Estimated Tax Payments White Paper

Depending on how your business entity is setup, you may be required to make estimated tax payments. One of the most common areas of confusion we see from small business owners is in regard to personal taxes they owe at the end of the year. As a Single Member Limited Liability Corporation, or a Member in a Limited Liability Partnership the business owner is often not taking payroll, but rather taking draws against the company. As I am sure you know by now having read every single one of our previous white papers, payroll is where your individual taxes are predominately pulled from. If you are not having taxes pulled, you are going to have to make those payments yourself throughout the year or come the end of the year in one lump sum with estimated tax payments.

The key word here is "estimated". How are you supposed to know how much tax to pay by the end of the year? After all, you cannot tell the future, right? As a business owner, you should be forecasting revenue and expenses. In a previous white paper, we explained how to do that. The Internal Revenue Service explains what they view as a simple way to calculate your estimated tax payment. You estimate your adjusted gross income, taxable income, taxes, deductions, and credits for the calendar year. The IRS will even provide a handy-dandy little form to help you, form 1040ES. You can procure this form from the IRS.gov website. Better yet, engage your tax preparation professional for assistance. You will probably want to after taking a look at this form, or Publication 505 which in 59 pages explains the estimated tax process.

In order to make the financial "bite" more manageable, it is recommended that estimated tax payments be made on a quarterly basis. These payments are due on the 15th of the month proceeding the end of the traditional quarterly calendar. So estimated tax for Quarter 1, which includes the months of January, February and March would be made on April 15th, the same day that individual income tax is due. The payment date can be adjusted based on changes to income, deductions, adjustments or credits or if income is not received evenly throughout the year.

Much like not paying your taxes on time, there are penalties should your estimated tax payment not be made on time, or if the amount paid is not correct. In true IRS fashion the exact calculation for the penalty is difficult to determine. Essentially, the IRS will calculate this penalty. There are numerous exceptions that include minimum amount due and tax liability from the previous year. Should you have an over-payment, the IRS will apply that balance to tax due in the following quarter.

We see numerous ways that business owners attempt to not claim income and avoid paying any sort of tax. There is an old saying that applies perfectly to this situation. "Pigs get fed, Hogs get slaughtered". While a business owner may be able to avoid paying tax on some of the draws made against the company, trying to claim a zero income or an unrealistic income will trigger penalties and investigation from taxing entities. The last thing a business owner wants is for a taxing entity to start conducting a lifestyle analysis.

As a business owner, what can you do to avoid underpaying estimated tax and avoiding investigation and penalties from taxing entities? First thing first, implement a formal revenue and expense tracking system. If its hand written or you are using a program such as Quickbooks, keep it up to date regularly and be honest with what the revenue and expense figures truly represent. If you do not have time to do this, engage a bookkeeping professional to do this for you. Yes, you will need to answer any questions from this person honestly when they question sources of revenue or draws made against the business. Make sure annual financial figures get in the hands of your tax preparation professional early. A year-end meeting during Quarter 4 is a good business practice so that your accountant can analyze your year-end financial situation. Your accountant may recommend purchasing equipment or take less in draws to avoid paying additional tax.

Time and again we see estimated tax trip up business owners. It does not have to be that way. Be honest with what funds are being pulled from your company and for what purpose. Run these scenarios by your tax preparation professional throughout the year to avoid penalties or additional tax payments in the future.