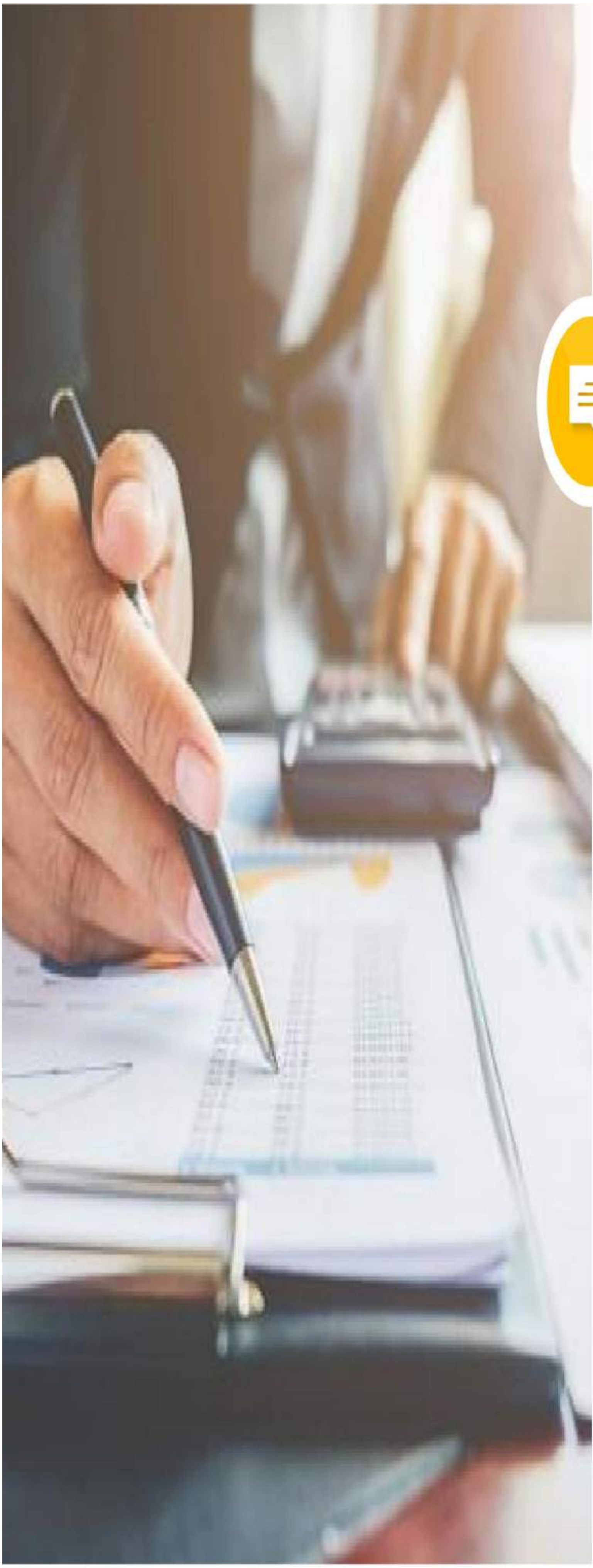
INDIA EXPERT

Freelancers & Taxes



About

INDIA EXPERT, Chartered Accountants, is one of the leading providers of financial and business advisory, internal audit, statutory audit, corporate governance, & international taxation and regulatory services. With a global approach to service delivery, we are responds to clients' complex business challenges with a broad range of services

across industry sectors and national boundaries. The Firm has been set up by a group of energetic, open minded, highly skilled and motivated professionals who have gained experience from top consulting companies and are extensively experienced in their chosen fields has providing a wide array of Accounting, Auditing, Assurance, Risk, Taxation, & Business advisory services to various clients & their stake holders. We have been associated with various national & International recognized associations in the field of our profession; Association of International tax consultants (AITC) is one of them.

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Freelancers & Taxes

A guide to understanding your income and income tax returns

A 9 to 5 job is not something that appeals to everyone. Some people like a bit of flexibility so that they can pursue other interests, have more time for their loved ones, or simply avoid a tedious routine. That is why people freelance at the comfort of their couch at home, a cool café, or a coworking space. As per the income tax laws, freelancers too are liable to pay taxes for the income they earn just like other salaried or business taxpayers.

Freelancing income

Freelancing income comes into picture when you get hired to work on specific assignments for a specific term and get paid for the work upon completion and submission. You will not be an employee of the company or placed on their payroll. You will not get perks (like PF) mandated by the Company Act. You are not required to go to the office – in fact, you can complete the work at leisure (by pre-agreed deadline) from any place convenient to you.

Any income that you earn by displaying your intellectual or manual skills is the income from a profession according to income tax laws in India. Such income will be taxable as "Profits and Gains from Business or Profession". Your gross income will be the aggregate of all receipts you get in the course of carrying out your profession. Your bank account statement is a document you can rely on to cull out this information, provided that you have received all your professional income through banking channels.

Expenses allowed as a deduction

Freelancers can deduct expenses they incurred to do the job from their income. This could be anything from office furniture to cab fares to visit clients. These expenses must be directly related to the job you are doing.

Conditions to claim expenses as a deduction from freelancing income

The expense is for the freelancing work being carried on

It has been spent fully and exclusively for the purpose of your work

It is incurred during the tax year

It is not a capital expenditure or a personal expenditure of the freelancer

It is not incurred for any purpose which is an offence or is prohibited by law

Expenses that can be claimed as a deduction against income

Rent of the property
If you take a property on rent for carrying out your work, the rent paid can be deducted.

Repairs undertaken
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 other equipment are also allowed to be deducted.

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 charged every year is called depreciation.
For instance, when you buy a laptop for Rs.60,000 to do your freelance work, the Rs.60,000 will be considered as your asset. Assuming a straight line depreciation of 33.33% each year, Rs.20,000 shall be charged as expenses yearly. In the next 3 years, we would consider the asset to be fully depreciated. Note that the type of assets, methods of depreciation, and rates of depreciation to be charged are laid down by the Income Tax Act itself and those shall be applied.

Office expenses
Expenses incurred to carry out your work such as purchasing a printer, office supplies, your monthly telephone bills, internet bills, and conveyance expenses can be claimed as a deduction.

Travel Expenses
The cost of travel to meet your clients within or outside of India is allowed as a deduction.

Meal, entertainment or hospitality expenses
It can be claimed when you conduct client meetings, take your clients out for dinner, or some other outings and money has been solely spent with the intention of getting new business or retaining existing business.

Local taxes and insurance for your own business property

Domain registration and apps purchased to test your product are also allowed as expenses.

How to claim expenses common to both personal and professional purposes

When assets claimed or expenses incurred are used for both professional and personal purposes, only a reasonable amount of the expenses and depreciation is allowed as a deduction, and not the full amount.

For example:
Your mobile phone is used for both business and personal calls. Therefore, only a reasonable portion of your mobile bill attributable to your freelance work will be considered for deduction.

Expenses that are explicitly disallowed to be deducted from your income

Case Study:
Rohit, a freelance photographer, takes premises owned by his married sister for carrying out his freelancing work. Rent is an expense, which is allowed to be deducted from the freelancing income of Rohit. Since the premises is owned by Rohit's sister he decides to divert some of his income to his sister by paying her higher than reasonable market rent. Such excess payment will not be considered as a deduction.

Will this come under the scanner of the I-T Department when he files his income tax return?

The following expenses are explicitly disallowed to be deducted from one's income as per the Income Tax Act:

Income Tax paid by you

Any interest or penalty or fine for non-payment or late payment of income tax

Payment made to relatives shall not be allowed to be deducted when:

You have received goods, facility or services

Payment has been made to a relative(spouse, or any lineal ascendant or descendant of you or your spouse) or to a person who has substantial interest (20% or more in equity or in profits) in your business

The payment is – either (a) Not in line with the fair market value of the

goods/facility/service
(b) Not a legitimate need of your profession
(c) When you incur that expense you actually end up deriving a benefit.

If you pay for an expense which is more than Rs.10,000 in cash, such expenses will not be allowed for deduction.

Case Study:

Rohit, a freelance photographer, takes premises which is owned by his married sister for carrying out his freelancing work. Rent is an expense which is allowed to be deducted from the freelancing income of Rohit. Since the premises is owned by Rohit's sister he decides to divert some of his income to his sister by paying her higher than a reasonable rent as per the market.

Will this come under the scanner of the IT Department when he files his income tax return?

Rohit claimed the rent payment as a business expense and reduced his overall income. His sister, who has no other income, paid only a 10% tax on the rental income. The Assessing Officer may not allow a rent payment, which is not in line with the fair market value of the premises, especially when the recipient is a relative.

Get help on your income taxes and tax filing from us. Tax Experts can prepare your tax returns and e-file within 48 hours. Plans start at Rs.3,700 for freelancers and consultants.

Check out our Expert Assisted Plans →

Books of accounts for freelancers

How should freelancers account for their income — when it is due or when it is actually received? Here are the two types of accounting methods that can help you to determine this.

Accrual Basis of Accounting (also called Mercantile Basis)

Cash Basis of Accounting

Accrual Basis of Accounting	Cash Basis of Accounting
Income is accounted or booked when the right to receive arises	Income is booked when it is actually received
Expenses are accounted or booked when the obligation to pay arises	Expenses are booked when they are actually paid
Tax liability arises when income is booked – tax may become payable when income may not have been received	Tax liability arises in the year income is received – so it makes you pay tax only when income is in your hands.
This approach can be followed for all heads of income, compulsorily for heads such as salary, house property, and capital gains.	The approach is allowed only for profits and losses from business/profession and income from other sources.
Example 1: You raise an invoice for a transaction with your client on 2 February but receive the payment on 4 April. The revenue will be booked in your account based on the date the invoice was raised to the client.	Example 1: In this same example, revenue would be accounted for 4th April (which will be the tax year next to the year in which invoice was raised or work got completed), when the payment is received.

Example 2: Your mobile bill dated 15th February to 15th March has been received. This bill will be captured as an expense in the month of March for accounting purposes. This is applicable irrespective of you paying this by 31 March or not (you may actually pay in the next tax year). Based on an estimation, the mobile bill for the remaining 15 days of March will be accrued using a reasonable basis when your books of accounts are closed on 31st March for tax purposes.	Example 2: Your mobile bill dated 15th February to 15th March has been received and this bill will be booked as an expense in the month of March when you pay it before the 31 March (therefore, gets booked in the same tax year). If you decide to pay it in April it will get booked as an expense in the next tax year (though the expense or mobile usage pertains to the previous tax year).

Note that the accounting method you choose will have to be followed for all clients, all revenues as well all expenses.

How to choose an accounting method

It may appear that using the cash basis of accounting method will reduce your tax liability. However, the reality is that it may only postpone your tax outgo. However, you will not be able to achieve any tax reduction.

Once you choose a method of accounting you are expected to regularly comply with that method. You are not allowed to change the method of accounting often i.e. if your intention is to save taxes or avoid taxes.

Usually, it seems more logical to follow the Accrual Basis unless your receipts are irregular, uncertain, or unpredictable. The Income Tax Act has specified that the books of accounts must be maintained for the purpose of Income Tax. These have been prescribed under section 44AA and Rule 6F.

Total taxable income and tax payable

One can reduce their tax outgo by making full use of deductions under Section 80. In that, Section 80C of the Income Tax Act offers tax relief on certain expenses and encourages taxpayers to save for the future (by giving deductions on investments in financial products).

Net Taxable Income = Gross Taxable Income – Deductions

You can reduce your taxable income by up to Rs.1.5 lakh by claiming deduction for the amount actually invested/spent under this section. If you are aged within 60 years and your net taxable income is more than Rs.2.5 lakh, you are liable to pay tax on your income.

Here is how tax will be calculated on your income:

Tax payable for a freelancer

If the total tax liability during a financial year exceeds Rs.10,000, the taxpayer is required to pay taxes every quarter. This is called advance tax.

How to calculate advance tax?

Add up all your receipts and determine your total income.

Subtract expenses directly related to your work.

Add income from other sources, say a house property or savings account.

Find out the tax slab you belong to and calculate your tax due.

Remember to deduct TDS

If the tax due exceeds Rs.10,000, you are required to pay advance tax by the following due dates.

Due date for Advance Tax

On or before 15th June	Not less than 15% of advance tax
On or before 15th September	Not less than 45% of advance tax as reduced by the tax paid in the last installment.
On or before 15th December	Not less than 75% of advance tax as reduced by the tax paid till the last installments.
On or before 15th March	The whole amount (100%) of advance tax as reduced by the tax paid till the last installments.

Which ITR to file? Need help from an expert to calculate and pay your advance tax? Reach out to us support@carajput.com Freelancers must file income tax

returns on ITR-4.

Want to know more about the ITR-4 Form? Why not read our comprehensive guide to the ITR-4 Form? Read our ITR-4 Guide →

Get answers to all your questions about how to fill the ITR-4 Form.

How to pay advance tax?

There are two ways to do it.

You can pay online through the IT Department's website. Go here to see a screenshot guide to filing tax dues on the government website.

You can also fill out a paper challan and deposit tax by physically visiting your bank.

Penalties for non-payment of advance tax

Interest under Section 234B and Section 234C is applicable when you don't pay your advance tax. To avoid Interest Penalty under Section 234B and 234C –

Pay advance tax when your tax liability in a year is Rs. 10,000 or more

Advance tax payments done until 31st March of the year should be 100% of your total tax payable.

Section 234B applies when Advance Tax has not been paid and since Advance Tax is payable as per dates set out by the IT Department, 234C is applicable when interest is not paid according to these due dates. You can read in detail about 234B and 234C

Applicability of GST to freelancers

Earlier VAT & Service Tax applied on freelancers. Now these taxes have been replaced by GST.

If you sell goods

GST has replaced the earlier VAT applicable. The rate of GST will depend on the items you are selling. For example, if you make and sell cakes to bakeries then you must charge 18% GST. Currently, this is the applicable GST rate on cakes.

If you provide service

18% GST applies on most services. So, for your freelancing services you must charge 18% GST from clients. Refer our handy GST Rate finder to check find out the latest rates.

Example:
Let's say your total billing to your client is Rs.75,000. GST rate is 18%, i.e.,Rs. 13,500 (75,000*18%). You must invoice your client Rs.88,500 and Rs.13,500 will be GST collected from the client. This amount has to be deposited with the government. [Earlier Swaccha Bharat cess and Krishi Kalyan cess are no longer applicable under GST]

Things to remember under GST

If the total revenue from freelancing work is not more than Rs. 20 lakhs, then GST does not apply. (Click here to find out who has to register mandatorily under GST)

You are eligible for composition scheme, if you are selling goods.

Composition scheme does not apply on services. However, you can provide inter-state services upto Rs. 20 lakhs without registering under GST.

GST does not apply on exports

Refer our article on the impact of GST on freelancers for more information.

How to understand whether I need to apply for GST?

You must register under GST if your aggregate turnover in a year is more than Rs.20 lakhs (Rs.10 lakhs for North Eastern and hill states).

How to calculate my aggregate turnover in a year?

Refer our article on how to calculate aggregate turnover to check if you have to register for GST.

How to make GST payments?

GST payments can be made online. It is mandatory to make payments online if your payments exceed Rs.10,000. GST has to be deposited to the government either quarterly or monthly based on your turnover and the choice of composition scheme. Interest will be payable for any delays in depositing service tax with the government. Refer our article to find out more on GST payments.

How to file GST returns?

GST returns have to be filed quarterly or monthly based on your turnover and if you have opted for composition scheme. Composition dealers and those with annual sales below Rs.1.5 crore can file quarterly returns.

Once you obtain a GST Identification number, return filing is compulsory for you.

Refer our article to find out more on GST returns.

Do you have a question about GST?

Refer to our articles on GST registration to find out how to register and the benefits of registering.

If you have any questions related to GST applicability to your income or need to get yourself registered, let us know at support@carajput.com

Should Freelancers file TDS Return?

Freelancers may get their payments after tax being deducted at source. Similarly, freelancers are required to deduct tax at source before making a payment. Here is an illustration:

Roshni is a graphic designer who works as a freelancer for multiple clients. She is paid for each project she works on and not a fixed monthly salary. In each such payment, the client deducts tax at source before paying out. But, she does not know about the tax she has to deduct at the source.

Many freelancers have a name for the business and a current account meant for business purposes; they are treated as small businesses from a taxation perspective. At times when Roshni has tight deadlines, she hires professionals to keep up with the deadlines. In this case, she must deduct tax at source on the amounts payable to them.

Every time a freelancer or a small business owner makes a payment to professionals which exceeds Rs.30,000 per transaction or in aggregate during a financial year, TDS applies at the rate of 10%. The deducted tax at source must be deposited with the government.

Further, a freelancer must deduct tax or TDS only if he has been audited during the previous financial year. A freelancer will be audited only if the annual gross receipts exceed Rs 50 lakh. Otherwise, there is no need to deduct tax at source. Hence, where the annual gross receipts exceed Rs 50 lakh, and the freelancer has had his accounts audited in the earlier year, TDS would apply to various payments including salary, contractual payments made by the freelancers.

The freelancer would have to check for applicability of TDS on all payments covered under the provisions of TDS. Also, once the taxes are deducted, the freelancers are required to deposit the tax and file TDS returns.

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