KS academy

TAX COMPLIANCE GUIDE FOR FREELANCERS AND BUSINESS OWNER

MODULE 4

LESSON 1:

CREATING A TAX SAVINGS PLAN

Module 4. Tax Planning and Saving Strategies

Lesson 1. Creating a Tax Savings Plan

1. Why You Need a Tax Savings Plan

As a freelancer, you're responsible for paying taxes on your own—no one is withholding tax from your paycheck like they would if you were an employee. This means that, unless you plan ahead, it's easy to find yourself short on cash when tax deadlines roll around.

A tax savings plan ensures you:

Avoid penalties for underpayment or late payment of taxes.
Reduce financial stress by having the funds available when tax payments are due.
Develop better financial discipline and keep your business finances healthy.

Example:

Let's say you owe ₱50,000 in annual income taxes, but you don't set aside any money throughout the year. When the tax deadline approaches, you might find yourself scrambling to come up with the funds, possibly dipping into savings or taking out a loan. By saving for taxes regularly, you eliminate this pressure.

2. Calculating Your Estimated Tax Liability

The first step in creating a tax savings plan is determining how much you should be setting aside. To do this, you need to estimate your annual tax liability.

Step 1: Estimate Your Annual Income

Start by calculating how much you expect to earn during the year from all freelance work or business activities.

Example:

If you expect to earn ₱800,000 in gross income from freelance work, that's your starting point.

2. Calculating Your Estimated Tax Liability

Step 2: Deduct Expenses

Next, subtract your allowable deductions. These can include business expenses like office supplies, rent, utilities, transportation, and software subscriptions. Alternatively, you can use the Optional Standard Deduction (OSD), which allows you to deduct 40% of your gross income without needing to itemize.

Example:

If you choose to use the OSD method, and your gross income is ₱800,000, your deduction will be:

₱800,000 x 40% = ₱320,000.

This leaves you with a net taxable income of ₱480,000.

2. Calculating Your Estimated Tax Liability

Step 3: Apply the Income Tax Brackets

Now that you have your net taxable income, apply the appropriate income tax rates based on the current tax brackets in the Philippines.

For example:
Income up to ₱250,000 is tax-exempt.
For income from ₱250,001 to ₱400,000, the tax rate is 15% of the amount exceeding ₱250,000.
For income from ₱400,001 to ₱800,000, the tax rate is 20% of the amount exceeding ₱400,000.

Example:
Let’s say your net taxable income is ₱480,000. The tax calculation would look like this:
The first ₱250,000 is exempt.
For the next ₱150,000 (₱400,000 - ₱250,000), you’ll pay ₱22,500 (15% of ₱150,000).
For the remaining ₱80,000 (₱480,000 - ₱400,000), you’ll pay ₱16,000 (20% of ₱80,000).
In total, your estimated tax liability is ₱22,500 + ₱16,000 = ₱38,500.

3. Setting Aside Funds for Tax Payments

Once you've estimated your annual tax liability, the next step is to regularly set aside funds throughout the year so that you're ready when it's time to pay your taxes. There are two main approaches you can use:

a. Percentage-Based Savings

Set aside a fixed percentage of your income every time you get paid. This is the simplest and most straightforward approach.

Example:
If your estimated tax liability is ₱38,500 for the year and you expect to earn ₱800,000, you should set aside roughly 5% of each payment you receive. So if you get paid ₱100,000 from a client, you'll set aside ₱5,000 for taxes.

3. Setting Aside Funds for Tax Payments

b. Fixed Monthly Savings

Alternatively, you can set aside a fixed amount each month based on your estimated annual tax liability. This is a good approach if you prefer consistent monthly savings and want to avoid the stress of calculating savings for every payment.

Example:
If you expect to owe ₱38,500 in taxes for the year, you can set aside ₱3,208 per month to reach your goal by the end of the year.

4. Automating Your Savings

To make sure you stay on track, consider automating your tax savings. Here are some practical ways to do this:

Automatic Transfers: Set up automatic transfers from your checking account to a dedicated savings account for taxes. This way, every time you get paid, a portion of the money is automatically moved to your tax savings account.

Separate Bank Account: Open a separate bank account specifically for tax savings, and use this account solely to store the funds you'll need to pay your taxes.

Tax Savings Apps: Use apps that help you set aside money for taxes. Some apps even allow you to calculate your tax liability and track how much you've saved toward it.

LESSON 1

Key Takeaways

1. Estimate your annual tax liability by calculating your net taxable income and applying the current tax brackets.

2. Regularly set aside funds for taxes by saving a percentage of each payment or a fixed amount each month.

3. Consider automating your tax savings to ensure you're always prepared for tax deadlines.

Learning Activity

Estimate your expected income and tax liability for the year based on your freelance earnings and deductions.

Choose a savings method (percentage-based or fixed monthly) and start setting aside funds for your taxes.

If possible, automate your savings by setting up an automatic transfer to a dedicated tax savings account.

What's Next?

In the next lesson, we'll cover Quarterly Tax Filing and Payment Schedule, where you'll learn how to create a checklist for tracking filing deadlines and staying compliant. Stay tuned for Lesson 2 of Module 4!

KS