



Testimony of Deputy Commissioner Michael Hyman,
NYC Department of Finance

On the Effect of the Unincorporated Business Tax on
Freelancers and Sole Proprietors

Before the City Council
Committee on Small Business
April 28, 2009

Good morning Chairman Yassky and members of the Committee on Small Business. I am Michael Hyman, Deputy Commissioner for Tax Audit, Policy and Enforcement at New York City's Department of Finance. On behalf of Commissioner Martha E. Stark, I want to thank you for inviting us to testify today at this oversight hearing on the City's Unincorporated Business Tax (or UBT) and how it affects freelancers and sole proprietors. I am joined today by Francesco Brindisi, Vice President at the Economic Development Corporation (EDC) and Andrew Eisner, Director of Tax Law in Finance's Legal Affairs Division.

First, I want to underscore that the Bloomberg Administration recognizes the central role that freelancers will play in revitalizing our City's economy, through this belt-tightening recession. We know that some of the greatest innovations of American commerce and industry often started with the bright ideas of individuals working for themselves --- And in tough economic times, it's government's role to support the innovations provided by small business people like those joining us here today.

In my testimony, I will do three things: first, I'll give an overview of the Unincorporated Business Tax, which is not well understood. Second, I'll review two legislative reforms of UBT that the Bloomberg Administration and the Council promoted in 2007. And third and finally, I'll end with the good news: describing the

details of an important UBT initiative the Bloomberg Administration will pursue in this State legislative session. If passed, this new legislation will significantly reduce or end the "double-taxation" of freelancers and independent workers who now pay both the UBT and the City's Personal Income Tax.

Unincorporated Business Tax Overview

First, by way of background, the Unincorporated Business Tax is one of four different business income taxes that the City collects. As its name implies, the Unincorporated Business Tax applies to unincorporated businesses -- such as partnerships, limited liability companies and, of course, sole proprietors.

In Tax Year 2007, the latest year for which we have data, 22,000 individual proprietors and 11,000 partnerships and limited liability companies paid the tax. The UBT with a tax rate of 4 percent imposed on City taxable income, will bring in an estimated \$1.7 billion in revenue this year. Of this amount, individual proprietors will pay less than \$200 million.

It may be helpful to give some more context. It is often said that the City's economy should be more diverse, and that the City's fiscal fortunes are too closely tied to Wall Street and real estate. While it's true that the City has relied heavily on these sectors, , we actually have a far more diverse base than many other cities - and, until last year's downturn, one that has been growing steadily for the seven preceding years.

Business income taxes are an important part of our revenue base that funds much needed public services - and the Unincorporated Business Tax helps ensure that business income taxes - an inherently volatile revenue source - remain relatively stable. Across the U.S., an increasing number of firms are organizing as limited liability companies and S-corporations to avoid paying corporate income taxes. The nationwide decline in corporate tax revenues has been unmistakable. National data show that state corporate tax revenues as a percentage of total state taxes has declined from about 10 percent to six percent over the past 25 years. And IRS data shows that half of all business income earned in the US in recent years has been generated by so-called "flow-through" entities -- unincorporated businesses and S-corporations. In New York City, we've been able to buck this trend due in no small part to the fact that our taxes apply to all entity types, including unincorporated business.

Smaller firms, like freelancers and independent workers are also subject to City business taxes. But many are exempt from UBT or pay a relatively small amount. For example, about 60 percent of the 22,000 proprietors who do owe the Unincorporated Business Tax each pay less than \$5,000 in taxes. Individual proprietors receive \$15,000 in exclusions and deductions, and firms owing up to \$1,800 in taxes receive a 100 percent credit that fully offsets the taxes.

Those with tax liabilities between \$1,800 and \$3,200 receive a partial credit. In Tax Year 2007, for example, of the 100,000 proprietors who filed Unincorporated Business Tax returns with the City, more than 78,000 of them owed no taxes because of deductions and credits provided by the tax.

Still, we understand that for those struggling small firms a small tax burden is still a burden. And tax return filing itself can be a burden, or at the very least a nuisance.

The City has raised filing thresholds over the years, relieving many businesses of the responsibility of having to file a tax return. But many people who are not required to file a UBT return still want to do so to be on record as complying with City tax law. We are committed to working with groups such as the Freelancers Union to streamline reporting requirements for those who choose to file even if not legally required to do so.

Recent Changes to the UBT

Mayor Bloomberg advocated a package of business tax reforms back in 2007, and two specific measures brought relief to small businesses subject to the UBT. These measures collectively have already brought \$44 million in small business tax relief in just this current fiscal year.

Thanks to the leadership of Speaker Quinn and Chairman Yassky, the City passed Local Law 35 in 2007 that expanded the City's effort to address the double-tax burden of City residents who pay both the UBT and the City's Personal Income Tax. The UBT credit against the Personal Income Tax was increased by 50 percent, allowing City residents with taxable incomes up to \$42,000 to receive a 100 percent credit against Unincorporated Business Tax liability that flows through to them. The credit phases down to 23 percent for individuals who earn more than \$142,000. The second major change that same year was Chapter 491 of 2007, a State law that, among other provisions, increased the deduction allowed for an unincorporated business's active owners. Because distributions to owners of unincorporated businesses are partly a return on capital to the owners, they're not deductible against UBT taxable income. However, they are also frequently payment for services provided by owners.

Instead of a compensation deduction, the UBT allowed a \$5,000 deduction per active partner or proprietor. This legislation doubled the \$5,000 personal-service deduction to \$10,000, the first increase in the deduction since the UBT was enacted in 1966.

New Albany Legislation

As Commissioner Stark made clear when she testified before this committee back in 2006, there is more that can be done for freelancers and sole-proprietors. So I am pleased today to share

the details of a major small-business tax relief measure being advanced in Albany to address concerns about the UBT expressed by Mayor Bloomberg, Speaker Quinn and many others, a measure that can build on what we were able to achieve two years ago.

The State Legislature will soon see the introduction of legislation to further address double-taxation - which is a concern for freelancers. That is, many small businesses paying the UBT are run by individuals who are also New York City residents, and so they are subject to the New York City Personal Income Tax on the same income. This legislation will provide tax relief to half of the total population of firms paying the UBT by effectively exempting nearly 11,000 of them - those with taxable incomes of \$100,000 or less - from the UBT, while providing partial tax relief to an additional 6,000 businesses with taxable incomes between \$100,000 and \$150,000.

About 80 percent of the 17,000 businesses affected by this legislative proposal are sole-proprietorships. If enacted, the reform would take effect during the current tax year.

Let me conclude by saying again that we're grateful for the important contributions freelancers and independent workers make to our City - and we know that they'll be central in our next resurgence. Mayor Bloomberg has created a very specific five-borough economic opportunity plan to bring New York City through the current downturn, which includes job training, start-up business-siting and seed funding. The new UBT tax relief legislation

I just described is an important part of this package of initiatives that can and will foster entrepreneurship.

The active support of freelance workers and the Council members who serve on this crucial committee will be critical to seeing this bill become law. We look forward to the opportunity of working together with you. Thank you, and we will be happy to answer your questions.