

REVISED INITIAL STATEMENT OF REASONS FOR THE
ADOPTION, REVISION, AND REPEAL OF CERTAIN SECTIONS
OF CALIFORNIA CODE OF REGULATIONS, TITLE 18:

- A. ADOPT REGULATION SECTION 18622-0;
- B. AMEND EXISTING REGULATION SECTIONS 18662-1 THROUGH 18662-8;
- C. REPEAL EXISTING REGULATION SECTION 18662-7 AND RESERVE SECTION FOR
FUTURE USE;
- D. REPEAL EXISTING REGULATION SECTIONS 18662-11 THROUGH 18662-14;
- E. AND AMEND AND RENUMBER REGULATION SECTION 25401b TO REGULATION
SECTION 19002 (CREDIT FOR TAX WITHHELD)

**PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR
CIRCUMSTANCE THAT THE PROPOSED ADOPTION, REVISION, AND REPEAL OF
CERTAIN REGULATIONS ARE INTENDED TO ADDRESS**

California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements. (Revenue and Taxation Code (RTC) section 18662, subdivision (a).) While withholding regulations remain in effect (California Code of Regulations, Title 18, Regulation (CCR) sections 18662-1 through 18662-14), these regulations have not been updated in over 20 years. During this period, a number of new withholding laws were enacted. As a result, the current withholding regulations do not reflect the statutory changes that have been made as a result of the enactment of more recent withholding laws.

The proposed regulations conform to current withholding laws and existing Franchise Tax Board withholding procedures. The proposed withholding regulations are being promulgated to create a comprehensive set of procedural regulations that cover the Franchise Tax Board's existing withholding processes, excepting those processes specifically identified as not included in the regulations.

Withholding at source is an essential part of the Franchise Tax Board's Tax Gap Compliance Initiative. The ultimate goal of withholding is to facilitate fair and efficient tax compliance and administration by requiring payers to remit a portion of payments due to payees directly to Franchise Tax Board to pay amounts approximating the tax due with respect to the income from the payment. Thus, withholding at source benefits the state by reducing the risk that the income and resulting tax will not be reported and paid, and encouraging the filing of returns to report taxable income and claim credit for the withheld amounts.

NECESSITY

California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements. (RTC section 18662, subdivision (a).) While withholding regulations remain in effect (CCR sections 18662-1 through 18662-14), these regulations have not been updated in over 20 years.

The current withholding regulations do not reflect the changes that have been made as a result of enactment of more recent withholding laws. For example, statutory changes such as the addition of withholding on real estate transactions, the adoption of an alternative real estate withholding election, the inclusion of nonresident partnership withholding, and the use of different types of business entities, especially pass-through entities, are not addressed in the existing regulations. The current regulations are also not organized in a useful framework, given the number of legislative amendments and new statutes that have been adopted since the current regulations went into effect, and given the new processes adopted by Franchise Tax Board staff.

This rulemaking action is necessary because the existing withholding regulations are not well-suited to piecemeal amendment but instead require a complete reorganization and restructuring. The new withholding regulations are designed to provide guidance consistent with the current statutory framework, reflect Franchise Tax Board's current administrative practices and procedures, and reflect changes determined to be necessary or desirable after consulting with taxpayers, tax practitioners, and other parties at the interested parties meetings held August 13, 2007, and July 14, 2011.

Beginning in 2008, Franchise Tax Board staff implemented a new quarterly withholding process, which changed due dates to report and remit withholding to match the estimated tax due date schedule, and required withholding agents to identify taxpayers for immediate posting of the credit to the taxpayers' accounts. In 2008 and 2009, the Legislature adopted amendments to the real estate withholding statute (Stats. 2008, ch. 305), changed the withholding requirements regarding real estate installment sales (Stats. 2008, ch. 305), changed the maximum withholding rate (Stats. 2009, 4th Ex. Sess, ch.16), and enacted legislation dealing with modified backup withholding (Stats. 2009, 4rd Ex. Sess, ch.16).

Since 2007, Franchise Tax Board staff has been working on the Withhold at Source System Project (WASS), a modernization project designed to integrate the Franchise Tax Board's withholding system into its other systems, implement greater security, and provide greater transparency for taxpayers subject to withholding. For the past four years of its development, Franchise Tax Board staff has further refined the proposed regulations to ensure consistency with the new statutes, the WASS project forms and practices, and other departmental changes (such as electronic banking and file processing) into the withholding process.

Accordingly, the Franchise Tax Board proposes to adopt, amend, repeal, and/or renumber the current withholding regulations in order to comprehensively replace the existing procedural rules with improved regulations that consistently, clearly, and fully describe Franchise Tax Board's current withholding processes in a structurally integrated and logical framework. In this way, the Franchise Tax Board intends to provide additional clarity and transparency for taxpayers, tax practitioners, withholding agents, and the public.

The regulations are rewritten and reorganized into a simpler, more descriptive order. For example, the regulations contain a Table of Contents, definitions, and rules applicable to all withholding at source. The regulations then provide specific guidance for major withholding areas that Franchise Tax Board administers (e.g., real estate withholding, nonresident withholding, nonresident independent contractors, entertainers, athletes, and pass-through entities), provide guidance on different types of California source income, set forth reporting and remitting obligations and penalties, as well as identifying the specific contents of relevant forms, and provide rules for the crediting of withheld amounts.

SPECIFIC PURPOSE OF EACH PROPOSED SECTION

§ 18662-0. Table of Contents.

Purpose and Scope: The table of contents is intended to assist withholding agents, taxpayers, and the public to quickly locate the appropriate regulations for their specific need.

§ 18662-1. Withholding – Generally.

Purpose and Scope: This section provides a general overview of the regulations. Specifically, subsection (a) provides that the regulations being adopted and amended apply to California's withholding at source programs excepting the following withholding programs: wage withholding (administered by the Employment Development Department); withholding orders for delinquent taxes; withholding on foreign (non-U.S.) partners and members (California law conforms to federal law in this area and federal regulations and procedures apply); California's backup withholding as required by RTC section 18664 (enacted in 2009 and operative in 2010); and the Interagency Intercept Program under Government Code section 12419.5.

Subsection (b) explains that under RTC section 18661, et. seq., withholding at source is required from all payments of California source income and from the sale of California real estate, unless specific identified exceptions apply. This subsection provides general withholding rules relating to California source income and real estate withholding, and cross-references to withholding subsections being adopted or amended.

Subsection (c) explains that even if an exception applies, withholding may nevertheless be required if the FTB has specifically notified the withholding agent in writing to withhold. After such written notification, this subsection also identifies the specific contents of the relevant forms to be used to submit required information and accompany payments. Finally, this subsection contains an example of who can be a withholding agent.

Subsection (d) identifies the specific contents of the information form required to be filed by the withholding agent, including but not limited to, the withholding agent's

and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (e) identifies the specific contents of the payment voucher required to be filed by the withholding agent, including but not limited to, withholding agent's information, amount of payment submitted with the form, total number of payees reported on the form, and an indication of whether the method of submission is electronic or paper.

§ 18662-2. Definitions.

Purpose and Scope: This section provides definitions of the following terms as used in the proposed regulations – Buyer, California business entity, California real estate, California resident, California trust or estate, exempt organization, individual, items of income, Non-California business entity, Nonresident, Nonresident alien, Nonresident estate or trust, Owner of a pass-through entity (reserved), Partner, Partnership, Pass-through entity (reserved), Payee, Payer, Permanent place of business, Person, Real estate escrow person, Seller, Transferee, Transferor, and Withholding agent. These definitions are necessary to ensure consistency of terms within the individual related regulations, and some of these terms are specifically defined in the Revenue and Taxation Code, while others are defined in this regulation.

§ 18662-3. Real Estate Withholding.

Purpose and Scope: This section explains the real estate withholding requirements enacted in 2002 and modified in 2006, 2008, and 2009. Generally, the regulation follows and summarizes existing statutory requirements and administrative practice, as well as identifying the specific contents of relevant forms relating to real estate withholding.

Subsection (a) specifies the form and manner by which a seller may use the alternative withholding calculation, specifies the provisions under which no withholding is required under the provisions of Revenue and Taxation Code section 18662(e)(3), specifies the form and manner by which a withholding of tax may be exempted, and provides an example of certain available exemptions. This subsection also identifies the specific required contents of the alternative withholding calculation which may be elected, the required specific contents of the exemption from withholding certificate which may be filed under certain circumstances, and that the Franchise Tax Board has the authority to audit escrow documents to ensure compliance.

Subsection (b) identifies the statutory rates of withholding, as well as an alternative withholding calculation that a taxpayer may elect to have withholding based upon the

gain required to be recognized on the sale. This subsection also identifies the specific required contents of the alternative withholding calculation which may be elected.

Subsection (c) identifies the required notice that the real estate escrow person must provide to the buyer, as specified in Revenue and Taxation Code section 18668, subdivision (e)(1). This subsection also specifies the statutory penalty for failing to provide such notice, which is the greater of \$500 or 10 percent of the amount required to be withheld, unless reasonable cause applies. This subsection identifies the circumstances under which the real estate escrow person (withholding agent) may assist the buyer in complying with the withholding requirements, and identifies the specific contents of the information form required to be filed by the withholding agent, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments. Finally, this subsection identifies the specific contents of the payment voucher required to be filed by the withholding agent, including but not limited to, withholding agent's information, amount of payment submitted with the form, total number of payees reported on the form, and an indication of whether the method of submission is electronic or paper, and summarizes the statutory authorization for the withholding agent to charge a fee for such assistance.

Subsection (d) identifies the available statutory exemptions from withholding, and further identifies the required specific contents of the exemption from withholding certificate which may be filed under certain circumstances. These exemption circumstances include situations where the seller is a corporation or a partnership that is organized or qualified to do business in California, the total sales price is \$100,000 or less, the transaction is treated as a deferred exchange for income tax purposes, the trustee acquires real property under a foreclosure sale, where a bank is acting as a trustee, where the real property being sold is the principal residence of the seller under applicable income tax law, where the property has been involuntarily converted within the meaning of Internal Revenue Code section 1033 and the seller intends to replace the property with qualified replacement property within the required time period, where the seller certifies that there will either be a tax loss or zero gain on the sale, where the seller certifies that the disposition will be treated as a deferred recognition transaction under either Internal Revenue Code section 351 (for contributions to corporations) or 721 (for contributions to partnerships), where the seller is a corporation (including a limited liability company taxable as a corporation) that has either qualified to do business in or has a permanent place of business in California, the seller is a real estate investment trust (REIT) that has a permanent place of business in California, the seller is a partnership (including a limited liability company taxable as a partnership) that has either qualified to do business in or was organized in California, where the seller is a tax-exempt entity under California or federal law, where the seller is an insurance company under the California Constitution, or certain other entities such as pension plans or individual

retirement accounts. This subsection further identifies certain transactions where withholding will occur on a partial or ongoing basis, such as like-kind exchanges that qualify under Internal Revenue Code section 1031 or installment sales that qualify under Internal Revenue Code section 453. In the case of like-kind exchanges, the seller is required to provide certain identified information in order to partially exempt the sale from withholding, while in the case of installment sales, the buyer is required to provide certain identified information and commit to withhold as principal payments are made on the installment note.

Subsection (e) provides the rules for withholding on special entities, such as grantor trusts, other trusts, bankruptcy trusts and estates, decedent's estates, conservatorships and receiverships, and relocation companies. This subsection also identifies required information that must be filed with the Franchise Tax Board in situations where the special entity wishes to request an exemption or waiver to withholding. Finally, this subsection contains examples of when a relocation company will be required to withhold.

Subsection (f) sets forth the procedures governing the filing of exemption certificates, retention of such exemption certificates, circumstances where the real estate escrow person (withholding agent) may rely upon an exemption certificate in good faith without further verification, and the requirements for electing the alternative withholding calculation identified in subsection (a). This subsection also contains examples illustrating when a withholding agent will be treated as having acted in good faith under this regulation.

Subsection (g) contains special rules applicable to the sale of multiple family units (such as duplexes, triplexes, or apartment buildings), circumstances where there are multiple sellers, circumstances where there is a nominal seller on the title for incidental purposes only, when sales of multiple parcels will be aggregated, sales of leasehold interests and options, sales where personal property is included as part of the real estate transaction, and short sales. This subsection also contains examples of how to allocate the purchase price between a principal residence portion of a multiple family unit and a rented portion of such unit, how withholding is computed where multiple sellers are involved, circumstances where a nominal seller on title for incidental purposes will be disregarded and not subject to withholding, when sales of multiple parcels will be treated as a single transaction, and allocation between personal property and real property when they are included within the same sales contract.

Subsection (h) identifies the requirements for computing the gain or loss on a sale subject to withholding, including but not limited to, seller or transferor's information (including name and signature), selling price, selling expenses, net amount realized, basis in property, seller or transferor point paid, depreciation, decreases in basis, cost of additions and improvements, adjusted basis, total amount based on the gain on sale election, and total sales price withholding amount.

Subsection (i) identifies the requirements contained in the exemption from withholding certificate, including but not limited to, seller or transferor's information (including name and signature), an indication of the reason the seller/transferor or real estate transaction is exempt from withholding requirements, and an indication of the reason the seller/transferor may partially or fully exempt the sale from withholding requirements.

Subsection (j) identifies the requirements contained in the information statement required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the seller or transferor's information (including name and signature), escrow or exchange information, and the amount withheld from the seller or transferor.

Subsection (k) identifies the requirements contained in the payment voucher required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the total number of payees, the amount of payment and an indication of how the information statement under subsection (j) was submitted (paper or electronic).

Subsection (l) identifies the requirements contained in the buyer's agreement to withhold in the case of certain installment sales, including but not limited to, the buyer's information (including name and signature), the seller or transferor's information, and the installment agreement terms.

§ 18662-4. Withholding on Payments (Nonresident Individuals and Non-California Business Entities) – General.

Purpose and Scope: This section provides general rules applicable to withholding on payments (nonresident individuals and non-California business entities), as well as identifying the specific contents of relevant forms relating to withholding on such payments.

Subsection (a) identifies the general rule that withholding on payments is only applicable to non-resident individuals and non-California business entities. This subsection provides an optional de minimis rule whereby withholding is optional and at the discretion of the withholding agent on the first \$1,500 of income paid for the calendar year. This subsection also provides the current 7 percent nonresident withholding rate on gross payments or distributions, and provides certain cross-references.

Subsection (b) provides that withholding is optional by the withholding agent on payments of California source income to California residents, California business entities (including entities treated as a California business entity when included on a combined report with another California business entity), tax exempt organizations, California estates and trusts, banks and banking associations, sales of goods, services of a nonresident performed outside California, income from intangible personal property, payments to interstate motor carriers, employee wages, payments

of otherwise California source income to nonresident corporate directors, gross premiums paid to insurance companies, and payments of income from qualifying investment securities (within the meaning of Revenue and Taxation Code section 17955 and 23040.1). This subsection also contains examples relating to certification of residency status and how withholding agents may determine whether a business entity will be treated as a California business entity.

Subsection (c) identifies the certification requirements applicable to payees in establishing their exemption from withholding, and the requirements applicable to withholding agents in verifying a continuing exemption. This subsection also identifies what an exemption certificate must contain in order for a withholding agent to accept it as not being incomplete or invalid, or when the withholding agent may accept a substitute exemption certificate from the payee. This subsection specifies how long the withholding agent must retain an exemption certificate, and the penalties applicable to a withholding agent who knowingly accepts a false exemption certificate.

Subsection (d) specifies the form and manner by which a withholding agent who withholds tax at source may also be required to file an information return, including circumstances where the return may be filed electronically or filed together in a single document.

Subsection (e) specifies the form and manner by which a request for waiver from the withholding requirements can be made, as well as the requirements that apply to such waivers, and also the form and manner by which a request for reduction of the withholding amount can be made, in order to reflect expenses and costs to justify a reduced withholding amount. This subsection also specifies additional conditions for either waiver or reduced withholding to assure payment, such as bond, deposit, or other reasonable requirements.

Subsection (f) specifies that withholding does not relieve a taxpayer from the statutory obligation to file a California tax return, as provided otherwise in the Revenue and Taxation Code.

Subsection (g) specifies that withholding is still required from payments made to suspended or forfeited corporations if the payer has knowledge, or reason to know, of the suspension or forfeiture.

Subsection (h) identifies the requirements contained in the withholding exemption certificate, including but not limited to, the withholding agent's name (including signature), the payee information, and an indication as to the reason the payee is exempt from the withholding requirements.

Subsection (i) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding

agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (j) identifies the requirements contained in the foreign partner or member annual return, including but not limited to, the withholding agent's information (including name and signature), the payee information, the total number of foreign partners or members, the total tax amount withheld from all payees listed by withholding agent, excluding backup withholding, total backup withholding from all payees listed by withholding agent, total amount of tax withholding and backup withholding (combined), total of prior payments of foreign partners' or member's withholding, overpayment amount, credit to be applied, and refund information (if applicable).

Subsection (k) identifies the requirements contained in the nonresident withholding waiver request, including but not limited to, the withholding agent's information, the requester's information (including name and signature), an indication as to the type of income subject to withholding, payee's information, and an indication as to the reasons for the waiver request.

Subsection (l) identifies the requirements contained in the nonresident reduced withholding request, including but not limited to, the withholding agent's information, the payee's information (including name and signature), an indication as to the type of income subject to withholding, date of service, gross California source payment, withholding agent expenses, and net California source payment.

§ 18662-5. Other Types of Payments and Withholding Obligations.

Purpose and Scope: This section identifies other types of payments and the withholding obligations applicable to such other payments.

Subsection (a) summarizes the general withholding rules applicable to other types of payments (not otherwise covered by Regulation section 18662-4) made to nonresidents, and further summarizes the exemptions and waivers available to such types of payments (as previously described in Regulation section 18662-4). This subsection further identifies the types of payments that are subject to withholding, including payments made for services performed in California, payments received for a covenant not to compete in California, payments releasing a contractual obligation to perform services in California, income from options for performing personal services in California, bonuses paid for services performed in California, income from intangible personal property that has acquired a business situs in California, rent or lease payments where the property is located in California, royalty payments where the property is located in or has acquired a business situs in California, prizes, awards, competitions, contests, game shows, or races performed in California, distributions of California source income to nonresidents, gamblings or winnings won in California, premiums, annuities, emoluments, compensation for services, partnership income or gains, and other fixed or determinable annual or periodic

gains, profits, endorsement income, other types of income, and any other compensation representing California source income, and any other amount of California source income for which a state or federal information return is required to be filed. This subsection discusses how property acquires a business situs in California, including examples, specifies that payments of California source income to nonresident aliens or foreign entities are also subject to withholding, specifies when certain reimbursement expenses may be taken into account in computing the withholding amount, and specifies that withholding is required on the portion of a mixed sale of goods and services that relates to the service portion of such sale.

Subsection (b) specifies that withholding is required on payments to nonresident independent contractors for services performed in California

Subsection (c) specifies that payments to nonresident subcontractors for services performed in California are subject to withholding, including payments made by general contractors to their nonresident subcontractors. This subsection further specifies that payments to California resident contractors are not subject to withholding, and require a withholding agent, when payments are made to more than one contractor, to provide each contractor with either a worksheet to compute the amount of payments that are California source income, or an exemption certificate if the contractor is claiming an exemption from withholding.

Subsection (d) specifies that withholding is required on rent or lease payments made to nonresidents with respect to real or personal property located in California (including machinery, equipment, vehicles, aircraft, land and buildings) where the payments are made in the course of a trade or business and the total payments of California source income, excluding property management fees, exceeds \$1,500 for the calendar year. This subsection also provides examples of when a payment will be considered made in the course of a trade or business, as well as an example illustrating the deduction of property management fees,

Subsection (e) specifies withholding rules applicable to royalty payments to nonresidents, which include payments for the right to use natural resources located in California, including, but not limited to, oil, gas, other minerals, geothermal, and timber, and also payments that represent compensation for services derived from intangible property having a taxable or business situs in California, which include royalty payments related to the use of patents, copyrights, secret processes and formulas, good will, trademarks, franchises, and other like property having a taxable or business situs in California.

Subsection (f) specifies that payments to nonresident corporate directors for director services performed in California are not subject to withholding, including attendance at a board of directors' meeting. This subsection also requires that the nonresident director either files a California tax return or the income is included on a group return filed under Revenue and Taxation Code section 18536, and the entity paying the payments to such nonresident corporate directors must file any applicable information return.

Subsection (g) specifies that withholding is required on payments that represent compensation for services performed in California by a nonresident seminar speaker or expert witness.

Subsection (h) specifies income allocation rules to be used by contractors who are performing services both within and without California, and specifies two acceptable methods that may be used, as well as that other reasonable methods may be used. The two acceptable methods are either allocation by the payer in accordance with the terms of the contract, or use of a nonresident income allocation worksheet, the contents of which are specifically identified in subsection (k), and examples illustrating each method are provided. This subsection further provides that withholding agents may generally rely in good faith upon allocations provided by the payee, with certain enumerated exceptions. This subsection also specifies that allocations can be made based on use of the "duty days" formula applicable to professional athletes under Regulation section 18662-6, and may use the sales and use tax law allocation methods applicable to mixed contracts involving the sale of services and goods, including various special sales and use tax rules related to installation services, designing, consulting, and similar items, repairs, and mandatory maintenance contracts and warranties. Finally, this subsection provides that trustees may rely upon prior year's allocations in the case of determining the allocation of current year distributions.

Subsection (i) identifies the requirements contained in the nonresident withholding waiver request, including but not limited to, the withholding agent's information, the requester's information (including name and signature), an indication as to the type of income subject to withholding, payee's information, and an indication as to the reasons for the waiver request.

Subsection (j) identifies the requirements contained in the nonresident reduced withholding request, including but not limited to, the withholding agent's information, the payee's information (including name and signature), an indication as to the type of income subject to withholding, date of service, gross California source payment, withholding agent expenses, and net California source payment.

Subsection (k) identifies the requirements contained in the nonresident withholding allocation worksheet, including but not limited to, the withholding agent's information, the nonresident payee's information (including name and signature), an indication as to the type of payments, and information with respect to income allocation.

Subsection (l) identifies the requirements contained in the withholding exemption certificate, including but not limited to, the withholding agent's name (including signature), the payee information, and an indication as to the reason the payee is exempt from the withholding requirements.

§ 18662-6. Nonresident Withholding, Entertainers, Athletes and Speakers.

Purpose and Scope: This section provides general rules applicable to withholding on payments to nonresident entertainers, athletes, and speakers for services performed in California.

Subsection (a) specifies that withholding is generally required on payments to nonresident entertainers, athletes and speakers for services performed in California, including actors, bands, boxers, dance teams, orchestras, performers, singers, speakers, sports entertainers and athletes, wrestlers, stage crews, lighting crews, promoters, and talent agents. This subsection specifies that withholding is required even if the contract provides for no withholding from compensation, and that certain reimbursement expenses may be taken into account in computing the withholding amount. This subsection further specifies that withholding is required even if the entertainer is not notified, if the payments are made to a promoter or agent on behalf of the entertainer, and that any exemption is only available to the entertainer performing the services in California, which is illustrated by an example. This subsection further clarifies that withholding is required for payments made to nonresidents who provide sound and light services in California.

Subsection (b) specifies the form and manner by which a request for waiver from the withholding requirements can be made, as well as the requirements that apply to such waivers, and also the form and manner by which a request for reduction of the withholding amount can be made, in order to reflect expenses and costs to justify a reduced withholding amount.

Subsection (c) provides that withholding is optional by the withholding agent on payments to California residents, California business entities, or tax exempt organizations, or where the total payments are less than \$1,500 for the calendar year, services of a nonresident performed outside California, or a withholding waiver has been received from the Franchise Tax Board.

Subsection (d) provides a special rule for circumstances where the entertainment venue mistakenly receives a reduced withholding approval letter or other correspondence from the Franchise Tax Board for a performance not being held at that venue, and requires the venue owner to notify the Franchise Tax Board of the mistake.

Subsection (e) specifies a special rule for circumstances where a withholding agent receives a reduced withholding approval letter or other correspondence from the Franchise Tax Board for a performance that is later canceled, the withholding agent is required to return the letter or other correspondence to the Franchise Tax Board with "Canceled" written on it and an explanation that the performance was canceled and no payment was made to the nonresident entertainer.

Subsection (f) provides special rules applicable to athletes, one specifying the computation of "duty days" and the other specifying how performance and signing bonuses are treated for withholding purposes.

Subsection (g) identifies the requirements contained in the withholding exemption certificate, including but not limited to, the withholding agent's name (including signature), the payee information, and an indication as to the reason the payee is exempt from the withholding requirements.

Subsection (h) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (i) identifies the requirements contained in the nonresident withholding waiver request, including but not limited to, the withholding agent's information, the requester's information (including name and signature), an indication as to the type of income subject to withholding, payee's information, and an indication as to the reasons for the waiver request.

Subsection (j) identifies the requirements contained in the nonresident reduced withholding request, including but not limited to, the withholding agent's information, the payee's information (including name and signature), an indication as to the type of income subject to withholding, date of service, gross California source payment, withholding agent expenses, and net California source payment.

§ 18662-7. [Reserved].

Purpose and Scope: The text of the existing section is repealed and the section is reserved to provide withholding rules for domestic (U.S.) pass-through entities, which rules will be adopted in a future rulemaking action.

§ 18662-8. Reporting and Remitting Amounts Withheld; Penalties and Interest.

Purpose and Scope: This section specifies the reporting procedures for information returns, remitting procedures, quarterly withholding procedures, payment due dates, withholding adjustments, penalties, withholding liabilities, and interest for Regulation sections 18662-1 through 18662-8.

Subsection (a) specifies that the Franchise Tax Board will prescribe the necessary forms containing the information set forth in Regulation sections 18662-1 through 18662-8, and any necessary successor forms, for the reporting and remitting of withholding amounts.

Subsection (b) specifies that withholding on real estate sales is due by the 20th day of the calendar month following the month in which escrow closes, or, in the case of an Internal Revenue Code section 1031 exchange, the 20th day of the calendar month following the month in which the exchange was completed or failed. This subsection further specifies that the required information return may be filed either on paper or electronically, along with any remittance, and that information returns are required to be provided to the payee at the time of sale but not later than January 31st of the following calendar year.

Subsection (c) specifies that withholding on payments of other than real estate sales are due on the same schedule as that required for estimated tax payments, or April 15th, June 15th, September 15th, and January 15th. This subsection further provides that remittances may be made by either paper check or electronically, and in the case of foreign (non-U.S.) partners, the due dates for payments are the same as under federal law. This subsection further specifies that the required information return may be filed either on paper or electronically, along with any remittance, and should include the name and taxpayer identification number of the payee so payments may be properly associated with the correct payee, and an annual information return aggregating all such withholding amounts for a payee are required to be provided to the payee not later than January 31st of the following year. Finally, this subsection specifies that when a withholding agent discovers that an amount was withheld in error, the withholding agent should file the appropriate amended information return or request a refund or credit of the erroneously withheld amount to be paid to the withholding agent or payee, as appropriate, or retained and credited to satisfy future withholding obligations.

Subsection (d) specifies that interest on any withholding not remitted by the due date of such withholding, and various penalties may also apply, including an information return penalty, or a real estate information return penalty. The withholding agent is, in circumstances where the withholding amount is not withheld or remitted, themselves liable for payment of the withholding amount, plus interest and penalties, unless the failure is due to reasonable cause, and may be repaid if the payee files a return and pays the tax that should have been withheld. A special penalty applies to withholding agents who fail to properly notify buyers of their required withholding obligation, and another special penalty applies if sellers are not provided correct copies of the real estate information returns by the withholding agent. Finally, this subsection specifies another special penalty for sellers who knowingly execute a false exemption certificate in a real estate transaction.

Subsection (e) specifies that the Franchise Tax Board will prescribe in writing when other information returns must be provided to either the payee or the Franchise Tax Board.

Subsection (f) provides a special rule regarding how withholding will be allowed as a credit against any tax liability when a group nonresident return is filed under Revenue and Taxation Code section 18534 and 18536.

Subsection (g) identifies the requirements contained in the information statement required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the seller or transferor's information (including name and signature), escrow or exchange information, and the amount withheld from the seller or transferor.

Subsection (h) identifies the requirements contained in the payment voucher required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the total number of payees, the amount of payment and an indication of how the information statement under subsection (g) was submitted (paper or electronic).

Subsection (i) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (j) identifies the requirements contained in the payment voucher required to be filed by the withholding agent, including but not limited to, withholding agent's information, amount of payment submitted with the form, total number of payees reported on the form, and an indication of whether the method of submission is electronic or paper.

Subsection (k) identifies the requirements contained in the foreign partner or member annual return, including but not limited to, the withholding agent's information (including name and signature), the payee information, the total number of foreign partners or members, the total tax amount withheld from all payees listed by withholding agent, excluding backup withholding, total backup withholding from all payees listed by withholding agent, total amount of tax withholding and backup withholding (combined), total of prior payments of foreign partners' or member's withholding, overpayment amount, credit to be applied, and refund information (if applicable).

Subsection (l) identifies the requirements contained in the payment voucher for foreign partner or member withholding, including but not limited to, withholding agent's information, an indication of the beginning and end of the partnership's or LLC's calendar or fiscal year, and the amount of payment submitted.

Subsection (m) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees

listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (n) identifies the requirements contained in the exemption from withholding certificate, including but not limited to, seller or transferor's information (including name and signature), an indication of the reason the seller/transferor or real estate transaction is exempt from withholding requirements, and an indication of the reason the seller/transferor may partially or fully exempt the sale from withholding requirements.

§§ 18662-11 through 18662-14.

These sections are repealed.

§ 19002. Credit for Tax Withheld.

Purpose and Scope: This section amends and renumbers existing Regulation section 25401b to new Regulation section 19002, adding specific guidance for the credit of withholding of payments by pass-through entities, and the date of the credit for withholding.

Subsection (a) specifies that withholding amounts are credited against the tax liability for the same taxable year that the withholding relates to, and are so credited even if the withholding agent has not paid the tax yet to the Franchise Tax Board.

Subsection (b) specifies that in the case of withholding on payments made to pass-through entities, the withheld tax is treated as a pass-through item for the partners or members of the entity according to their ownership interest and claimed on their own tax returns, except that such partners or members may authorize the pass-through entity to instead use some of such amounts as a credit to offset any entity-level tax imposed.

Subsection (c) specifies that in the case of year-end distributions made by a pass-through entity, subject to the authorization of the partners or members of the pass-through entity, payments made after the close of the taxable year may be applied as payments to either the previous taxable year or the following taxable year to the extent those payments represent income required to be included in the partner's or member's return for that respective taxable year.

Subsection (d) specifies that for purposes of computing the applicable statute of limitations on refund claims, the date of all withholding payments is deemed to be the original due date for filing the income tax return. This subsection further specifies that for purposes of computing the estimated tax penalty, the date withholding is credited is deemed to be the date withheld as reflected in the resident and nonresident withholding statement described further in subsection (h), and in the case of individuals, withholding is treated as paid on each applicable estimated tax payment due date, unless the individual elects to have payments treated as paid

on the date withheld. This subsection also specifies that in computing interest and penalties imposed under Revenue and Taxation Code section 18668, withholding payments are credited on the date such payments are remitted to the Franchise Tax Board.

Subsection (e) specifies that certain federal regulations under Internal Revenue Code sections 31 and 6513 are applicable to the crediting of the tax under this regulation.

Subsection (f) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (g) identifies the requirements contained in the information statement required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the seller or transferor's information (including name and signature), escrow or exchange information, and the amount withheld from the seller or transferor.

Subsection (h) identifies the requirements contained in the resident and nonresident withholding statement, including but not limited to, the withholding agent's and payees' information (including name and signature), the number of payees, the types of income being reported, the total tax withheld from all payees listed by withholding agent excluding backup withholding, the total backup withholding from all payees listed by withholding agent, the total amount of tax withholding and backup withholding, and prior payments.

Subsection (i) identifies the requirements contained in the payment voucher required to be filed by the withholding agent, including but not limited to, withholding agent's information, amount of payment submitted with the form, total number of payees reported on the form, and an indication of whether the method of submission is electronic or paper.

Subsection (j) identifies the requirements contained in the payment voucher required to be filed by the withholding agent, including but not limited to, the withholding agent's information, the total number of payees, the amount of payment and an indication of how the information statement under subsection (g) was submitted (paper or electronic).

NONMONETARY AND MONETARY BENEFITS ANTICIPATED FROM THE REGULATORY ACTION, INCLUDING THE BENEFITS OR GOALS OF THE AUTHORIZING STATUTE

Statewide benefits are derived from the withholding statutes, not from the proposed regulations. However, nonmonetary benefits to taxpayers, tax practitioners,

withholding agents, the public, and the state from the proposed regulations include the following:

- The proposed regulations revise outdated withholding regulations and bring the regulations up to current laws and existing withholding procedures.
- The proposed regulations are intended to provide additional clarity and transparency for taxpayers, practitioners, withholding agents, and the public.
- The proposed regulations align with Franchise Tax Board's newly modernized WASS.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS.

The Franchise Tax Board examined and considered the regulatory history of the current regulation sections, the legislative history and amendments to RTC sections 18662 and 19002, forms, instructions, and publications of the Franchise Tax Board, the Withholding at Source Project Feasibility Study Report (www.ftb.ca.gov) interested parties' meetings relating to the proposed regulatory action, public hearing documents, notices, statements of reasons, written comments and responses thereto. The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing the adoption, revision, or repeal of the above sections.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION BY THE PUBLIC THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS. IF REASONABLE ALTERNATIVES WERE PROPOSED AND REJECTED, EXPLAIN THE PROCESS.

In accordance with the requirement of Government Code section 11346.2, subdivision (b)(5), that the Franchise Tax Board consider alternatives to the proposed regulatory action, staff of the Franchise Tax Board conducted two interested parties meetings, described below.

In 2007, Franchise Tax Board staff began its project to revise the outdated withholding regulations. Staff determined that the proposed regulations were outdated and sought public input to bring the regulations up to current withholding laws and Franchise Tax Board procedures. Through interested parties meetings, staff considered the below alternatives and/or mitigation measures.

On June 27, 2007, Franchise Tax Board staff received approval from the three-member Franchise Tax Board to proceed with the first interested parties meeting on the proposed amendments to the withholding regulations. Staff included the first draft of the proposed regulations in the Board materials. Staff explained that it was necessary to begin to revise and update the withholding regulations and to bring them into conformity with then-current law and current withholding practice, in anticipation of the Withholding at Source System modernization system to be implemented over the next four years.

The first interested parties meeting was held on August 13, 2007. The following documents were provided to the public in advance of the meeting: a topic list, an outline of the history of California withholding, the first draft of the proposed regulations, and draft forms and instructions for 2008. Franchise Tax Board staff also invited questions and comments on the draft regulations.

For the Board meeting of November 28, 2007, Franchise Tax Board staff requested permission to proceed with the formal regulatory process, which was granted. The following materials were provided in advance of the meeting: a report of the first interested parties meeting; staff responses to comments received from the public; and the second draft of the proposed regulations showing revisions made as a result of the interested parties meeting.

During 2008 through 2009, the Legislature enacted a number of new laws that substantially changed the withholding requirements. Some of these laws related to real estate installment sales (Stats. 2008, ch. 305), real estate withholding (Stats. 2008, ch. 305), the maximum withholding rate (Stats. 2008, 4th Ex. Sess, ch.16), and backup withholding (Stats. 2009, 4th Ex.Sess, ch. 16). As a result of these new laws, Franchise Tax Board staff prepared a third draft of the proposed regulations.

On July 14, 2011, Franchise Tax Board staff held the second interested parties meeting to solicit input on the third draft of the proposed regulations. Several documents were provided to the public in advance of the meeting: discussion topics; an overview of the purpose and scope of the regulations; revisions since 2007; a cross-reference chart of proposed regulations to existing regulations; and the third draft of the proposed regulations. Staff discussed that it planned to repeal the existing Regulation section 18662-7 and reserve this section for a future interested parties meeting relating to domestic (U.S.) pass-through entities as a separate regulatory action. Staff received comments and encouraged the submission of additional comments for an additional month, through August 12, 2011.

For the Board meeting of December 1, 2011, Franchise Tax Board staff requested permission to proceed with the formal regulatory process, which was granted. The following materials were provided in advance of the meeting: a report of the second interested parties meeting; a detailed response to the comments received and revisions implemented by staff as a result of public comments; and the fourth draft of the proposed regulations showing revisions made as a result of the interested parties meeting.

As a result of the above interested parties meetings, in accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board has determined that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons and businesses than the proposed regulatory action.

ECONOMIC IMPACT ANALYSIS

The nonmonetary and monetary benefits anticipated from the regulatory action are set forth under the topic heading, “Nonmonetary and Monetary Benefits Anticipated from the Regulatory Action, Including Benefits or Goals of the Authorizing Statute.”

Pursuant to Government Code section 11346.3, subdivision (b), the Franchise Tax Board has made the following assessments regarding the proposed regulations:

Creation or Elimination of Jobs Within the State

None. Since the proposed regulations are being revised to comply with current laws and existing withholding procedures, Franchise Tax Board has concluded that no new jobs will be created or eliminated as a result of the adoption of the proposed regulations.

Creation of New or Elimination of Existing Businesses Within the State

None. Since the proposed regulations are being revised to comply with current laws and existing withholding procedures, the Franchise Tax Board has concluded that no business will be created or eliminated as a result of the adoption of the proposed regulations.

Expansion of Businesses or Elimination of Existing Businesses Within the State

None. Since the proposed regulations are being revised to comply with current laws and existing withholding procedures, the Franchise Tax Board has concluded that there will be no effect on the expansion of businesses or the elimination of existing businesses within the state as a result of the adoption of the proposed regulations.

DOES THE REGULATORY ACTION MANDATE THE USE OF SPECIFIC TECHNOLOGIES OR EQUIPMENT?

The proposed regulations do not mandate any specific technologies or equipment.

DOES THE REGULATORY ACTION CONTAIN ONE OR MORE REGULATIONS THAT ARE IDENTICAL TO ONE OR MORE CORRESPONDING FEDERAL REGULATIONS?

The proposed regulation is not a federally-mandated regulation. The proposed regulations do not contain one or more regulations that are identical to one or more corresponding federal regulations.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board estimates that approximately 105,000 businesses will be impacted by the proposed regulations. Of this amount, it is anticipated that approximately ninety percent (90%) of such businesses are small businesses. In

addition, the proposed regulations address the process by which withholding credits are claimed by businesses and individuals on tax returns. Since the proposed regulations are revised to comply with current withholding laws and existing withholding procedures, the Franchise Tax Board has concluded that there is no economic impact on businesses and individuals as a result of the adoption of the proposed regulations.

Facts in support of this initial determination are found under the heading, "Reasonable Alternatives To The Proposed Regulatory Action By The Public That Would Lessen Any Adverse Impact On Affected Private Persons Or Small Business."