

## Quarterly Estimated Taxes: A Cost and Benefit Analysis

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If you've owed \$1,000 or more when filing your federal tax return, you might have paid something called the Underpayment of Estimated Tax Penalty. This article explores the whole picture, and not just the penalty itself, to determine if paying estimated quarterly taxes could work for you.

### Introducing Quarterly Estimated Taxes

Every U.S. taxpayer has an obligation to pay their taxes over the course of the year. For employees, that requirement may be met through taxes withheld on their wages and salary. However, if your withholding is too low, or you have supplementary income such as bonus, equity compensation, or other taxable benefits, then you may not have enough tax withheld to cover the requirement.

If you have other income such as from self-employment, or profit allocated as a partner, or an S corporation shareholder, or returns on your investments, then there are typically no taxes withheld on that income on your behalf, and you may need to make payments to avoid a penalty.

There are exceptions to the penalty: **1.** If the current year balance is less than \$1,000 after withholding. **2.** If you had no liability for the prior year, you were a U.S. citizen or resident alien for the whole year, and your prior year return was for a full 12 months. **3.** If you paid an amount equal to 90% of the current year tax, or 66  $\frac{2}{3}$ % if at least 66  $\frac{2}{3}$ % of your income is from fishing and farming. **4.** If you paid an amount equal to your prior year tax. (Or 110% if your adjusted gross income is over \$150,000, or \$75,000 if you are married filing separately.) **5.** Additional exceptions are available for decedents, estates, and people in (or affected by) federally declared disasters.

### What is the Benefit of Paying Quarterly Estimated Taxes?

If you make quarterly tax payments meeting the requirements, you avoid having to pay the Underpayment of Estimated Tax Penalty due the following April 15th. Historically, the penalty has ranged between 3-9% since 2000, and it has been set at 7% for all four quarters of 2025.

Example: In 2025, an individual with \$90,000 of self-employment income, no deductions, could owe approximately \$22,600 in combined ordinary and self-employment taxes. Let's assume the individual doesn't meet any other exceptions and must pay 90% of the current year tax, \$20,340.

By paying appropriate quarterly estimated taxes, **they save \$947** that would otherwise be due in penalties. (Note that it's not a flat 7% against the total tax requirement, which would be \$1,424, because the penalty is calculated for unpaid quarters as they come due rather than the full year. For convenience and comparison against alternatives, you could call it a 4.7% annualized penalty.)

Besides saving on penalties, there are the benefits of having peace of mind, improved cash flow management, avoiding a large balance due in April, and insulation against other tax surprises.

## What Does it Cost to Estimate My Taxes?

The benefit of paying quarterly estimated taxes is avoiding having to pay the Treasury more than you have to pay in penalties. But how much does it cost to estimate your tax? If your tax situation is relatively simple, then you may find inexpensive services or tools to make the calculation cost negligible. If your situation is complicated, then you may need to seek out professional assistance.

The second cost is the opportunity cost. Do you have a 'guaranteed' investment in mind? The highest yielding bank accounts advertising online appear to offer less than 5% as of this writing. The public stock market and private markets may have higher potential, but they have risks too. A notable factor is that interest and/or dividend income is taxed, so that the effective yield on any '5%' yield accounts could be closer to 3%, after income taxes due on that income are considered.

The third cost is the cost of living. Can you afford to pay your taxes now? If you can't afford to make your estimated tax payments, then you essentially have a loan at an expensive rate. If you don't pay down the "loan" by April 15<sup>th</sup>, the rate increases rapidly as additional penalties accrue.

There is also some administrative burden which can be alleviated by setting up an [online account with the IRS](#) to schedule and track your estimated tax payments. States may have similar systems.

## Comparing the Costs and the Benefits

Most professionals (including this author) suggest paying estimated taxes for peace of mind, but let's put this all together in a couple examples to check that the common belief really works out.

Let's assume an effective annualized penalty of 4.7% based on the the earlier example. Let's also assume an effective high-yield bank account, net of taxes, to yield 3% annualized. Already this is looking like an argument in favor of paying estimated taxes, benefiting 1.7% over bank interest.

Now we can go bigger in the next example. A person with \$400k of self-employment income, no deductions, \$132k of combined taxes. They pay 90%, or \$119k, evenly over four quarters, saving and **avoiding \$5,531 of underpayment penalties**. If they put that \$119k in a high-yield account at 5% rate, reducing for 37% ordinary tax and 3.8% investment tax, they could earn \$3,516 net of tax. If they paid less than \$2,015 for professional help, they'd still be ahead by paying their taxes.

*(A tax professional can also help you identify tax deductions, which can further offset the costs.)*

## Next Steps:

**Consult your tax advisor** before you commit to any decisions inspired by things you read here. If you don't have a tax advisor, take a look at my company website ([davconsultingllc.com](http://davconsultingllc.com)), fill out the contact form, and let's talk about how we could work together. Short story, my name is Daniel, and I am a CPA with 11+ years' experience in helping my clients stay ahead of tax-day surprises.