

Request for Permission to Proceed with the Formal Regulatory Process to Adopt Proposed California Code of Regulations, Title 18, Section 18662-7, Addressing Domestic Pass-Through Entity Withholding, and to Adopt Proposed Amendments to California Code of Regulations, Title 18, Sections 18662-0 Through 18662-6 and 18662-8, Addressing Withholding, Generally.

Withholding at source is an essential part of the Franchise Tax Board's (FTB) Tax Gap Compliance Initiative. The ultimate goal of this proposed regulatory action is to facilitate fair and efficient tax compliance and administration by requiring domestic pass-through entity withholding agents to remit a portion of a nonresident owner's distributive share of the pass-through entity's California source income directly to FTB to pay amounts approximating the tax due. Thus, this withholding at source would benefit the state by reducing the risk that the income and resulting tax would not be reported and paid, and encouraging the filing of returns to report taxable income and claim credit for the withheld amounts.

Background

California Revenue and Taxation Code (RTC) section 18662 sets forth the general withholding requirements for withholding. RTC section 18662, subdivision (a) provides that FTB may, by regulation, require any person in whatever capacity having the control, receipt, custody, disposal, or payment of items of income, to withhold an amount that reasonably represents the amount of tax due. RTC section 18662, subdivision (b) lists the items of income from which FTB may require withholding, and includes partnership income or gains, and other fixed or determinable annual or periodical gains, profits, and income. The corresponding regulations at California Code of Regulations, Title 18 (18 CCR), sections 18662-0 through 18662-6, and section 18662-8 (Final Regulations) provide specific guidance with respect to California's nonresident and real estate withholding procedures. On October 8, 2019, amendments to the Final Regulations became operative pursuant to Government Code section 11343.4, subdivision (b)(3) (Register 2019, No. 41).

The proposed adoption of 18 CCR section 18662-7 (Proposed Regulation) would provide specific and clear guidance with respect to California's domestic pass-through entity withholding. The proposed amendments to the Final Regulations (Proposed Amendments to the Final Regulations) would include language from the Proposed Regulation relating to domestic pass-through entity withholding to ensure consistency across all of the withholding regulations, among other minor changes.

The current regulations implementing RTC section 18662 require a pass-through entity to withhold tax on distributions of California source income paid in the tax year to a nonresident owner. However, a nonresident owner is taxed on their distributive share of a pass-through entity's California source income in the tax year, whether or not distributions are paid in the tax year. Therefore, California's current requirement for a pass-through entity to withhold tax on distributions paid in the tax year does not effectively withhold an amount that reasonably represents the amount of tax owed by a

nonresident owner of a pass-through entity on their California source income. The Proposed Regulation would address this inefficiency in California's withholding regime by requiring a pass-through entity to withhold tax on a nonresident owner's distributive share of the pass-through entity's California source income in the tax year.

The Proposed Regulation would effectuate the collection of tax owed by a nonresident owner, including but not limited to, a nonresident partner and member under Subchapter K of the Internal Revenue Code (IRC),¹ a nonresident shareholder under Subchapter S of the IRC,² and a nonresident beneficiary of a simple trust under Subchapter J of the IRC.³ Additionally, the Proposed Regulation would update the pass-through entity withholding requirements to be more consistent with a large majority of the states and the Internal Revenue Service's (IRS) foreign partner withholding requirements under IRC section 1446.⁴

The Proposed Regulation would also change the withholding requirements such that a pass-through entity would be required to withhold tax at the nonresident owner's highest marginal tax rate rather than at the current flat 7 percent tax rate. This would increase withholding compliance and encourage the filing of returns to report taxable income, while also update the pass-through entity withholding requirements to be more consistent with a majority of the states and the IRS foreign partner withholding requirements under IRC section 1446.

Finally, the Proposed Regulation would mitigate issues arising from the imposition of late-filing penalties for the late filing of withholding forms in tiered pass-through entity structures. Currently, an upper tier pass-through entity that has been withheld upon is required to file a withholding form before it receives the withholding information necessary to complete the withholding form, often resulting in a late-filed withholding form and the imposition of a late-filing penalty on the upper tier pass-through entity. The Proposed Regulation would mitigate this issue by providing an upper tier pass-through entity with a safe harbor from the imposition of a late-filing penalty when it self-certifies that it is filing the withholding form within thirty days of receiving the withholding information from the lower tier pass-through entity.

The Proposed Amendments to the Final Regulations would provide consistency with the Proposed Regulation, revise the regulatory language to more closely reflect federal language for withholding on foreign partners, and clarify withholding rules relating to trusts and estates.

¹ California conforms to Subchapter K of the IRC at RTC section 17851.

² California conforms to Subchapter S of the IRC at RTC section 23800.

³ California conforms to Subchapter J of the IRC at RTC section 17731.

⁴ At the first IPM, FTB provided the public with a state analysis indicating 33 states with mandatory withholding required withholding on distributive share of pass-through entity income, and only four states, including California, required withholding on distributions paid.

Interested Parties Meetings and Notices⁵

FTB held a first Interested Parties Meeting (IPM) on December 12, 2014 for the public to provide input on requiring a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's California source income rather than on distributions paid to a nonresident owner. Additionally, at the first IPM the FTB solicited feedback on issues which were arising from domestic pass-through entity withholding, particularly relating to the late filing of withholding forms in tiered pass-through entity structures.⁶ The Proposed Regulation would address these topics discussed at the first IPM. Prior to the first IPM, FTB published the following documents: the Meeting Notice and Information; and the Tiered Structure Handout. Following the first IPM, FTB published the Summary of IPM.

The FTB held a second IPM on September 8, 2017 for the public to provide input on the draft text of the Proposed Regulation, which included language which would require a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's California source income. Additionally, it included language creating a new withholding form for pass-through entities which would be due on an annual basis rather than on a quarterly basis, and language which would provide a 10-Day Notification period to address the issue of late filing of withholding forms in tiered pass-through entity structures.⁷ Prior to the second IPM, FTB made the following documents available: Meeting Notice and Information; Draft Language of the Proposed Regulation; Diagrams to illustrate the examples of the Proposed Regulation text; and Explanation and Background for Proposed Adoption of Regulation 18662-7. Following the second IPM, FTB published a Summary of IPM.

After considering public comments, on March 15, 2019 FTB published a Ninety-Day Notice of Proposed Amendments (Ninety-Day Notice) to revise the Proposed Regulation draft language. The revisions to the Proposed Regulation draft language included the deletion of the 10-Day Notification Requirement and the addition of a safe harbor for an upper tier pass-through entity from the imposition of a late-filing penalty when it self-certifies that it is filing the withholding form within 30 days of receiving the withholding information from the lower tier pass-through entity.⁸ In lieu of a third IPM, the FTB provided a 90-day public comment period. FTB published the following documents: the Ninety-Day Notice, Discussion of Amendments; Amended Proposed Regulation Draft Language. After the close of the comment period, FTB considered public comments.

On June 25, 2020, FTB published a Thirty-Day Notice of Proposed Amendments (Thirty-Day Notice) and Proposed Amendments for Thirty-Day Notice to propose additional revisions to the Proposed Regulation, including language specifying an

⁵ All documents made available to the public for each IPM and notice were published on the following website: <https://www.ftb.ca.gov/tax-pros/law/regulatory-activity/index.html>

⁶ Exhibit A.

⁷ Exhibit B.

⁸ Exhibit C.

applicability date of the Proposed Regulation as the first full quarter beginning after the effective date of the Proposed Regulation.⁹ The Proposed Amendments for the Thirty-Day Notice were made available with the Thirty-Day Notice. After the close of the comment period, FTB staff considered public comments.

On June 8, 2021, FTB published a Forty-Five-Day Notice of Proposed Amendments (Forty-Five-Day Notice) and Proposed Regulatory Text for Forty-Five Day Notice, to propose additional revisions to the Proposed Regulation and Proposed Amendments to the Final Regulations. The revisions included a proposed deletion of the applicability date subsection of the Proposed Regulation following FTB staff's determination to prescribe the effective date as January 1st following the filing of the Proposed Regulations with the Secretary of State under Government Code section 11343.4, subdivision (b)(2).¹⁰ Additionally, FTB proposed to amend the Final Regulations for purposes of consistency with the Proposed Regulation. The Proposed Regulatory Text for Forty-Five-Day Notice was made available with the Forty-Five-Day Notice. After the close of the comment period, FTB staff received no public comments and decided to make no further changes to the Proposed Regulation and the Proposed Amendments to the Final Regulations.

Summary and Explanation of Proposed Regulation

The Proposed Regulation (i.e., 18 CCR section 18662-7) is summarized below:

Subsection (a), *General*, provides the general rule which requires a pass-through entity to withhold on behalf of a nonresident owner's distributive share of the pass-through entity's California source income at the highest marginal tax rate. The general rule describes the two most important technical changes made to domestic pass-through entity withholding by the Proposed Regulation: (1) a pass-through entity would be required to withhold on behalf of a nonresident owner's distributive share of the pass through entity's California source income rather than on distributions paid; and (2) the change to withholding rate from a flat 7 percent to the highest marginal tax rate for each nonresident pass-through entity owner.

Subsection (b), *Income From California Sources Subject to Withholding*, provides the applicable 18 CCR sections which determine the nonresident owner's distributive share of a pass-through entity's California source income, which was a clarification requested by the public at the second IPM.

Subsection (c), *Nonresident Owner's Tax Rate of Withholding*, provides the RTC section references for the tax rate applied to each nonresident owner that is required to have income tax withheld. The IRS and a majority of states require a pass-through entity to withhold at the highest marginal tax rate. This subsection is modeled after the law of the majority of states, federal law, and RTC section 18535, which applies the highest marginal tax rate for group returns for nonresident partners, shareholders and

⁹ Exhibit D.

¹⁰ Exhibit E.

members, including amounts treated as if imposed under section 17041, and including the 1 percent mental health tax rate and the additional tax rates imposed by Proposition 30, approved by California voters at the November 2012 election. At the second IPM members of the public requested that the Proposed Regulation provide clear guidance on the applicable tax rate for each payee, and what is included in the tax rate, e.g. the mental health tax. This subsection provides the tax rate of withholding guidance requested by members of the public.

Subsection (d), *Withholding Payment Due Dates*, describes the payment due dates as the federal estimated tax due dates. Although the Form 592-PTE is due on an annual basis, withholding payments are due on the quarterly basis consistent with the federal estimated tax due dates. FTB staff requested public comment on whether the public had concerns with the quarterly withholding payment due dates in the first IPM. Since no specific concerns were raised, FTB staff made no changes to the quarterly withholding payment due dates.

Subsection (e), *Reporting Requirements*, provides the reporting requirements for domestic pass-through entity withholding, particularly for tiered pass-through entity structures. To provide clear guidance, subsection (e) prescribes reporting requirements to FTB, reporting requirements to a payee that has been allocated withholding paid on their behalf, and reporting requirements for a lower tier pass-through entity and an upper tier pass-through entity.

Subsection (f), *Credit for Tax Withheld*, provides guidance on how a nonresident owner that has had income withheld upon, or an owner that has been allocated withholding paid on their behalf can claim the withholding credit on their income or franchise tax return. The public requested at the first and second IPMs that an upper tier pass-through entity be allowed to claim a refund for withholding paid on its behalf. To address the public comments, this subsection provides clear guidance on the law. Although a refund is not allowed for an upper tier pass-through entity, the upper tier pass-through entity that has been withheld upon may use some or all of the withholding credit to satisfy the entity-level income tax under 18 CCR section 19002, subsection (b).

Subsection (g), *Separate Withholding Requirement for Upper Tier Pass-Through Entities*, identifies the separate withholding requirement that may exist for an upper tier pass-through entity that has California source income other than the income that has already been withheld upon. If this is the case, then unlike an upper tier pass-through entity that only allocates withholding paid on its behalf, an upper tier pass-through entity with other California source income not withheld upon is required to withhold tax on behalf of a nonresident owner for such income as a lower tier pass-through entity. With the separate withholding requirement comes the additional requirement to remit withholding payments on a quarterly basis with the Form 592-Q voucher and an additional Form 592-PTE to allocate withholding paid on behalf of a nonresident owner. This subsection provides clear guidance and notice to ensure withholding payment and filing compliance with an upper tier pass-through entity.

Subsection (h), *Penalties and Corresponding Provisions for Relief from the Applicable Penalty Provisions*, lists penalties which may be imposed for failures under the Proposed Regulation to ensure withholding filing compliance. There was a public comment at the second IPM stating it was unclear which penalty applies for each respective failure and suggested explicit language stating the specific penalty that corresponds to each applicable failure. This subsection identifies which penalty corresponds to each respective failure.

Subsection (i), *Examples*, assists the public in understanding the requirements in the Proposed Regulation, particularly with tiered structures and the withholding payment and filing requirements for each tier.

Summary and Explanation of Proposed Amendments to the Final Regulations

The Proposed Amendments to the Final Regulations (i.e., 18 CCR sections 18662-0 through 18662-6, and section 18662-8) are summarized as follows:

Consistency with the Proposed Regulation. A majority of the proposed amendments to the Final Regulations add language relating to domestic pass-through entity withholding from the Proposed Regulation to ensure that all withholding regulations operate together.

Foreign Partner Withholding. Proposed amendments to 18 CCR section 18662-1, subsection (a)(1)(C), 18 CCR section 18662-4, subsection (a), and other Final Regulation language relating to foreign partner withholding add language to more closely reflect the language of the foreign partner withholding rules under RTC section 18666 and IRC section 1446.

Trusts and Estates. Proposed amendments to 18 CCR section 18662-4, subsection (a), relating to trusts and estates, are to provide clear guidance on the withholding rules for trusts and estates.

Request for Permission

FTB staff believes that the Proposed Regulation and Proposed Amendments to the Final Regulations provide appropriate criteria and guidance in implementing RTC section 18662, and now requests permission to commence the formal regulatory process under the Administrative Procedure Act.

Exhibit A

First Interested Parties Meeting Brief Overview Proposed 18 CCR Section 18662-7 Domestic Pass-Through Entity Withholding

FTB held a first IPM on December 12, 2014 for the public to provide input on transitioning from the current requirement for a pass-through entity to withhold on distributions paid to a nonresident owner, to a requirement for a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's California source income. Additionally FTB sought public input on issues arising from pass-through entity withholding, particularly relating to the late filing of withholding forms in tiered pass-through entity structures. The Proposed Regulation would address the issues discussed at the first IPM and provide clear guidance on how a pass-through entity is to withhold on a nonresident owner.

The first issue discussed was a proposal to transition from requiring a pass-through entity to withhold on distributions paid to a nonresident owner to requiring a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's income. FTB staff shared that 33 states require a pass-through entity to withhold on a nonresident owner's distributive share of income rather than on distributions paid, while only four states require withholding on distributions paid. No members of the public indicated any concern with transitioning to requiring withholding on an owner's distributive share rather than on distributions paid.

The second issue discussed was the late filing of withholding forms for tiered pass-through entity structures. Before the implementation of the Final Regulations, a pass-through entity that has withheld from a nonresident owner, or had been withheld upon by a lower tier pass-through entity, was required to file Form 592 on a quarterly basis. This often resulted in an upper tier pass-through entity that had been withheld upon filing a late Form 592 because the upper tier pass-through entity did not receive the necessary withholding information to complete the Form 592 from the lower tier pass-through entity until the Form 592-B due date of January 31st of the following taxable year, after the last Form 592 quarterly due date of January 15th. FTB staff and members of the public discussed two potential solutions: (1) the withholding form could be due annually rather than quarterly, similar to Michigan; and (2) withholding could be required on behalf of a nonresident individual or corporation, but not on behalf of a pass-through entity, similar to New York and Colorado.

The third and fourth issues discussed were whether there were other state pass-through entity withholding rules that could be helpful in resolving issues, and whether there were any concerns or issues with requiring withholding payments on an annual basis versus on a quarterly basis. FTB staff received no public comments as to either issue.

After the first IPM, FTB staff considered public comments in drafting the proposed regulatory language, incorporating and adopting some of the suggestions made by the public, and by FTB staff after further staff review.

The Proposed Regulation draft regulatory language for the September 8, 2017 IPM was in single underline for the insertion of the Proposed Regulation to be adopted.

Exhibit B

Second Interested Parties Meeting
Brief Overview
Proposed 18 CCR Section 18662-7
Domestic Pass-Through Entity Withholding

After the first IPM, FTB staff considered public comments in drafting the Proposed Regulation, incorporating and adopting some of the public comments. FTB held a second IPM on September 8, 2017, and invited the public to provide input on draft text of the Proposed Regulation. The text of the Proposed Regulation aimed to provide clear guidance on how a pass-through entity is to withhold on a nonresident owner while also alleviating the late filing of forms issue in tiered pass-through entity structures. In the second IPM, FTB staff read each subsection of the draft text of the Proposed Regulation aloud, and solicited public comments for each.

This brief overview discusses the draft text that prompted the most comments from members of the public during the second IPM.

Proposed 18 CCR section 18662-7:

- (a) General. A pass-through entity is required to withhold tax on behalf of a nonresident owner in an amount equal to the nonresident owner's tax rate of withholding multiplied by the nonresident owner's distributive share of the pass-through entity's California source income.

Summary: The most important changes made to pass-through entity withholding requirements are found in Proposed 18 CCR section 18662-7, subsection (a). A pass-through entity will be required to withhold on behalf of a nonresident owner's distributive share of the pass-through entity's California source income rather than withhold on distributions paid, and the withholding rate for pass-through entity withholding will be increased from the 7 percent flat rate to the highest marginal tax rate.

Public comment: FTB received no public comments when the general rule for domestic pass-through entity withholding, Proposed 18 CCR section 18662-7, subsection (a), "General," was read in the second IPM. However, throughout the second IPM, public comments relating to the general rule arose. Notably, members of the public requested clarity on the term "California source income," whether the nonresident owner's tax rate of withholding would include the 1 percent mental health tax, and whether the S corporation tax rate would include 13.3 percent in addition to the shareholders, resulting in a 14.8 percent rate.

Proposed 18 CCR section 18662-7:

(d) Reporting Requirements.

(1) Reporting to Franchise Tax Board.

(A) Form 592-Q, Payment Voucher for Pass-Through Entity Withholding. A pass-through entity must submit a Form 592-Q with each withholding remittance in accordance with Regulation sections 18662-0 through 18662-8. An upper tier pass-through entity that is only allocating withholding paid on its behalf is not required to file Form 592-Q unless it has a separate withholding requirement under subsection (f). See Regulation section 18662-8, subsection (l).

(B) Form 592-PTE, Pass-Through Entity Annual Withholding Return. A pass-through entity that has withheld on the income of a nonresident owner or has had its income withheld upon is required to file a Form 592-PTE on an annual basis to allocate withholding in accordance with Regulation sections 18662-4 and 18662-8. See Regulation section 18662-4, subsection (j).

- (i) Lower Tier Pass-Through Entity. A lower tier pass-through entity that has withheld on income of nonresident owners is required to file a Form 592-PTE to allocate withholding to each nonresident owner that has income that has been withheld upon, in accordance with each nonresident owner's interest in the lower tier pass-through entity.
- (ii) Upper Tier Pass-Through Entity. An upper tier pass-through entity that has income that has been withheld upon by a lower tier pass-through entity is required to file a Form 592-PTE to allocate withholding paid on its behalf to each owner, whether a resident or nonresident of California, in accordance with each owner's interest in the upper tier pass-through entity.
 - (I) Upper Tier Pass-Through Entity Owner. Any owner of an upper tier pass-through entity that is itself a pass-through entity must likewise file a Form 592-PTE to allocate withholding to each owner, whether a resident or nonresident of California.
 - (II) Allocation of Withholding Paid. Once Form 592-PTE allocates withholding paid to an upper tier pass-through entity, the withholding payment made by the lower tier pass-through entity is treated as having been paid on behalf of each upper tier pass-through entity owner.
 - (III) Credit for Tax Withheld. If an upper tier pass-through entity claims any of the amount withheld on its tax return for the entity-level tax imposed, it must attach a schedule to Form 592-PTE specifying the amount claimed on the upper tier pass-through

entity's income tax return and amount to be allocated to the upper tier pass-through entity's owners. See subsection (e)(2) and Regulation section 19002, subsection (b).

Summary: Proposed 18 CCR section 18662-7, subsection (d), "Reporting Requirements," provided clear guidance on who is required to file a withholding form with the FTB, and what form is required to be filed. Proposed 18 CCR section 18662-7, subsection (d)(1)(B), "Form 592-PTE, Pass-Through Entity Annual Withholding Return," changed the pass-through entity withholding form filing frequency from a quarterly basis to an annual basis. Without the anticipated updates to the withholding regulations, any pass-through entity, including a lower tier pass-through entity and an upper tier pass-through entity, that had been withheld upon by a lower tier pass-through entity, was required to file a Form 592 by the federal estimated tax due dates. This often resulted in an upper tier pass-through entity filing a late Form 592 because the upper tier pass-through entity did not receive the withholding information necessary to file each Form 592 until January 31st or thereafter, as a lower tier pass-through entity is not required to send the Form 592-B to the upper tier pass-through entity until January 31st.

Proposed 18 CCR section 18662-7, subsection (d)(1)(B) included Form 592-PTE. Currently, Form 592-PTE is at 18 CCR section 18662-4, subsection (j), which became operative on October 8, 2019 (Register 2019, No. 41). Originally, FTB staff determined 18 CCR section 18662-4, subsection (j) to be the appropriate subsection for Form 592-PTE, because 18 CCR section 18662-4 contained all withholding forms and rules relating to withholding forms. Adding Form 592-PTE to 18 CCR section 18662-4 allowed the issue of the late filing forms in tiered pass-through entity structures to be partially alleviated prior to promulgation of the Proposed Regulation. The purpose behind Form 592-PTE, was to allow more time for an upper tier pass-through entity to receive withholding information via the Form 592-B from a lower tier pass-through entity.

Public Comment: At the second IPM, members of the public suggested other solutions, such as not requiring an upper tier pass-through entity to file a Form 592-PTE to report withholding, or allowing an upper tier pass-through entity that has been withheld upon to claim a refund for over-withholding. There was also a public comment expressing concern that Forms 592-B and 592-PTE would have the same, January 31st due date. There was extensive discussion as to whether the new proposed annual withholding form, i.e., Form 592-PTE, would still be filed late if it was due on the same date as Form 592-B, the form that the upper tier pass-through entity needs to receive from a lower tier pass-through entity in order to complete Form 592-PTE. Potential solutions raised by members of the public included: (1) not requiring an upper tier pass-through entity to file Form 592-PTE; (2) designating a later filing date for Form 592-PTE to allow time to receive Form 592-B; and (3) adding a safe harbor provision.

Proposed 18 CCR section 18662-7, subsection (d):

(2) Notification to Owners of Withholding.

(A) Form 592-B, Resident and Nonresident Withholding Tax Statement. A pass-through entity that has withheld on income of a nonresident owner or has income that has been withheld upon is required to provide a Form 592-B to each owner that is allocated withholding in accordance with Regulation sections 18662-0 through 18662-8. See Regulation section 18662-8, subsection (m).

- (i) Lower Tier Pass-Through Entity. A lower tier pass-through entity that has withheld on income of nonresident owners is required to provide a Form 592-B to each nonresident owner that has income that has been withheld upon.
- (ii) Upper Tier Pass-Through Entity. An upper tier pass-through entity that has income that has been withheld upon by a lower tier pass-through entity is required to provide a Form 592-B to each owner, whether a resident or nonresident of California, that is to be allocated withholding. Any owner of an upper tier pass-through entity that is itself a pass-through entity must likewise provide a Form 592-B to each owner, whether a resident or nonresident of California, that is to be allocated withholding.

(B)10-Day Notification Requirement. A pass-through entity must notify each nonresident owner of the withholding paid on the nonresident owner's behalf when the pass-through entity remits a withholding payment to the Franchise Tax Board. The notice required to be given must be provided within 10 days of the withholding payment due date, or, if paid later, the date such payment is made. No particular form is required for a pass-through entity's notification to a nonresident owner, but each notification must include the pass-through entity's name, identification number, address, and the owner's name, identification number, address, the owner's distributive share of income, and the amount of tax paid on behalf of the owner for both the current pass-through entity's taxable year.

(C)10-Day Notification Exception. A pass-through entity is not required to notify a nonresident owner of a withholding payment made on the owner's behalf, unless requested by the owner, if –

- i. The pass-through entity's agent responsible for providing notice pursuant to this paragraph is the same person that acts as an agent of the owner for purposes of filing the owner's California income tax return for the owner's taxable year that included the withholding payment date; or
- ii. The pass-through entity has at least 500 nonresident owners and the total withholding the pass-through entity determines it is required to pay for the tax year on behalf of such owner's distributive share of income is less than \$1,000; or

- iii. The pass-through entity is an upper tier pass-through entity that is only allocating withholding paid on its behalf.

Summary: Proposed 18 CCR section 18662-7, subsection (d)(2), "Notification to Owners of Withholding," provided clear guidance as to who would be required to send a withholding form to a pass-through entity owner, and what form would be required to be sent. Proposed 18 CCR section 18662-7, subsection (d)(2)(B), "10-Day Notification Requirement," required a pass-through entity to notify each nonresident owner of withholding paid on its behalf within 10 days of the withholding payment due date, and was modeled after the federal foreign partner withholding. An October 2019 amendment to 18 CCR section 18662-4 added Form 592-PTE as subsection (j), due on an annual basis. This amendment provided some relief for the issue of an upper tier pass-through entity late filing Form 592. However, FTB staff was aware that Form 592-PTE was due the same day as Form 592-B, which contains the withholding information an upper tier pass-through entity needs to complete Form 592-PTE. Therefore, an upper tier pass-through entity may not have the information necessary to complete Form 592-PTE by the due date. Proposed 18 CCR section 186662-7, subsection (d)(2)(B) was drafted to ensure that the withholding information is received by the nonresident owner before the due dates for Forms 592-B and 592-PTE, allowing an upper tier pass-through entity to timely file Form 592-PTE.

Public Comment: A member of the public expressed concern that the proposed 10-day notification requirement may be ineffective if it only is required at the first tier and not at the other tiers. Public comments suggested that it was uncertain what would trigger an owner further up the chain to know that they had been withheld upon.

For the March 15, 2019 Notice, the Proposed Regulation draft language, as initially noticed at the September 8, 2017 IPM, was in single underline.

Further inserted text after the September 8, 2017 IPM was marked in double underline and stricken text after the September 8, 2017 IPM was in ~~double strikethrough~~.

Exhibit C

Ninety-Day Notice of Proposed Amendments (Ninety-Day Notice)
Brief Overview
Proposed 18 CCR Section 18662-7
Domestic Pass-Through Entity Withholding

After the second IPM, FTB staff considered public comments and revised the Proposed Regulation, incorporating and adopting some of the public comments and revisions based on further staff review. On March 15, 2019, FTB issued the Ninety-Day Notice to elicit public comments on the revisions to the Proposed Regulation following the second IPM. With the notice, FTB published a Discussion of Amendments to Proposed Adoption of Regulation 18662-7 and the Proposed Amended Tax as Discussed in the Ninety-Day Notice Dated March 15, 2019. This brief overview discusses the notable revisions to the Proposed Regulation.

Proposed 18 CCR section 18662-7, subsection (d)(2)(B)2.:

d. Self-Certification. An upper tier pass-through entity may certify on Form 592-PTE under penalty of perjury that the Form 592-PTE is filed by the upper tier pass-through entity within 30 days of receipt by the upper tier pass-through entity of the Form 592-B from the lower tier pass-through entity. If the upper tier pass-through entity certifies on Form 592-PTE under penalty of perjury that the Form 592-PTE is filed within 30 days of receipt of the Form 592-B from the lower tier pass-through entity and the Form 592-PTE is received by FTB within 30 days of the upper tier pass-through entity's receipt of the Form 592-B from the lower tier pass-through entity, then a late filing penalty will not be imposed on the upper tier pass-through entity for a late filed Form 592-PTE. A late filing penalty may still be imposed if the self-certification is fraudulent or otherwise factually incorrect.

Summary: As detailed in the notice, one of the main revisions to the Proposed Regulation was the addition of a self-certification provision to act as a safe harbor for an upper tier pass-through entity that receives a late Form 592-B from its lower tier pass-through entity. If an upper tier pass-through entity receives a Form 592-B beyond the Form 592-PTE January 31st due date, then a late-filing penalty will not be imposed on the upper tier pass-through entity if it certifies that it is filing the Form 592-PTE within 30 days of receiving the Form 592-B, so long as it files the Form 592-PTE within 30 days of

receiving the Form 592-B, and the self-certification is not fraudulent or otherwise factually incorrect. The purpose of this revision was to provide further relief to an upper tier pass-through entity in the late filing of a withholding form.

Public comment: FTB received no public comments.

Proposed 18 CCR section 18662-7, subsection (d)(2):

~~(B) 10-Day Notification Requirement. A pass-through entity must notify each nonresident owner of the withholding paid on the nonresident owner's behalf when the pass-through entity remits a withholding payment to the Franchise Tax Board. The notice required to be given must be provided within 10 days of the withholding payment due date, or, if paid later, the date such payment is made. No particular form is required for a pass-through entity's notification to a nonresident owner, but each notification must include the pass-through entity's name, identification number, address, and the owner's name, identification number, address, the owner's distributive share of income, and the amount of tax paid on behalf of the owner for both the current pass-through entity's taxable year.~~

~~(C) 10-Day Notification Exception. A pass-through entity is not required to notify a nonresident owner of a withholding payment made on the owner's behalf, unless requested by the owner, if—~~

- ~~i. The pass-through entity's agent responsible for providing notice pursuant to this paragraph is the same person that acts as an agent of the owner for purposes of filing the owner's California income tax return for the owner's taxable year that included the withholding payment date; or~~
- ~~ii. The pass-through entity has at least 500 nonresident owners and the total withholding the pass-through entity determines it is required to pay for the tax year on behalf of such owner's distributive share of income is less than \$1,000; or~~
- ~~iii. (iii) The pass-through entity is an upper tier pass-through entity that is only allocating withholding paid on its behalf.~~

Summary: FTB proposed to eliminate the 10-day notification requirement in order to avoid imposing additional administrative burdens on a pass-through entity. Instead, FTB proposed the self-certification provision under subdivision (d)(2)(B)(2)(d) to provide relief for a pass-through entity receiving a late Form 592-B.

Public Comment: FTB received no public comments.

For the June 25, 2020 Notice, the Proposed Regulation draft regulatory language, as initially noticed at the September 8, 2017 IPM, was in single underlined. Further inserted text after the March 15, 2019 Notice was in **underlined bold**.

Exhibit D

Thirty-Day Notice of Proposed Amendments (Thirty-Day Notice)
Brief Overview
Proposed 18 CCR Section 18662-7
Domestic Pass-Through Entity Withholding

On June 25, 2020 FTB issued the Thirty-Day Notice to elicit public comments on additional revisions to the Proposed Regulation. With the notice, FTB published the Proposed Amendments for Thirty-Day Notice. This brief overview discusses the notable revisions to the Proposed Regulation.

Proposed 18 CCR section 18662-7:

- (i) **Applicability Date. The provisions of this regulation, including the payment due date specified in subsection (c), are applicable commencing with the first full quarter beginning after the effective date of this regulation.**

Summary: FTB proposed the addition of 18 CCR section 18662-7, subsection (i), "Applicability Date," to specify that the provisions of the Proposed Regulation would be applicable commencing with the first full quarter beginning after the effective date of the Proposed Regulation. The first withholding payment would be due on the first federal estimated tax due date after the first full quarter following the effective date of the Proposed Regulation. For example, if the effective date of the Proposed Regulation is February 2nd, the first full quarter beginning after the effective date would be April 1st through May 31st, and the first payment would be due on the next federal estimated tax due date, i.e. June 15th. Because the provisions of the Proposed Regulation are applicable commencing with the first full quarter beginning after the effective date of the Proposed Regulation. The Form 592-PTE due on January 31st after the taxable year would not include a reconciliation of withholding before the applicability date of the Proposed Regulation.

Public Comment: FTB received no public comments.

The Proposed Amendments to the Final Regulations for the June 8, 2021 Notice had inserted text in underline and had stricken text in ~~strikethrough~~.

For the June 8, 2021 Notice, the Proposed Regulation draft regulatory language, as initially noticed at the September 8, 2017 IPM, was in single underline. Stricken text after the June 25, 2020 Notice was in ~~**bold strikethrough**~~.

Exhibit E

Forty-Five-Day Notice of Proposed Amendments (Forty-Five-Day Notice)
Brief Overview
Proposed 18 CCR Sections 18662-0 through 18662-8
Domestic Pass-Through Entity Withholding and Withholding Generally

On June 8, 2021, FTB issued the Forty-Five-Day Notice to elicit comments on the revisions to the Proposed Regulation and the proposed amendments to the Final Regulations. With the notice, FTB published the Proposed Regulatory Text for Forty-Five-Day Notice.

FTB proposed substantive amendments to the Final Regulations to provide consistency with the Proposed Regulation, to more closely reflect federal language for withholding on foreign partners, and to clarify withholding rules relating to trusts and estates. Additionally, FTB proposed non-substantive amendments for purposes of consistency and clarity. Additionally, FTB proposed revisions to the Proposed Regulation as it appeared on June 25, 2020 including the following: (1) deletion of definitions relating to pass-through entities in order to add them to 18 CCR section 18662-2, Definitions; (2) addition of Form 592-PTE to associate the form with its operative regulation; and (3) deletion of the "Applicability Date" provision following FTB staff's determination to prescribe a later effective date of January 1st in a written instrument filed with the Proposed Regulations under California Government Code section 11343.4, subdivision (b)(2).

This brief overview discusses the notable amendments to the Final Regulation and revisions to the Proposed Regulation draft text.

Proposed Amendment to 18 CCR section 18662-1, subsection (a)(1):

(C) Foreign ~~(Non-U.S.)~~ Partners and Members. Revenue and Taxation Code section 18666 and federal provisions incorporated by reference apply if a partnership has effectively connected taxable income that represents income from California sources for any taxable year, and any portion of such income is allocable to a foreign partner ~~to withholding on foreign (non-U.S.) partners and members who have allocable amounts of effectively connected income to a California trade or business.~~ Regulation sections

18662-0 through 18662-8 do not cover withholding on foreign (~~non-~~U.S.) partners ~~and members~~, except with respect to the reporting on and filing of information returns and remittance of payments as set forth in Regulation sections 18662-4 and 18662-8. (See Treasury Regulation section 1.1446-0 et seq. and Internal Revenue Service (IRS) publications.)

Summary: FTB proposed to amend Final Regulation section 18662-1, subsection (a)(1)(C), "Foreign (Non-U.S.) Partners and Members," among other Final Regulation sections relating to withholding on foreign partners. As set forth in RTC section 18666, IRC section 1446 applies for amounts representing California source income unless otherwise provided. The purpose of these proposed amendments to the Final Regulations is to more closely reflect the language of the withholding on foreign partners rules under RTC section 18666 and IRC section 1446. Examples of the proposed changes include: (1) deleting language relating to "limited liability companies" or "members;" (2) replacing references to "foreign entity" with references to "foreign partner;" and (3) replacing references to "withholding on payments" with references to "withholding on partnership's effectively connected taxable income that is allocable to a foreign partner."

Public Comment: FTB received no public comments.

Proposed Amendment to 18 CCR section 18662-4(a):

- (2) Non-California Complex Trusts, Grantor Trusts, Estates, and Nonresident Beneficiaries of Complex Trusts and Estates. Except as otherwise provided in Revenue and Taxation Code section 18662 and Regulation sections 18662-0 through 18662-8, withholding of tax at source is required for payments of California source income made to non-California complex trusts, simple trusts, grantor trusts, and estates. Withholding of tax at source is also required for complex trust and estate distributions of California source income paid to nonresident beneficiaries, provided that such withholding of tax at source has not already been paid on behalf of the complex trust and estate. Withholding on payments of income to California complex trusts, simple trusts, grantor trusts, and estates is optional, and withholding on complex trust and estate distributions of California source income paid to resident beneficiaries is optional; however, if withholding and remitting of tax at source is performed, it must be performed according to the rules applicable to mandatory withholding of tax as set forth in Revenue and Taxation Code section 18662 and Regulation sections 18662-0 through 18662-8.

Summary: FTB proposed to amend the Final Regulations to specify withholding requirements for trusts and estates. Specifically, FTB proposed to add Final Regulation section 18662-4, subsection (a)(2), to specify the requirement to withhold on payments of California source income made to non-California complex trusts, simple trusts,

grantor trusts, and estates, and to withhold on complex trust and estate distributions of California source income paid to nonresident beneficiaries. The purpose for this proposed addition was to provide clear guidance for the withholding rules relating to trusts and estates.

Public Comment: FTB received no public comments.

Proposed 18 CCR section 18662-7:

- ~~(i) **Applicability Date. The provisions of this regulation, including the payment due date specified in subsection (c), are applicable commencing with the first full quarter beginning after the effective date of this regulation.**~~

Summary: FTB proposed to delete Proposed 18 CCR section 18662-7, subsection (i), "Applicability Date" in order to prescribe a later effective date in a written instrument filed with the Proposed Regulations under Government Code section 11343.4, subdivision (b)(2). As outlined in the June 25, 2020 draft of the Proposed Regulation, subsection (i) provided that the provisions of the regulation would be applicable commencing with the first full quarter beginning after the effective date of the regulation. In the Forty-Five-Day Notice, FTB proposed a later effective date of January 1st of the first calendar year following the filing of the Proposed Regulations with the Secretary of State or January 1st if the Proposed Regulations are filed with the Secretary of State on January 1st. Since the proposed later date would be prescribed in a written instrument pursuant to Government Code section 11343.4, subdivision (b)(2), neither subsection (i) nor any additional regulatory language was needed. The purpose of this revision was to alleviate administrative burdens on the Withholding Services and Compliance Section at FTB, while still addressing the quarterly withholding payment timing issue this subsection was originally designed to resolve.

Public Comment: FTB received no public comments.

Other Proposed Amendments to 18 CCR sections 18662-0 through 18662-6 and 18662-8; and Other Revisions to Proposed 18 CCR section 18662-7:

Summary: Other amendments to the Final Regulations and revisions to the Proposed Regulation are as summarized as follows: (1) FTB proposed amending the Final Regulations to add language relating to domestic pass-through entity withholding to ensure that all withholding regulations operate together; (2) FTB proposed to delete the definitions subsections in the Proposed Regulation, and add the subsections to 18 CCR section 18662-2 because the definitions relate to all withholding regulations, not only the Proposed Regulation; (3) FTB proposed delete the Form 592-PTE subsection in 18 CCR section 18662-4, and add it to the Proposed Regulation because only a pass-through entity is required to file Form 592-PTE, and therefore it is more appropriate to include it in the regulation pertaining to domestic pass-through entity withholding.

Public Comment: FTB received no public comments.