. If you're self-employed, you will need to pay both halves of the tax yourself. The self-employment tax is a combined 15.3% of your profit from your business.

Self-employment tax is on top of any income taxes owed and it is possible to owe no income taxes but still owe self-employment tax. Self-employment tax is not a bad thing as it counts toward your Social Security eligibility. While it can feel frustrating to owe, you will be glad you paid it when you reach retirement age.

UNDERPAYMENT PENALTY

If you don't prepay enough of your taxes throughout the year, you may owe an underpayment penalty. The penalty is based on the amount of tax you still owe when you file your tax return. The calculation is complicated, and it is based on the number of days an estimated payment was late and changing interest rates. In most cases, the IRS and Minnesota Department of Revenue will calculate the penalty.

SAFE HARBOR

You generally will not owe any underpayment penalty if your total tax owed when you file your tax return falls within the safe harbor level. When you file your tax return, you will not owe any penalty if:

- the total you still owe is less than \$1000, or
- you paid at least 90% of the tax you owe during the year, or
- you paid at least 100% of the prior year's tax owed to this year's taxes.

There are special rules for farmers and higher income earners, but most people will not owe a penalty if they meet any of the three conditions above. The only difference between the IRS safe harbor and Minnesota Department of Revenue safe harbor is that the threshold in the first bullet is lowered to just \$500 of MN tax owed.

CALCULATING ESTIMATED TAX PAYMENTS

Calculating the proper payment depends on how accurately you want to estimate your tax payments. Two common options are outlined below.

| Option | Considerations | How to calculate |
|--|---|--|
| Simple Option: Pay based on prior year's taxes | <ul style="list-style-type: none"> • Guaranteed to avoid the underpayment penalty • Good option if your income is similar to the previous year • Can lead to large refund or large balance due at tax time if income has changed | Start with tax calculated on prior year tax return and then pay one quarter of that amount for each quarterly estimated payment (find amounts on Form 1040 line 24 and MN Form M1 line 17) |
| Advanced Option: Estimate based on current year-to-date income | <ul style="list-style-type: none"> • Owe \$0 in taxes and get \$0 in refunds when filing your tax return • Good option for those with detailed income and expense tracking | Track income from all sources and tax deductible expenses monthly and use worksheets to calculate estimated taxes for each quarter |

The IRS and Minnesota Department of Revenue issue some worksheets to help calculate your estimate. Prepare + Prosper has an Income/Expense Tracker to assist, find it here: www.prepareandprosper.org/customer-tax-tools.

ESTIMATED TAX PAYMENTS DUE DATES

Estimated payments are due every quarter. The IRS and Minnesota Department of Revenue use the same schedule. If a payment due date falls on a weekend or holiday, it is due the next business day.

| Period covered | Due date |
|----------------------------|--------------|
| January through March | April 15 |
| April and May | June 15 |
| June through August | September 15 |
| September through December | January 15 |

If you miss a payment, the IRS and Minnesota Department of Revenue have the discretion to assess a penalty. However, the penalties can be waived with an explanation, such as income fluctuations during the year.

MAKING AN ESTIMATED TAX PAYMENT

The IRS allows taxpayers to make estimated payments by mail or online. You can schedule payments to be automatically withdrawn each quarter on the IRS website. www.irs.gov/businesses/small-businesses-self-employed/estimated-taxes.

Minnesota Department of Revenue allows taxpayers to make payments online or by mail with payment vouchers. www.revenue.state.mn.us/estimated-tax.

When you make a payment, you will want to keep a record of amount paid and when you paid it. You will need this information when you file your tax return.

LEARN MORE

The IRS has additional information about figuring and making estimated tax payments as part of their online Small Business and Self-Employed Tax Center: www.irs.gov/businesses/small-businesses-self-employed/estimated-taxes.

Minnesota Department of Revenue also has additional information about MN estimated tax payments on their website: www.revenue.state.mn.us/estimated-tax.

If you have additional questions about making estimated tax payments, you can call the Prepare + Prosper Self-Employment line at 651-262-2169.