GROWERTALKS

Features

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A Taxing Guessing Game

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It should come as no surprise that Uncle Sam wants taxes paid in full during the course of the year. Avoiding the penalties associated with guessing wrong about estimated tax payments is easy. Anyone, including growers large or small, can usually avoid penalties by basing its estimated tax payments on the previous year's tax bill.

Unfortunately, if the coming year turns out to be a bad one financially, basing estimated tax payments on the previous year can mean the government, not the grower, gets to use those funds, interest free, for as long as a year. If the coming year turns out to be a good one, basing estimated tax payments on the previous year may mean no penalty, but a whopping tax bill when the tax return is filed—along with the first estimated tax installment for the upcoming tax year.

Estimating the income—and the tax bill—of any growing business can be a nightmare, especially when compounded by the economy, our battling lawmakers and the uncertainty over the Affordable Care Act and tax reform. While most self-employed and businesses have software programs or a professional to help with estimated tax payments, few are aware of how to anticipate—or handle—changes.

Estimating taxes

Think of estimated taxes as a "pay-as-you-go" tax. Four times a year (quarterly), the owner of every growing business is required to send Uncle Sam enough of his or her revenue to cover income tax, as well as their self-employment tax (Social Security and Medicare) obligations.

If enough taxes aren't paid throughout the year, either through payroll withholding or by making estimated tax payments, a grower and/or his or her business may face a penalty for underpayment of estimated tax. Because the IRS knows that calculating earnings isn't easy, it offers a safe harbor rule—paying at least as much as the previous year's liability or paying within 90% of the actual liability, with no penalty for underpayment.

Paying estimated taxes

Anyone filing as a sole proprietor, partner, S corporation shareholder and/or a self-employed individual is generally required to make estimated tax payments if they expect to owe a tax of $1,000 or more. If it's not through withholding, then it has to be done by quarterly estimated taxes. If the growing business is structured as a corporation, estimated tax payments are required if a final tax bill of $500 or more is expected.

For estimated tax purposes, the year is divided into four payment periods, with each period having a specific payment due date. If not enough estimated tax is paid at the end of each payment period, a penalty may be charged—even if a refund is due at year's end.

Almost inevitable underpayments

If enough estimated tax was not paid throughout the year, either through withholding or by making estimated tax payments, a penalty for underpayment of estimated tax is almost inevitable. Fortunately, if income is received unevenly during the year, penalties can be avoided or lowered by "annualizing" income and making unequal payments.

The annualized income installment method annualizes tax at the end of each period based on a reasonable estimate of income, deductions and other items relating to events that occurred from the beginning of the tax year through the end of the period. Form 2110—Underpayment of Estimated Tax by Individuals, Estates and Trusts—is used.

Paying up

Those filing as a sole proprietor, partner, S corporation shareholder and/or as self-employed, should use Form 1040-ES—Estimated Tax for Individuals—to both figure and pay estimated tax. Incorporated growing businesses are also required to pay an estimated income tax bill.

When filing as a corporation Form 1120-W—Estimated Tax for Corporations—is used to figure the estimated tax. In general, each quarterly federal tax payment is 25% of the corporation's "required annual payment," which is the lesser of two amounts:

> Current-year tax liability—100% of federal income tax reported on return for the year of the payment.
>
> Prior-year safe harbor—100% of a corporation's federal income tax reported on return for the preceding year.

Corporations with no tax liability in the preceding year obviously cannot use the 100% prior-year safe harbor amount to determine their required estimated tax payment. And certain "large corporations"—those with taxable income of $1 million or more in any of the three preceding tax years—can only use the prior-year safe harbor amount when calculating their first-quarter payment.

Much as is the case with individuals, if a corporation doesn't pay a required estimated tax installment by its due date, it may be subject to a penalty. That penalty is figured separately for each installment due date even if it paid enough tax later to make up the underpayment. This is true even if the corporation is due a refund when its tax return is filed.

Should an incorporated growing business figure and deposit its estimated tax only to find that its tax liability for the year will be more or less than originally estimated, it may have to refigure the required installments. An immediate catchup payment should be made to reduce any penalty resulting from the underpayment of any earlier installments.

All incorporated businesses are generally required to use EFTPS to pay their taxes, while Form 2220—Underpayment of Estimated Tax by Corporations—is used to determine if a corporation is subject to the penalty for underpayment of estimated tax and to figure the amount of the penalty.

Estimated tax refunds

Don't forget the special "Quick Refunds" for some estimated tax overpayments. An incorporated growing operation or business that has overpaid its estimated tax for the year may be able to apply for a quick refund by using Form 4466—Corporation Application for Quick Refund of Overpayment of Estimated Tax. A corporation can apply for a quick refund if the overpayment is:

- At least 10% of its expected tax liability

> and

- At least $500.

A changing of the mind

Uncle Sam in the form of the IRS demands each grower and every growing business that's required to pay taxes guess their income for the coming year—and pay an estimated tax bill by making installment payments over the course of the year. After an estimated tax payment has been made, changes in income, adjustments, deductions, credits or exemptions may make it necessary to refigure the estimated tax installment.

An individual or growing business that doesn't receive income evenly throughout the year will often find that the required estimated tax payments may vary. Failure to make timely payments that accurately reflect the tax liability of the commercial growing business—or that of its owner—can result in penalties.

Obviously, every grower should give careful consideration to their estimated tax payment calculations. Fortunately, our tax rules can not only help in figuring those estimated tax bills, but provide so-called "safe harbors" that can substantially reduce or even avoid those penalties. Obviously, professional assistance may be necessary, not only when first computing the estimated tax bill for the year ahead, but also should events dictate change. **GT**

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