State Tax Observations

Employees Telecommuting Due to COVID-19 Create Potential NYC Unincorporated Business Tax Savings Opportunity

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New York City (NYC) imposes unique taxes that often surprise NYC business owners. These include the Commercial Rent Tax and Real Property Transfer Tax. Perhaps, a more significant tax is the NYC Unincorporated Business Tax (UBT).

The UBT is a tax on partnerships and LLCs that have not elected to be treated as corporations, as well as sole proprietorships that conduct business in NYC. The tax rate is 4% of income allocated to NYC.

As in so many aspects of our existence, COVID-19 is impacting the UBT. The pandemic has altered the day-to-day operations of many businesses and their employees. Specifically, a high percentage of NYC-based employees are still temporarily working remotely at locations outside NYC. They are uncertain when they will return to their NYC offices. In fact, for some, the shift to remote locations may be permanent.

Where are services being performed in this pandemic? Critically, unless employees went back to their NYC locations, it is the location from which they are telecommuting. And working remotely often reduces the UBT for NYC businesses.

For service companies specifically, telecommuting employees performing services outside of NYC, can trigger a lower UBT allocation. In turn, this will lower the service companies' UBT.

Who Can Benefit?

Examples of service businesses that can benefit include:

- Accounting firms
- Law firms
- Private equity and hedge fund management companies structured as a limited partnership or an LLC
- Consulting firms and other service companies

How Does the Tax Savings Opportunity Work?

For UBT purposes, income is allocated based on a single receipts factor. For service companies, receipts are sourced based on where services are performed – not based on where the client is located, not based on where the business is paying rent or owns a building, and not based on where the company is headquartered. Thus, the numerator of the receipts factor is receipts earned from the performance of services in NYC. The denominator contains total receipts.

Take the example of a law firm partnership with 20 employees and $3 million of net income in 2019. Pre-COVID, all of its employees worked in its downtown Manhattan office. Its NYC UBT receipts factor was 100%. Thus, all of the firm's income was subject to the UBT. At the 4% tax rate, its UBT was $120,000.

Since the pandemic, the firm is fortunately expecting income to match its prior year, but 60% of its services are now performed by employees working, for example, at home in Sag Harbor, at a summer home in the Hamptons, in a newly rented home on the Jersey Shore, or an apartment in Stamford, CT. In 2020, only 40% of the law firm's receipts will be allocated to NYC. Its 2020 UBT will be $48,000 ($3 million X 40% X 4%).

The UBT savings from employees telecommuting will be a significant $72,000.

Proving Your Case

If your company wants to take advantage of reducing its UBT burden due to pandemic telecommuting, it must maintain adequate records. The burden of proof in a UBT examination is on the taxpayer.

Employers need an HR policy to determine employee work locations. The company also has to decide who will be documenting this information – the HR department or the employees themselves? Also, exactly how do you document it?

Clients may be able to use their existing time sheet software, or may need modifications to their IT systems. Cell phone data, tracking software (used by individuals for residency audit purposes) may be useful. In any event, employee locations may prove to be a focus of future UBT tax exams.

Other Considerations

NYC UBT filers should be aware that the opportunity does not apply to sellers of tangible personal property. Nor does the opportunity apply to NYC service corporations which are subject to the NYC General Corporation Tax as that tax is based on market-based sourcing.

For partnerships and LLCs, if employees are working remotely from new jurisdictions, could that create nexus and thus a new income tax filing obligation? Does it create a withholding tax and unemployment registration and filing obligation? Can working remotely result in a new state in which personal income could be sourced? Lastly, can an individual spending time in a state which is not his or her domicile be deemed a resident of the state in which he or she is working in remotely?

Some of these questions are answered in our prior article. Others are still being addressed by the states.

Next Steps for UBT Savings

Back to the UBT. We are more than halfway through 2020 and four months into the pandemic. If your company is subject to the UBT, you should be implementing best practices now. Compare the additional cost of compliance and the administrative burden to the potential tax savings in making the decision to allocate. Be aware that the opportunity is not one-size-fits-all. We are here to help you address the specifics of your situation.

Contact Us

For further questions concerning these issues or if you have state or city tax questions generally, contact:

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