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Comparing the New York City Unincorporated Business Tax and General Corporation Tax

By: Robert Thee, CPA

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Most businesses operating in New York City in the form of pass-through entities for federal tax purposes—such as partnerships, limited liability companies, S corporations, and sole proprietorships—will be subject to an entity-level tax: either the Unincorporated Business Tax (UBT) or the General Corporation Tax (GCT). Although federal and state income tax considerations will usually be the driving forces behind the choice of entity, it's important for practitioners and their clients to be aware of the differences between the two tax systems and how they impact the business's tax liability.

The GCT is imposed on only S corporations at a rate of 8.85%. (Note that for years beginning in 2015, C corporations are subject to the Business Corporation Tax, which is modeled after the New York State General Business Corporation Franchise Tax—only the GCT is addressed in this article.) All other businesses are subject to UBT, which is imposed at a rate of 4%.

Aside from the tax rates, there are various differences between the two regimes.

<u>Taxable Activities</u>

Almost all businesses operated in New York City are subject to GCT, while several activities are specifically exempt from UBT—most notably the holding, leasing, and managing of real property for the purpose of producing rental income or gain upon the property's disposition.

<u>Measure of Tax</u>

The UBT has only one measure of tax (income), while the GCT has a minimum tax, tax on capital, and alternative computation based on income plus shareholders' compensation.

<u>Income Threshold</u>

UBT is not imposed if taxable income is under $85,000. GCT applies to all levels of income.

Deductibility of Owners' Compensation

No compensation paid to owners may be deducted for UBT purposes, although there is a limited "allowance for active members' services." Shareholder compensation is deductible for GCT.

Net Operating Losses

For UBT purposes, the net operating loss (NOL) deduction is calculated after applying the business allocation percentage for both the year of the loss and deduction, but before allocation for GCT. The UBT NOL is eliminated or reduced if there are certain levels of ownership changes between the deduction and the loss year—this does not apply for GCT purposes, although a pro-forma IRC section 382 limitation might apply.

Capital Losses

Net capital losses are deductible in the year incurred for UBT. For GCT purposes, net capital losses can only be carried back or forward for a limited period.

Estimated Tax Payments

The first and last estimated tax installments for UBT are due one month later than for GCT—i.e., April and January for calendar year filers. The first payment for GCT is also a "mandatory first installment" based on 25% of the prior year's tax—and must be paid even if no tax is expected for the current year.

Owners' Credit for Tax Paid

Corporate partners can claim a credit (subject to limitations) against their New York City corporate tax liability for their share of UBT paid by partnerships in which they have an interest. New York City resident individuals and fiduciaries with interests in partnerships or proprietorships are entitled to a similar credit against their city tax. For taxpayers with taxable income of $142,000 or more, the credit is limited to 23% of the UBT.

New York City resident shareholders of S corporations can claim a credit for their share of the GCT, but the credit begins to phase out when their taxable income exceeds $35,000 and is reduced to zero when taxable income is $100,000 or more.

Deductibility of Tax for New York State

UBT that was deducted in arriving at federal adjusted gross income (on Schedule C, or passed through from a partnership) must be added back by individuals and fiduciaries to determine New York adjusted gross income. No add-back is required for GCT.

Conclusion

Although there are many similarities between the UBT and the GCT, there are a large number of pronounced differences between the two, and these differences can significantly impact a business's New York City tax burden.

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Robert Thee, CPA, *is tax director at Gettry Marcus CPA, P.C. He has been in tax practice for over 35 years, working extensively in consulting and compliance for partnerships/LLCs in a broad range of industries. A member of the AICPA and NYSSCPA, Robert has lectured frequently for FAE, and has been actively involved on several tax committees. He currently serves on the Partnerships and LLCs Committee. Robert holds a BBA in Accounting and an MS in Taxation from Baruch College. He can be reached at rthee@gettrymarcus.com.*