

## NYC Small Business Tax Obligations by the Neighborhood Entrepreneur Law Project (NELP)

In the United States, there are a number of taxes that most small businesses are subject to. This guide provides a brief overview of the most common taxes that New York City-based small businesses must typically pay. You'll find that the types of taxes you must pay as a small business owner and entrepreneur will vary depending on how your business operates.

The information below is designed to provide you with a general overview and understanding of some of the taxes your small business may be subject to and is not intended to provide tax advice. Therefore, we encourage you to seek further assistance from a tax professional to discuss your specific situation and needs.

### Basic Regulatory Structure

Let's start off by examining the government agencies that regulate the tax system. Most of us are familiar with the [Internal Revenue Service](#) (IRS), which is the branch of the federal government that enforces federal tax laws.

For New York City businesses, there are two other agencies that are equally important: the [New York State Department of Taxation and Finance](#) (the "State") and the [New York City Department of Finance](#) (the "City"). These agencies enforce the tax laws of New York State and New York City, respectively.

Now, let's examine five common types of taxes that apply to small businesses operating in New York City:

1. Income Tax
2. Corporate Franchise Tax
3. Self-Employment Tax (including estimated tax)
4. Sales Tax
5. Real Property Tax

Because the tax system is complex, we have created two hypothetical small businesses so we can see how these tax concepts are applied. Meet Alice and Jake – fictional entrepreneurs grappling with some common small business tax issues.



Alice is the sole owner of a small boutique in Manhattan called **Baubles of Fun, Inc.**, where she sells costume jewelry and accessories. She rents a storefront and has no employees. Her business is set up as a corporation under the laws of New York State.

Jake is a personal fitness trainer. He doesn't have any employees and provides his services at his clients' homes, so he doesn't maintain a commercial space. Jake set up his business as an LLC under the laws of New York State and named his business **Be Fit with Jake, LLC**.

## 1. Income Tax

**Income tax**, the most well-known form of taxation that small businesses are subject to, is the tax that an entity pays based on the income it earns. Generally, businesses are required to pay income tax to federal, state, and local taxing authorities.

In general, all corporations are classified under the federal tax code by default as C corporations. In a C corporation, there are two levels of taxation. The corporation itself must pay income tax, and all of the owners of the corporation must pay income tax on any income they receive from the corporation by way of shared profits or dividends. In a small corporation, like our hypothetical business Baubles of Fun Inc., Alice is the sole owner and derives her income from that business. The income she earns through the business could be taxed twice by the taxing agencies – first when the business reports its income and secondly when Alice reports the income earned from the business on her personal income tax returns. This is called double taxation and it means that Alice would have less take-home income.

To avoid double taxation, Alice has made a tax filing called the S election. By filing federal *and* state S elections, Alice has informed the IRS and the State that she wants her corporation to be treated as a subchapter S corporation (S Corp). An S Corp does not pay federal or state taxes on the income it generates – instead, all of its profits and losses flow through to the owners of the corporation who then report this information on their personal income tax returns. This is called flow-through taxation. As a result, for federal and state tax purposes, the income generated by the corporation will only be taxed once which, in Alice’s case, is when she files and pays her personal income taxes.

**Note:** The City does not recognize the S Corp election – so, the S Corp will still have to pay a corporate level income tax to the City.

Jake also decided to form a type of business entity to help him avoid the double taxation of a traditional corporation and offer flow-through taxation similar to that of an S Corp. He, however, formed a Limited Liability Company (LLC). An LLC with only one owner/member is known as a single-member LLC and is considered a disregarded entity for federal and state income tax purposes. So, Jake’s LLC is considered a disregarded entity by federal and state taxing authorities and therefore, any income generated by the LLC will be reported on Jake’s personal income taxes and taxed only once at Jake’s personal income tax level.

**Note:** The City imposes an entity level tax called the “unincorporated business tax (UBT)” on sole proprietors and disregarded entities, which includes single-member LLCs operating in New York City with gross receipts over \$95,000.



### **Baubles of Fun, Inc.:**

As an S Corp, Baubles of Fun does not pay federal or state income tax on its earnings; instead, Alice will report information about the corporation’s profits and losses on her personal income tax return. Although the S Corp is exempt from federal and state income tax, the business will have to pay income tax to New York City.

### **Be Fit with Jake, LLC:**

As an LLC, Be Fit with Jake does not pay federal or state income tax on its earnings, instead Jake will report information about the LLC’s profits and losses on his personal tax return and, since Jake is the only member of his LLC, the business will not be subject to the New York City UBT, unless it has gross receipts over \$95,000 for the year.

## 2. Corporate Franchise Tax

The [corporate franchise tax](#) is assessed by New York State for the privilege of doing business in New York. Although it is called a franchise tax, the business does not have to be a franchise in order to be subject to the tax.

New York State uses a [formula](#) based on the highest of three tax bases to calculate how much corporate franchise tax an entity owes. These tax bases are 1) business income, 2) capital, and 3) a fixed dollar minimum tax. See the New York State [website](#) for more information on the formulas used as well as the minimum tax rates.

Corporations that have filed the S Corp election both federally *and* in New York State can bypass the income-based calculations and pay a fixed dollar minimum tax for the corporate franchise tax.

As mentioned earlier, LLC's are treated differently from corporations and are disregarded entities for federal and state tax purposes. Therefore, they do not have to pay a corporate franchise tax, although they do have to pay an annual filing fee.



### **Baubles of Fun, Inc.:**

As an S Corp, Baubles of Fun is subject to paying a fixed minimum tax amount for the corporate franchise tax based on its New York State receipts.

### **Be Fit with Jake, LLC:**

Because Be Fit with Jake is a single-member LLC, it is disregarded for tax purposes and treated as a sole proprietorship, which does not have to pay the corporate franchise tax. Instead, it is subject to an annual filing fee.

## 3. Self-Employment Tax & Estimated Quarterly Taxes

The **self-employment tax** is a federal tax that consists of Social Security and Medicare taxes, primarily for individuals who work for themselves.

**Note:** The self-employment tax is not a tax paid by the business; instead it is paid by the entrepreneur who operates the business. So, with regard to our two hypothetical businesses, the self-employment taxes would have to be paid by Alice and Jake personally and not by their businesses. Generally, an entrepreneur is required to pay self-employment tax if his or her net earnings from self-employment exceed \$400. However, it is important to note that self-employment tax is not the same as personal income tax.

Income taxes must be paid as income is earned or received during the year. Employers typically withhold these taxes. However, when you are self-employed, you must make estimated tax payments. For the self-employed entrepreneur, self-employment taxes are often paid along with **estimated quarterly personal income tax payments**. To calculate your estimated taxes, you must determine your expected adjusted gross income, taxable income, taxes, deductions, and credits for the year. For purposes of determining your estimated taxes, the year is divided into four payment periods, or quarters.



**Baubles of Fun, Inc.:**

As the sole owner of her S Corp, Alice is considered a self-employed business owner and does not withhold taxes from the income she earns from the business. As such, she must calculate her earnings (along with any deductions or credits) at least every three months in order to make her quarterly tax payments. When she calculates her personal income taxes, she also will need to calculate how much she owes for self-employment tax and make the proper payments to the IRS and the State taxing authorities.

**Be Fit with Jake, LLC:**

As a single-member LLC, Jake considers himself a self-employed business owner and, as such, he does not withhold taxes on the income he earns from the business. Like Alice, Jake will also need to figure out his quarterly earnings and deductions along with the amount he owes to cover his personal income tax and self-employment tax to make the proper payments to the IRS and State.

**4. Sales Tax**

The fourth type of tax which businesses should be aware of is the **sales tax**. Both New York State and New York City require that certain types of businesses, such as those that sell tangible goods (and certain service related businesses), collect sales tax from their customers at the point of sale. The businesses must then pay the taxes that they have collected to the State. Businesses that are required to collect sales tax must [register](#) with the State as a sales tax vendor and receive a Certificate of Authority before making any sales and collecting sales tax.

Registered sales tax vendors must keep a record of all sales made and all sales tax collected, and then must file a sales tax return annually, quarterly, or monthly. The frequency of the filing depends on the type of business activity that the business is engaged in and how it is classified by the State. Regular and timely sales tax returns must be made even if the business did not make sales and collect sales tax during a specific reporting period. For more information on sales tax in New York State, see [Publication 750: A Guide to Sales Tax in New York State](#).



**Baubles of Fun, Inc.:**

Since Baubles of Fun sells tangible personal goods, specifically jewelry, the business is required to collect state and local sales tax and follow all of the requirements imposed on sales tax vendors.

**Be Fit with Jake, LLC:**

Since Jake's business is a service business, specifically one that involves the sale of his services as a personal fitness trainer, Be Fit with Jake is not required to collect sales tax on services sold.

## 5. Real Property Taxes

The final type of tax to be considered is the **real property tax**. Commercial tenants in New York City are typically required to pay a portion of the real property taxes for the building in which their leased space is located. This is not a legal requirement. However, it is a customary practice in New York City which is often included in commercial leases.

A commercial tenant's contribution to real property taxes should correlate to the amount of space the business occupies in the building. Before signing a lease, it would be wise to negotiate for the right to see statements from the New York State Department of Taxation and Finance to ensure that you are paying your fair share of property taxes.



### **Baubles of Fun, Inc.:**

Alice's business occupies the ground floor of a three-story building. The lease states that the business is responsible for 1/3 of the building's property taxes. This seems like a fair distribution of property tax liability.

### **Be Fit with Jake, LLC:**

Jake's business is a service business. Jake travels to his client's homes and offices, and does not have a commercial space. Therefore, the business doesn't have to worry about real property taxes.

## Questions?

Remember, this guide is meant for informational purposes only and does not constitute legal advice. We recommend that you meet with a tax professional to discuss your specific situation and to determine your tax liabilities.

We hope that you found this information helpful and that you will continue to use the resources in the Community Economic Development ([CED](#)) Unit's [Financial Empowerment Hub](#) as they become available.

For more information on starting a business in New York City, you can contact the City Bar Justice Center's Neighborhood Entrepreneur Law Project (NELP) and register for a free appointment at one of our legal clinics where you can speak with an attorney about your particular small business matter. To learn more about NELP's services or our upcoming events, including legal clinics and presentations, please visit our [webpage](#). To learn more about other opportunities and resources for entrepreneurs in New York City, like us and follow us on [Facebook](#).

**Contact NELP :** Phone: 212-382-6633    Email: [nelp@nycbar.org](mailto:nelp@nycbar.org)    Website: [www.bit.ly/nelpcbjc](http://www.bit.ly/nelpcbjc)

To learn more about the CED Unit and access our resources, please click [here](#).

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