



# TAX COMPLIANCE GUIDE FOR FREELANCERS AND BUSINESS OWNER

## MODULE 1

## LESSON 4:

# KEY TERMS AND CONCEPTS IN TAX COMPLIANCE






# **Module 1. Introduction to Freelance Tax**

## **Compliance**





# Lesson 4. Key Terms and Concepts in Tax Compliance



## 1. Taxable Income

Let's start with one of the most important concepts: taxable income. This refers to the portion of your income that is subject to taxes after accounting for deductions and exemptions.

### What is Taxable Income?

In simple terms, taxable income is your gross income minus any allowable deductions. The BIR uses this figure to determine how much income tax you owe.



### Example:

Imagine you earned ₱800,000 in a year from your freelance work. You also had ₱100,000 worth of business-related expenses, like office supplies, software subscriptions, and internet costs. Your taxable income would be:

$$₱800,000 \text{ (gross income)} - ₱100,000 \text{ (deductions)} = ₱700,000 \text{ (taxable income).}$$

This ₱700,000 is what the BIR will use to compute your tax liability based on the tax brackets we discussed earlier.



## 2. Gross Income vs. Net Income

Next, let's differentiate between gross income and net income. These terms are often confused, but they have distinct meanings.

### Gross Income

Gross income refers to the total amount of money you earn from your freelance work before any deductions. This includes all the payments you receive from clients for services rendered.

### Example:

If you earned ₱500,000 from various clients in a year, this amount is your gross income. You haven't yet subtracted any business expenses or deductions.



## Net Income

Net income, on the other hand, is what's left after you subtract all your allowable business expenses from your gross income. Think of net income as your real profit—what you actually take home after covering all your costs.

### Example:

If your gross income is ₱500,000, and you spent ₱50,000 on business expenses (like travel, office rent, and supplies), your net income would be:

₱500,000 (gross income) - ₱50,000 (expenses) = ₱450,000 (net income).

Your net income is crucial for determining your taxable income.



### 3. Deductions

Deductions are specific expenses that the BIR allows you to subtract from your gross income to reduce your taxable income. The goal is to reflect the actual costs you incur to run your freelance business.

#### Common Deductions for Freelancers

**Office supplies:** Expenses for materials and tools you use for your business (e.g., notebooks, pens, printer ink).

**Utilities:** If you work from home, you can deduct a portion of your rent, electricity, and internet costs.

**Transportation:** Business-related travel expenses (e.g., taxi fares, gas for business trips).

**Professional fees:** Payments you make to others for business-related services, such as legal or accounting advice.

**Software subscriptions:** If you use tools like QuickBooks, Xero, or Adobe Creative Cloud for your freelance work, these subscriptions can be deducted.





### Example

Let's say you earned ₱600,000 as a graphic designer. Throughout the year, you spent ₱30,000 on software, ₱20,000 on utilities, and ₱10,000 on transportation. Your total deductions would be:

$$₱30,000 + ₱20,000 + ₱10,000 = ₱60,000.$$

You can subtract this from your gross income to get your taxable income.



## Standard Deductions vs. Itemized Deductions

Freelancers can choose between two types of deductions:

**Optional Standard Deduction (OSD):** This is a flat deduction of 40% of your gross income, which simplifies the process.

**Itemized Deductions:** This involves listing all your actual business expenses, which can reduce your taxable income further if your expenses are high.



## 4. Exemptions

Exemptions reduce the amount of income that is subject to tax, similar to deductions, but they typically apply to specific circumstances or individuals.

### What Are Exemptions?

Exemptions are amounts you can subtract from your income before calculating your tax. For freelancers, there aren't many personal exemptions unless you are supporting dependents.

### Example:

Exemptions are amounts you can subtract from your income before calculating your tax. For freelancers, there aren't many personal exemptions unless you are supporting dependents.



# Key Takeaways

**1**

**Taxable income** is your gross income minus deductions; this is the amount that is subject to tax.

**2**

**Gross income** is the total amount you earn, while net income is what remains after deducting business expenses.

**3**

**Deductions** lower your taxable income and can include business-related expenses such as office supplies, rent, and utilities.



# Learning Activity

Now that you've learned about these key concepts, here's an exercise:

**Identify** one or two deductions you think you could apply to your freelance business based on your expenses over the past year.

**Calculate** your taxable income using your estimated gross income and the deductions you've identified.



# What's Next?

In the next lesson, we'll cover Understanding the Importance of BIR Registration. You'll learn why it's crucial to register with the BIR as a freelancer, what documents you need, and the consequences of not registering. Stay tuned for Lesson 5!



