

PLANNING FOR ESTIMATED TAXES (& AMT)

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The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.

With April 15th just around the corner, your first quarterly tax payment for 2009 is soon due. Learn how to calculate just what you owe; not a penny more! Should you use the annualized method to calculate your tax liability; should you make your 4th quarter payment in December; should you send money when you request an extension? These and other questions will be addressed as we cover such topics as withholdings, penalty assessments, installment plans, automatic debits, credit card payments, and recent tax code changes. Of course, no tax class is ever complete without mention of the dreaded Alternative Minimum Tax. Are you subject to AMT; what can you do to avoid this tax; are there other ways to save money in 2009? Let's find out...



I. Basic Tax Calculation

Form 1040 (See instructions on page 12.) Use the IRS label. Otherwise, please print or type. L A B E L H E R E	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 20	IRS Use Only—Do not write or staple in this space.
For the year Jan. 1–Dec. 31, 2007, or other tax year beginning _____, 20____, ending _____, 20____		OMB No. 1545-0074
Your first name and initial _____ Last name _____		Your social security number _____
If a joint return, spouse's first name and initial _____ Last name _____		Spouse's social security number _____
Home address (number and street). If you have a P.O. box, see page 12. _____ Apt. no. _____		▲ You must enter your SSN(s) above. ▲
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. _____		Checking a box below will not change your tax or refund.
Presidential Election Campaign <input type="checkbox"/> Check here if you, or your spouse if filing jointly, want \$3 _____		
Filing Status		
1 <input type="checkbox"/> Single		
2 <input type="checkbox"/> Married filing jointly (even if only one spouse has income)		
3 <input type="checkbox"/> Married filing separately (each spouse must file a separate return and full name and address must be shown on each return)		

Income (Wages, Investments, Pensions, etc.)
 – Adjustments (IRA contributions, Tuition, Moving expenses, etc.)

= Adjusted Gross Income (AGI)
 – Deductions (Standard \$5,700 in 2009 or Itemized)
 – Personal Exemptions (\$3,650 in 2009)

= Taxable Income

→ Tax
 + Alternative Minimum Tax (AMT)
 – Non-refundable Credits (Child-care, Education, etc.)
 + Additional Taxes (Self-employment, Household employee, etc.)

= Total Tax
 – Prior Tax Payments (Withholdings, Estimated payments, Prior-year refund, etc.)
 – Refundable Credits (Earned Income, Excess Social Security, etc.)

= Tax Due or Refund

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II. Additional Amounts Due

A. Penalties (IRC § 6651)



1. Late Filing (Failure to File)
 - 5% of unpaid balance for each month or part of a month the return is late (max. 25%)
 - If more than 60 days late, the minimum penalty is the lesser of \$100 or tax due
 - No penalty if the return shows a refund
 - If the taxpayer is subject to Failure to File and Failure to Pay Penalties for the same month, the Failure to File Penalty is reduced by the Failure to Pay Penalty
2. Late Payment (Failure to Pay)
 - 0.5% for each month or part of a month there is an unpaid balance (max. 25%)

 **TAX TIP:** Timely filing of the return or extension avoids the Late Filing Penalty, although Late Payment Penalty and interest may continue to accrue

B. Interest

- Applied to the underpaid amount for the number of days late at currently applicable rates
- Interest is *not* deductible on Schedule A

Quarter	2008	2009
1 st	7%	5%
2 nd	6%	4%
3 rd	5%	
4 th	6%	

C. Safe Harbor Rule

No Late Payment Penalty if:

- Tax due is < \$1,000, or
- Taxpayer had no tax liability on prior-year return that covered 12 months, or
- 90% of the tax shown on current year return, or
- Payments equal 100% of the tax shown prior-year
OR 110% of prior-year tax if AGI > \$150,000 (\$75,000 MFS)

CA: No penalty if < \$500 due

D. Abatement

- No Late Filing Penalty if reasonable cause rather than willful neglect, including:
 - Taxpayer's or immediate family member's death or serious illness
 - Unavoidable absence on the filing date
 - Destruction of residence or business
- No Late Payment Penalty if unable to pay despite exercise of ordinary care and prudence
- Interest only rarely abated, i.e. if due to IRS error; or an extension in a presidentially-declared disaster area; or on erroneous tax refunds (< \$50,000) required to be repaid

III. Payments

A. Withholdings

- Use Form W-4 Employee's Withholding Allowance Certificate to claim withholding allowances (use Form DE-4 to change California withholdings)
- May claim "exempt" if taxpayer had no tax liability for the previous year and expects to have none for the current year



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- \$500 penalty if Form W-4 submitted without reasonable basis
- Ways to increase withholdings:
 - Decrease the number of allowances claimed, or
 - Enter an additional amount to be withheld from each paycheck
- Back-up withholding at 28% if no SS # or taxpayer did not report all prior-year interest or dividend income

B. Quarterly Payments

- Four equal installments to avoid a penalty
- Send checks payable to “US Treasury” with Form 1040-ES voucher to:
Internal Revenue Service Center
P.O. Box 510000
San Francisco, CA 94151
- If installment is paid late, penalty is charged for the number of days the payment is late
- Interest is charged but is not compounded
- A 4th quarter payment is not required if the return is filed and tax is paid by January 31st
- A taxpayer who underpays an installment cannot avoid the penalty by overpaying the next installment. (In contrast, an employee who has insufficient withholding mid-year can eliminate an underpayment penalty by increasing withholding for the remainder of the year.)

☞ **TAX TIP:** Front-load estimated tax payments—by overpaying in early quarters excess can be automatically “rolled-over” to next quarter

CA: Mandatory e-Pay as of 1/1/09

Required for taxpayers with any quarterly payment in excess of \$20K or total ES liability in excess of \$80K. Payments may be made using FTB’s Web-Pay, via credit card, or by e-file authorization for automatic debit. Failure to e-Pay results in penalty of 1% of amount paid.

C. Form 2210: Underpayment of Estimated Tax

- Not required to be filed with the return unless exception claimed [see § III.D below]
- IRS will calculate the penalty and bill the taxpayer
- No interest is charged on the penalty if the return was filed by the due date and the penalty is paid by the date specified on the bill

D. Exceptions to Penalty

1. Casualty, disaster or other unusual circumstance, such as becoming disabled after age 62
2. Annualized Income Installment Method
 - Quarterly payments can be calculated based on actual income in each quarter
 - Under this method, your required installment for one or more payment periods may be less than one-fourth of your required annual payment.

☞ **TAX TIP:** Use if income was higher in later quarters since this method will reduce the required quarterly payments at the beginning of the year
3. Using Actual Payment Dates for Withholding From Wages
 - Withholding from wages is considered to have been paid in 4 equal installments but taxpayer can elect to apply withholding to the quarter it was actually paid

☞ **TAX TIP:** Use if a large amount of tax was withheld at the beginning of the year
4. Switch from or to Joint Return
 - If a taxpayer is switching from a joint to an individual return, the prior-year tax used to calculate the required annual payment is the taxpayer’s separate liability



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- If taxpayers are filing jointly in the current year, they must use their combined prior-year tax to calculate the required annual payment
5. Qualified farmers and fishermen
- If $\geq 2/3$ of a taxpayer's gross income is from farming or fishing, special rules apply

IV. Payments


A. Due dates

Quarter	
1 st	April 15 th , 2009
2 nd	June 15 th , 2009
3 rd	September 15 th , 2009
4 th	January 15 th , 2010



B. Payment Options

1. e-Pay
 - Taxpayer must enroll with EFTPS at www.eftps.com or (800) 555-8778
 - Provide SS #, as well bank routing and account numbers at least day prior to due date
 - No charge by US Dept. of Treasury, but verify whether bank has processing fee

 **TAX TIP:** To use EFTPS, you must enroll online about 3 weeks prior to payment deadline to give the IRS time to send PIN and enrollment trace number via mail before obtaining an internet password online.
2. Automatic Debit
 - Available through tax preparation software and tax professionals
3. Credit Card (VISA, MasterCard, American Express, Discover)
 - The IRS does not receive or charge any fees and will not reimburse fees to taxpayers
 - Fees are non-deductible personal expenses or deductible business expenses

Service Provider	Telephone	Web Site	Convenience Fees (% of tax payment)	Customer Service
Official Payments Corporation	1-800-2PAY-TAX (1-800-272-9829)	officialpaymentsdebit.com	2.49%	1-877-754-4413
LINK2GOV Corporation	1-888-PAY1040 (1-888-729-1040)	pay1040.com	2.49%	1-888-658-5465

V. Options for Taxpayers Unable to Pay Tax Due

- A. Pay late
 - Pay as much as possible with return or extension and pay balance when billed by IRS
 - Cost: Interest at federal rate plus late payment penalty of 0.5% monthly
- B. Pay by credit card
 - Cost: Percentage of tax as a convenience fee plus interest at the credit card rate
- C. Installment Agreement (Form 9465)
 - Generally approved by IRS if the unpaid liability is \leq \$25,000 and tax will be paid within 5 years
 - If an installment agreement from a prior year is in effect, request consolidation
 - Failure to make a required payment may void agreement

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- Cost: Late Payment Penalty and interest on unpaid balance continue to accrue
\$105 user fee is charged to establish agreement; \$52 if using direct debit to pay
Interest and late payment penalties continue to accrue

D. Extension of Time to Pay

- Form 1127 Application for Extension of Time for Payment of Tax for six-month extension
- Taxpayer must show that he cannot sell assets or borrow to pay the tax except under terms that would cause severe loss and undue hardship
- Cost: If approved, the Late Payment Penalty is waived but interest continues to accrue

VI. Over-payments

- Refunds under \$1 will only be refunded on written request
- All or part of the refund may be used to pay certain debts such as student loans or state tax judgments
- Refund can be applied to next year's tax liability
- State tax refund is taxable on federal return if Schedule A was filed in prior year
- Refund can be automatically deposited to taxpayer's bank account
- Refund status can be checked by clicking "Where's My Refund?" at www.irs.gov
- Interest paid by the IRS is compounded daily beginning 45 days after the later of the original due date or the actual filing date—no interest is paid for the period prior to the filing date for late filed returns
- Interest on overpayments of estimated taxes begins to accrue only after the due date of the return
- Interest will be calculated at 5% (in Q3 of 2008) [adjusted quarterly] and is taxable

VII. Lost Opportunities

- IRS pays less interest than it charges
- IRS interest received is taxable—interest paid to IRS is not deductible
- Illiquidity
- Alternative investments [rates available nationally on February 9th, 2009]:

Maturity	CD Rates	Treasury Yields	Municipals (AAA-rated)
6 Month	1.80	0.43	
1 Year	2.22	0.52	
3 Year	2.54	1.40	
5 Year	2.80	1.87	
10 Year		2.88	3.17
30 Year		3.57	4.83

VIII. Why Pre-pay?

- Avoid short-falls
- Eliminate penalties and interest
- Easy to budget known payment amounts
- Forced savings plan
- No alternative investments need be considered



BUT...

A. Always More Tax (AMT)

AMT Preference Items = items that offer *regular* tax savings but are not permitted for *AMT*

- Personal Exemptions—none allowed
- Standard Deduction—none allowed
- Medical—must exceed 10%, rather than only 7.5%

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- Taxes—not allowed for state or estimated taxes and DMV registration

☞ **TAX TIP:** Don't pre-pay 4th quarter estimate if subject to AMT

- Miscellaneous Deductions—none allowed

AMT Adjustments

- Tax-exempt Interest—interest from Private Activity Bonds must be added
- Capital gains—large capital gains may cause taxpayer to exceed AMT exemption amounts
- Qualified Dividends—must be added back as a preference item for AMT
- State tax refund—prior year refunds received are subtracted from AMT calculations since amounts paid to other authorities are not deductible and must be added back

B. The Heroic Preparer

- “Harriet always got me refunds!
 - Under-report income (Fraud Penalty = 15% per month not to exceed 75%)
 - Over-inflate expenses
 - Over-estimate withholdings and quarterly payments
- Refunds make for happy clients
- Practitioner penalties [New: § 6694!]

Violation	Penalty
Understatement of taxpayer's liability due to unreasonable position	Greater of \$1,000 or 50% of tax prep fees earned
Understatement due to preparer's willful or reckless conduct or intentional disregard of rules	Greater of \$5,000 or 50% of tax prep fees earned

C. What's Mine is Theirs

- Although IRS currently pays interest on refunds at a rate equal to interest assessed on under-payments, interest does not begin to accrue until after the tax filing deadline
- Interest received from the IRS is taxable
- Refunds can take up to 6 or 8 weeks to process *after* returns have been filed



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