The Simple Guide to Taxes for

Freelancers

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Should I form a company or can I begin solo?

One of the first questions you encounter when you begin your business is whether you should form a company.

As such there is **no legal rule that a ‘company’** must be formed to start a business. Incorporating a company has its own pros and cons. But so long as you are solo and your work is well managed, there is little benefit in forming a company. By forming a company, your compliance work will increase.

If your business is getting large and unmanageable, it helps to separate it into a separate legal entity. This entity will have its own PAN and will file a separate tax return.

You can choose to continue business as a freelancer, which does not require any formalities. Your income tax return will include income from your business or profession and you won’t need to file a separate income tax return.

How do I compute my freelancing income?

Your income is the sum of receipts from the work you do for your clients.

Your clients may be based in India or outside of India. You can use your bank account statements to add up all the receipts that have been credited to your account by clients.

Domestic Clients

Clients based in India are bound by local laws to deduct TDS from the payments they make to you. You can take credit of this TDS against your total tax liability. If excess TDS has been deducted you can claim a tax refund or pay if there are any additional dues.

TDS deductions are linked to your PAN. Remember to provide PAN to all your clients. This is important since the tax department allows TDS credit which appears in your Form 26AS.

Usually TDS for freelancers is deducted @10%. The deductor also provides you a Form 16A, which is basically a proof that TDS has been deducted from your income and deposited by him to the government.

Foreign Clients

If you work for clients out of India, payments may be received by you via paypal or as a direct credit to your bank account. Usually these payments are without TDS.

In some countries, TDS may be deducted as per local laws. Don't worry, you can still take credit of this payment. Via DTAA (Double Tax Avoidance Agreement) which India has entered into several countries, your income is not doubly taxed. If no TDS has been deducted, there is nothing to worry. You need to include these receipts in your total income while making income calculations and pay applicable tax on them. To meet advance tax requirements you may have to estimate your annual income from all sources.

Are there expenses I can deduct from my income?

Unlike the salaried, as a freelancer you can claim expenses against your income for paying taxes. Any money spent which is related to your freelancing work can be deducted.

Freelancing Expenses

Freelancers can deduct expenses from their income. This could be anything from office furniture to cab fares to client visits. These expenses must be directly related to freelancing

Rent –Rent paid for your workplace is an eligible expense. If you are living at the same place, you can apportion a part of the rent to your freelancing work.

Repairs – If you have agreed to pay for repairs to the rented property then these repair costs can be deducted. If you own the business property and carry out repairs those are also allowed to be deducted. Any repairs to your laptop, printer, and equipment are also eligible.

Local taxes and Insurance for your own business property

Depreciation – When you purchase an asset which is a Capital Asset, the benefit of such an asset is usually expected to last more than a year, such assets are capitalized and not charged to expenses when they are bought. Every year a small portion of its cost is expensed and is allowed to be reduced from your income. This expense which is charged every year is called Depreciation. Depreciation can be claimed on computers, servers, printers. The type of assets, methods of depreciation and rates of depreciation to be charged as are laid down in the income tax act.

Office expenses – Printer supplies, your monthly telephone bills, electricity bills, internet bills or conveyance expenses, or advertisement expenses.

Expenses of Domain registration, apps purchased to test your product; those are also allowed as expenses.

Travelling expenses – expenses on travel to meet your client could be within or outside of India (assuming this is not paid for by your client).

Meal, entertainment or hospitality expenses – Expenses spent with the intention of getting new business or retaining existing business can also be claimed. Be extra careful with these expenses and make sure you don't claim any personal expenses.

Subcontracting & TDS compliance

If you have engaged a person to do work or subcontracted your work. Money paid to such a person is also eligible to be deducted as expense. It is recommended that you keep proper proofs such as a contract for the work and details of payments made. If you pay salary, you have to deduct TDS. Anyone who pays salary must deduct TDS and deposit it with the tax department.
Those who pay salary and deduct TDS also have to issue a Form 16. You can prepare Form 16 on ClearTax. TDS may also apply on other payments made by you. TDS must also be deducted from any payments for professional or technical services. Professional services could be that legal, medical, engineering, architectural, accountancy, technical consultancy, interior decoration etc.
TDS deducted by you must be deposited to the government. After depositing TDS, you need to submit a quarterly TDS return to the tax department. You can prepare TDS returns on www.cleartds.com.

As a salaried employee I could claim deductions from total income, can I do so as a freelancer?

Yes. As a freelancer, you are eligible to claim all deductions applicable to a salaried employee in your tax return.

Income tax allows you to deduct certain investments and expenses from your gross total income. These are called deductions. The most popular of these is Section 80C. Deposits to PPF, ELSS investments, life insurance premiums, school fees of your kids, are all eligible as deduction under section 80C. You can also secure your family’s health via a medical insurance and claim the premium paid under section 80D. Interest paid on education loan is eligible under section 80E

Sample Tax Computation for Freelancer

We provide a quick tax computation for Aditi, a freelance mobile app developer to help you understand your tax liability

Business Scenario

Aditi had a runaway hit with her task manager app on the Google App and iOS store last year. She made about 7 lakhs rupees after 35,000 downloads from all over the world. Let's look at all the expenses pertaining to app development incurred as a freelancer

She bought office furniture, a desk and a chair, for Rs.9,600 to work on the app. She took a high-speed internet connection that cost her Rs.12,000. She had a couple of meetings with consultants during the year and she took a taxi to meet them. Rs. 8,000. She hired a co-developer temporarily and paid her Rs. 35,000 overall. Registration on the Play Store and iOS cost her Rs.10,000.

Aditi can also claim depreciation on the laptop. A depreciation of 40% is allowed on laptops as per the Income Tax Act. Depreciation on Aditi's laptop of Rs.60,000 works out to be Rs.24,000. Aditi split her telephone bill of Rs.36,000 for the year as part business and part personal and claimed Rs.18,000 as expense directly related to app development. She paid Rs.24,000 to the payment gateway partners as fee. With all this, Aditi's freelancing income comes to Rs. 5,59,400

TABLE 1	
EXPENSES	Rs
Office furniture	9,600
High Speed Internet Connection	12,000
Taxi Expenses	8,000
Co-developer cost	35,000
App registration	10,000
Depreciation on laptop	24,000
Telephone bill-work	18,000
Payment gateway fees	24,000
Total expenses (B)	**1,40,600**
Total Income from App (A)	7,00,000
Aditi's Freelancing work income (A-B)	**5,59,400**

Calculating Taxable Income

Aditi's freelancing income is Rs 5,59,400. But total taxable income is the sum of income from the following heads:

Income from Salaries

This includes any income of salary or other payments received by virtue of an employment. Aditi's one month's salary of Rs 52,000 was credited to her account and PF of Rs 1,200 and TDS of Rs 2,000 was also deducted before she quit her job at the end of April 2014.

Income from House Property

Aditi owns a one bedroom apartment and has given it on rent to 2 students who pay her Rs 15,000 in total. She also paid property tax of Rs.15,000 to the local authorities. From total rental income from the house, property tax paid is allowed to be deducted.

Income from Freelancing/Business and Profession

Income from freelancing (business or profession) as calculated is Rs 5,**59**,400 for Aditi.

Income from Capital Gains

Aditi did not sell any capital asset.

Income from Other Sources

Income from interest on savings account, interest from fixed deposits - this is the residual head of income, incomes which cannot be taxed under any other head of income are taxed here. Aditi has a fixed deposit on which she earned an interest of Rs 12,000. She earned an additional interest of Rs 7,800 on her savings account.

Investments eligible for deduction under Section- 80

A PF of Rs.1,200 was deducted by Aditi's previous employer. Aditi purchased a life insurance policy for Rs.50,000. She also has a PPF account in which she contributed Rs.60,000 for this year. She also invested in an ELSS fund for Rs.25,000 on recommendation from her friend.

Aditi also took out a health insurance policy and paid a premium of Rs 12,000. For purchase of a health insurance policy a maximum deduction of Rs 15,000 can be claimed under section 80D. Therefore, Aditi can claim the entire premium of Rs 12,000. Aditi can also claim deduction under section 80TTA for interest on savings bank account of Rs 7,800. Maximum deduction available under this section is Rs 10,000 or interest earned.

TABLE 2		
Income computation		
Income from Salary		52,000
Income from Business and Profession		5,59,400
Income from house property	1,80,000	
Less: taxes paid	15,000	
Net Annual Value of the property	1,65,000	
Less: Standard Deduction at 30%	49,500	
		1,15,500
Income from other sources		
Savings bank interest	7,800	
Fixed deposit interest	12,000	
		19,800
Gross Taxable Income (A)		**7,46,700**
Less: Deductions under section 80C		
PF deducted by employer	1,200	
LIC Premium	50,000	
ELSS	25,000	
PPF	60,000	
Total Deductions (B)		**1,36,200**
Less: Deductions under section 80D (C)		**12,000.00**
Less: Deduction under section 80 TTA (D)		**7,800.00**
Net Taxable Income (A-B-C-D)		**5,90,700**

Calculating Tax Payable

For Aditi, TDS deducted was Rs 2,000 by previous employer and Rs 1,200 by Bank on Fixed Deposit Interest. She can claim TDS credit on her total tax payable.

TABLE 3		
up to Rs. 2,50,000	NIL	
Rs. 2,50,000 - 5,00,000	12,500	
Rs. 5,90,700 - 5,00,000	18,140	
Total Tax		30,640
Cess @ 4%		1225.6
Total tax including cess (A)		31,866
Less: TDS (B)		3,200
Net tax payable (A-B)		**28,666**

Do I need to maintain books of accounts for my business?

Professionals such as lawyers, doctors, engineers, architects, accountants and interior decorators with gross receipts of more than Rs 1.5 lakhs in the past 3 years have to compulsorily keep books of accounts. If yours is a newly set up profession, and receipts exceed Rs 1.5 lakhs in the first year, these rules shall apply to you. Cash book with details of day to day payments and receipts, an accounting journal and ledger are the prescribed records. Each year's books must be kept for 6 years from the end of that year.

Remember that non-maintenance of book keeping attracts penal provisions. If you fail to maintain books of accounts as prescribed, you may be charged a penalty of Rs 25,000 or in some cases where you may have international transactions and you have failed to maintain information and documents for such transactions - 2% of the value of each international transaction shall be the penalty.

We recommend you definitely keep accounting records however small or big your freelancing work may be. Books of accounts help keep track of all your expense and income in a methodical way.

Audit is compulsory for a person carrying on a profession, audit applies when gross receipts exceed Rs 50lakhs

What is Presumptive Business income? Does it apply to freelancers?

Yes. Form Financial Year 2016-17 i.e. Assessment Year 2017-18, presumptive income rule applies to professionals too and this includes freelance professionals besides being applicable for businesses engaged in trading of goods and services for his includes wholesalers/retailers and other trading intermediaries. It does not apply to freelancers.

To encourage small businesses and freelancers to report their taxes dutifully the government launched the presumptive scheme of income. Under this scheme your income is assumed to be 8% of your receipts. You are exempt from keeping books of accounts. And no expenses are allowed to be deducted from this 8%. This scheme was applicable to businesses if their annual turnover was Rs. 1 crore or less (now revised to Rs 2 cr).
Starting FY 2016-17, Professionals with annual receipts of Rs 50lakhs or less can opt for this scheme. For professionals or consultants, income shall be assumed to be 50% (8% for businesses)of their receipts. The biggest advantage of opting for the presumptive scheme is that you can file the very short and ITR-4 instead of the long form ITR-3. Since you are exempt from maintaining accounting records, this scheme saves you from the hassle of spending time on their upkeep. Freelancers or consultants can opt for this scheme starting 1st April 2016 and save themselves from the hassles of account keeping and filing the long form ITR-3.

Key Takeaways for Freelancers

As a freelancer, you can stay ahead of your tax compliance requirement with 5 simple steps

- File your tax returns on time
- Make sure you invest to save tax
- Set up a diligent system to keep track of your expenses
- Record invoices raised and payments received properly
- Hire experts to assist you with your tax filing and tax planning

Follow blog.cleartax.in for the latest on income taxes, investments and tax savings.

APPENDIX

Checklist: Documents you need to file your taxes

To be able to file your tax returns, you'll need some documents. Keeping these handy will help your return filing process get started quickly.

Document	Description
Form 26AS	This form has details of tax deposited by you and TDS deducted from your income. This form can be downloaded from the income tax department website. You'll need this form to take credit of all the tax that has already been deducted from your income.
Bank statements	You'll need these details to make sure all expenses have been accounted for and incomev has been included in your return.
Receipts of Expenses	Having bills and receipts handy will help in appropriate accounting of your expenses. These are also required for capitalisation of assets to make sure depreciation is properly claimed. Accrual of expenses is also done based on receipts of past months.
Proof of Deductions	If you want to claim deductions under section 80C or 80D or any other section, you must have proofs or receipts of these investments or expenses ready with you.
Form 16	If you have worked as an employee for a part of the year, your employee will issue you a Form 16, which you can upload to ClearTax and your income from salary shall be automatically prepared from this Form.

APPENDIX

Tax Glossary

The Indian income tax law runs into hundreds of pages. There is no good reason for you to spend precious time finding your way through it. Here's a little glossary to help you master some basic tax terms which can be very handy while filing your tax returns.

Heads of Income – Your total income is classified into 5 heads. Income from salary, income from house property, income from business and profession, income from capital gains and income from other sources. These classifications are fairly self-explanatory, the last one 'income from other sources' is a residual head of income. Under this head, interest income, gift income or winnings from lottery, basically any income which does not fall under the other four heads is reported here.

Books of accounts – Books of accounts means a record of all income, expenses, assets and liabilities of your business. These financial records are essential for understanding the performance of your business. These may be compulsorily required in some cases.

Accrual – This is a term that you'll hear often. Accrual means income & expenses are booked on due basis rather than payment basis. You book income when you raise an invoice and a payment is due from your client. Similarly expenses are booked when a service is used, even though you may not have paid or received an invoice. For example, rent expenses for an office are accounted for at the end of the month, even though the landlord may not have raised an invoice yet.

Deductions – Income from all the five heads is summed up and is called gross total income. From this gross total income, deductions can be claimed. These deductions reduce your total tax outgo since they lower your gross total income. Investments such as PPF, NSC or certain expense like life insurance premium, interest on education loan, medical insurance are allowed as deduction from your gross total income.

Depreciation - When you purchase a capital asset, the benefit of such an asset is usually expected to last more than a year, such assets are 'capitalized' and not charged to expenses when they are bought. Every year a small portion of its cost is expensed and is allowed to be reduced from your income. This expense which is charged every year is called depreciation.

Tax Deduction at Source (TDS) – Persons responsible for making payments have to deduct tax before making payment. The tax department wants payers to deduct tax beforehand and deposit it instead of waiting for you (the recipient) to make the tax payment yourself. The recipient of income receives the net amount (after deduction of tax at source). The recipient adds the gross amount to his income. TDS is adjusted against final tax due, since it is tax already deposited on the recipient's behalf. TDS ensures steady flow of taxes for the government.

Advance Tax - Advance tax means income tax should be paid in advance instead of lump sum payment at year end. It is also known as pay as you earn tax. These payments have to be made in instalments as per due dates provided by the income tax department.

Form 26AS - Form 26AS has all tax related information of your PAN. It shows how much tax has been received by the government against your PAN. It includes TDS, tax directly deposited by you, refunds made to you etc. You can understand how to view and download your Form 26AS here → https://cleartax.in/Guide/TaxCredit.

Audit – In some cases, the income tax department may require your accounts to be checked and certified. This review of your financial records is done by a Chartered Accountant and a certificate is issued by him. If audit rules apply to you, the certificate issued by the CA has to be submitted to the tax department.