

Penalty for under withholding Federal income taxes

IRS Underpayment Penalty

Arizona taxpayers have noticed an increased number of IRS tax notices related to underpayment penalties of Federal income taxes. If you owe \$1,000 or more on your completed 2023 tax return, you could get a letter from the IRS with a penalty for under payment during the calendar year.

In 2020 and 2021, the IRS suspended these notices during the pandemic, but the underlying law has not changed.

During the tax year, you must pay, through either withholding from wages or pensions, at least 90% of your tax liability or 100% of the total tax owed and paid on the previous year's tax return. If you have dividends, interest, capital gains, rents, royalties or are self-employed, you should consider making Estimated Payments.

Penalty Calculation

Tax penalties are assessed if the IRS determines you didn't make the required payments. The penalties are not tax-deductible.

The IRS will calculate the penalty separately for each quarterly period. Thus, the penalty cannot be reduced by paying more in one quarter to make up for a lesser payment in another quarter.

In addition, due to inflation, the penalty has increased from 3% to 9%. The penalty equals the Federal short-term interest rate in the first month of each quarter plus 3%. The current rate is the highest since 2007. The rate was 7% for the first three quarters of 2023 but increased to 9% for the fourth quarter.

The IRS will mail you a notice if you owe the Underpayment of Estimated Tax by Individuals Penalty. The IRS will **NOT** call, email or text you. It is important for you to respond promptly if you receive a notice in the mail.

Avoid Future Penalties

To avoid an underpayment penalty, taxpayers with income for which income taxes are not withheld must pay 25 percent of their "Estimated Annual Tax" to the IRS by April 15, June 15, September 15, and January 15.

Individuals who receive most of their income from wages or pensions normally satisfy their required annual tax payment through the income tax withheld by their employer or benefits manager.

Individuals who receive taxable Required Minimum Distributions or request additional distributions from a qualified retirement account should have tax withheld or pay an estimated tax.

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Self-employed individuals have no taxes withheld from their income, so they must make quarterly estimated tax payments. These include income earned through self-employment including sole proprietors, partners in a partnership, or members of limited liability companies.

LLC members or partners must make estimated tax payments on their share of the partnership or LLC income, whether the income is paid out to them or not. The partnership or LLC itself pays no tax.

Taxpayers do not need to make estimated tax payments if they expect to owe less than \$1,000 in federal tax for the year. Remember, the \$1,000 includes income tax and self-employment (Social Security and Medicare) tax.

Taxpayers can also avoid future penalties by paying at least 100% of the previous year's total income tax.

Estimated Tax Penalty Waivers

The IRS will NOT waive the estimated tax penalty based on the grounds of reasonable cause. These include serious illness or injury, a family member's death, or a similar circumstance beyond the individual's control. Nor will the IRS consider a first-time abatement penalty waiver.

The IRS can waive the estimated tax penalty only in the following circumstances.

Casualty or Disaster

The IRS can waive all or part of the penalty if the underpayment was due to a casualty, a disaster, or another unusual circumstance.

Individuals living in a federally declared disaster area automatically receive extra time to pay their estimated taxes (to be eligible for this extra time, their home or office doesn't need to be damaged). The IRS automatically identifies taxpayers located in a covered disaster area (by county or parish) and applies the appropriate penalty relief.

Newly Retired or Disabled Individuals

The IRS will waive all or part of your underpayment penalty if:

You retired after reaching age 62 during the tax year the estimated taxes were underpaid, or You became disabled, *and* there was reasonable cause.

For example, the IRS waived the penalty when a taxpayer failed to pay his estimated taxes because of a mental breakdown and complications due to AIDS. On the other hand, the IRS refused waivers where a taxpayer suffered from alcoholism and where another individual was caring for a spouse undergoing cancer treatment.

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To request a waiver, Form 2210 must be completed and attached to the return. A statement explaining (1) why you could not meet the estimated tax requirements, and (2) the time period for which you are asking for a waiver.

If you're requesting a waiver due to retirement or disability, you must attach documentation showing your retirement date (and your age on that date) or the date you became disabled.

If you're requesting a waiver due to a casualty, a disaster (other than a federally declared disaster), or another unusual circumstance, you must attach documentation such as copies of police and insurance company reports.

Estimated tax penalty waivers are not automatic. The IRS will review the information you provide and decide whether to grant your request for a waiver.

Remove or Reduce a Penalty

The penalty for underpayment of estimated tax generally cannot be waived for illness or injury or a death in the family, the IRS may reduce a penalty if any of the following apply:

- You or your spouse (if you file a joint return) retired in the past 2 years after reaching age 62 **or** became disabled **and** you had [reasonable cause](#) to underpay or pay your estimated tax late. See Waiver of Penalty in [Instructions for Form 2210](#).
- You had most of your income tax withheld early in the year instead of spreading it equally through the year.
- Your income varies during the year. Complete [Form 2210, Schedule AI, Annualized Income Installment Method](#).

Apply for a Payment Plan

If you cannot pay the full amount of your penalty, pay as much as you can as soon as possible and apply for a payment plan. ([apply for a payment plan](#)). This will lower the amount of interest added to the penalty until paid in full.

Get Help

For more help with an IRS penalty notice, call the phone number shown on your notice or letter.