



STATE OF CALIFORNIA
Franchise Tax Board

Nonwage Withholding Audit Process

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Introduction

California Revenue and Taxation Code (R&TC) Section 19504 authorizes the Franchise Tax Board (FTB) to conduct audits of [withholding agents](#) (we use the term withholding agent throughout this publication to refer to the payer, real estate escrow person, or the buyer). We provide education and outreach to withholding agents regarding their withholding obligations to ensure they withhold the required amounts and timely remit to us so we can apply withholding payments to payees' accounts. For more information about California's nonwage withholding requirements, go to ftb.ca.gov and search for **withhold audit**.

Our [Manual of Audit Procedures](#) (MAP) contains procedures and guidelines to complete all types of audits; however, it does not contain all possible audit situations. The Withholding Services and Compliance Section of the Filing Compliance Bureau conducts withholding audits that cover nonresident and real estate withholding. We conduct audits of withholding agents to determine if they are in compliance with California's nonwage withholding requirements. We generally follow the procedures described in the MAP; however, we may also follow procedures unique to nonwage withholding. As we explain in [FTB Notice 1994-8](#), manuals we provide for guidance are not authoritative interpretations of law. The audit manuals cannot be cited to support an audit position. Instead, use the MAP or the Nonwage Withholding Audit Process publication as an initial step in understanding audit procedures and guidelines.

We provide this information for general, informational purposes only. It provides a brief summary explanation that is subject to various exceptions, depending on specific facts and circumstances. This information is not applicable in all situations, should not be considered legal advice, and is not binding to FTB.

Scope of the Audit

We review your books and records to:

- Determine if you are a withholding agent as defined in R&TC Section 18662.
- Verify your payments of income are California sourced as defined in R&TC Section 17951.
- Discuss payments you made for personal services to a California nonresident, excluding payments to a nonresident corporate director for director services performed in California, including attendance at a board of directors' meeting (R&TC Section 18662(f)). Based on your input and facts we obtain from records, we determine whether we require withholding on the payment to the payee.
- Discuss escrow accounts on the sale of real property located in California. Based on your input and facts we obtain from records, we:
 1. Determine if the real estate escrow person provided written notification to the buyer of the buyer's withholding obligations.
 2. Determine whether the real estate escrow person accurately withheld on the sale of real property.
 3. Validate any withholding exemptions.

In addition, if you withheld and failed to remit payment to us, we perform the following tests:

- Verify you properly completed information returns.
- Verify you correctly withheld and reported the information return to the payee.

Power of Attorney

Use [FTB 3520 PIT](#), *Individual or Fiduciary Power of Attorney Declaration*, to establish power of attorney for individuals, or [FTB 3520 BE](#), *Business Entity or Group Nonresident Power of Attorney Declaration* to establish power of attorney for corporations, partnerships, limited liability companies, and others.

Recordkeeping

We require you to keep accounting records to provide a true and accurate account of all your payments. Accounting records can be as basic as a manual system with only a check register and general journal entries or as complex as a computerized double-entry system on an accrual basis. The type of system you use should meet the needs of your business and our requirements. We explain requirements in our audit regulations, contained in California Code of Regulations, Title 18, Section 19032.

Initial Contact

Our Withholding Services and Compliance Section conducts withholding audits which include nonresident and real estate withholding. Generally, we define the initial contact as the first audit letter to a withholding agent. The initial contact letter includes:

- The auditor's name and phone number.
- The supervisor's name and phone number.
- Instructions on how to contact us to proceed with the audit.
- A list of records we require to examine.

Generally, withholding audits cover a two-year period, comprised of the recently completed calendar year. However, in some situations, such as when no information returns are filed, the audit period may be longer.

Field Audit Entrance Interview

If we conduct the audit at your place of records, we introduce ourselves and provide proper identification before we review your records. We conduct an entrance interview with you or your designated representative to explain the purpose of the withholding audit and its processes as follows:

- The withholding laws.
- The withholding forms.
- Gather general information about your operations.
- Discuss your accounting records.
- Answer any of your questions.

Providing Business Records for the Audit

To expedite the audit process, you or your representative must provide the requested records. The examination of records may be limited to the records listed, but there may be a need to examine additional records, such as invoices, billings, corporate minutes, or other written agreements.

We may request the following business records to review during a withholding audit:

- Chart of accounts
- Complete financial statements
- Detailed general ledger
- Bank statements and bank reconciliations
- All ledgers used to disburse cash and cash equivalents
- Contracts and agreements (for example, rental agreements, agency contracts, final escrow statements)
- All broker statements
- Accounts payable ledgers
- Board of directors' meeting minutes
- Trust account files (for example, exchanger, seller, nonresident property owner, promoter agency)
- IRS Form 1099 (for example, Form 1099-B, *Proceeds from Barter and Broker Exchange Transactions*, Form 1099-MISC, *Miscellaneous Income Form*, 1099-S, *Proceeds from Real Estate Transactions*)
- IRS Form W-9, *Request for Taxpayers Identification Number and Certification*
- IRS Forms:
 - 945, *Annual Return of Federal Income Tax*
 - 945-A, *Annual Record of Federal Tax Liability*
 - 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*
 - 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*
 - W-2G, *Certain Gambling Winnings*
 - 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*
 - 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*

The listed items above are not all inclusive.

Withholding Forms We Obtain and Review for Verification

We obtain and review the following [FTB withholding forms](#):

- Form 587, *Nonresident Withholding Allocation Worksheet*
- Approved Form 588, *Nonresident Withholding Waiver Request*
- Approved Form 589, *Nonresident Reduced Withholding Request*
- Form 590, *Withholding Exemption Certificate*
- Form 590-P, *Nonresident Withholding Exemption Certificate for Previously Reported Income*
- Form 592, *Resident and Nonresident Withholding Statement*
- Form 592-A, *Payment Voucher for Foreign Partner or Member Withholding*
- Form 592-F, *Foreign Partner or Member Annual Return*
- Form 592-V, *Payment Voucher for Resident and Nonresident Withholding*
- Form 592-B, *Resident and Nonresident Withholding Tax Statement*
- Form 593, *Real Estate Withholding Tax Statement*
- Form 593-V, *Payment Voucher for Real Estate Withholding*
- Form 593-C, *Real Estate Withholding Certificate*
- Form 593-E, *Real Estate Withholding – Computation of Estimated Gain or Loss*
- Form 593-I, *Real Estate Withholding Installment Sale Acknowledgement*

Please refer to these forms and their respective instructions for additional guidance.

Withholding Reference Information

The following FTB [withholding publications and instruction booklets](#) include helpful information that we may reference during a withholding audit:

- Form 593 Booklet, *Real Estate Withholding Booklet*
- FTB Pub. 923, *SWIFT Guide for Resident, Nonresident, and Real Estate Withholding*
- FTB Pub. 1016, *Real Estate Withholding Guidelines*
- FTB Pub. 1017, *Resident and Nonresident Withholding Guidelines*
- FTB Pub. 1018, *Small Business Withholding Tool*
- FTB Pub. 1023R, *Real Estate Withholding Electronic Submission Requirements*
- FTB Pub. 1023S, *Resident and Nonresident Withholding Electronic Submission Requirements*
- FTB Pub. 1076, *Withholding on Nonresidents With California Source Income*
- FTB Pub. 4098, *Withholding Information Notice*
- FTB 4060, *California's Other Withholding*
- FTB 4060 *SPANISH, Otros Tipos De Retención En California*
- FTB 7429, *Do I Need to Withhold on this Trust?*

Audit Determination

We request and review documents related to the payment of California source income and determine if you followed the withholding requirements. Over the course of the audit, you can expect timely and professional correspondence and contacts. After we have all of the facts of the situation, we conduct an analysis of the information you provide and make a determination regarding your compliance with the withholding requirements.

Concluding the Audit

When we complete our analysis of the facts and the information you provide, we discuss the audit results with you or your representative. This discussion includes:

- Our analysis of the facts and application of the law.
- An attempt to resolve any issues you dispute.
- Our determination for liability or penalty assessments, if any.
- Any additional information that we request you provide.

We issue a determination letter upon completion of our analysis and discussion of findings with you or your representative. When you receive the determination letter, you or your representative have up to 30 days to submit additional documents to support your position (California Code of Regulations, Title 18, Section 19032). We evaluate any new information before we make a final determination. We send a second determination letter after we consider the additional information you provide, if any, in response to the first determination letter. If you receive the second determination letter, then you or your representative have up to 30 days to submit additional documents to support your position. We will not issue a closing letter until we consider all documentation.

Prior to closing the withholding audit, we:

- Document your or your representative's agreement or disagreement with the liability or penalty assessments.
- Attempt to obtain and document a full understanding of your position and request that you or your representative present your position in writing and include your supporting documentation.
- Inform you of your appeal rights if you disagree with our assessment.

It is important we agree on the facts regarding the withholding audit issues, even if you or your representatives do not agree with our conclusion or assessment.

We send a closing letter to close the audit. If our findings conclude the withholding agent is compliant with the withholding requirements, we issue a closing letter that states you are in compliance for the audit period and we close the audit. If our findings conclude the withholding agent is noncompliant, then we send a closing letter that states you are not in compliance. We address any revised assessments to your liability or penalty assessments, include payment instructions, and notify you that we will close the audit. In addition, we notify you that the withholding liability and penalty is nondeductible and you may not claim it as a withholding credit.

Our withholding audits address compliance of withholding requirements and not the determination of additional tax owed on an income tax return. Noncompliance results in liability or penalty assessments on the withholding agent for failure to comply. We issue a liability or penalty on a *Notice of Balance Due*, and the notice includes instructions to submit payment. You cannot protest a *Notice of Balance Due*. If you do not agree with the assessed liability or penalty, refer to [What to Do When You Do Not Agree With Our Audit Findings](#) below.

Penalties

The law contains numerous provisions for the assessment of penalties in various situations when you fail to comply with the law. We may impose several types of penalties based on these statutes. It is our practice to consider the imposition of any penalty in each case where the penalty is applicable.

Some penalties are automatically imposed by our systems, and we develop other penalties as appropriate during the audit. Penalties determined at the audit level include:

- Failure to withhold under R&TC Section 18668(a).
- Failure to remit withholding under R&TC Section 18668(a).
- Nonnotification liability under R&TC Section 18668(d).
- Information return penalty under R&TC Section 19183.

Unless you show that the failure to withhold is due to reasonable cause, you are liable for the withholding on or before the due date for 1) the amount actually withheld; or 2) the amount of taxes due from the taxpayer who received payment; whichever is greater, but not more than the required withholding amount (R&TC Section 18668(a)). Also, we apply a penalty if the real estate escrow person fails to provide written notification to the buyer (transferee), unless the failure to notify is due to reasonable cause (R&TC Section 18668(e)(1)). In addition, the real estate escrow person or the buyer (transferee) will not incur a penalty if the failure to withhold is the result of his or her reliance, based on good faith, and on all the information of which he or she has knowledge, upon the seller's (transferor's) written certificate executed under penalty of perjury (R&TC Section 18668(e)(4)).

Interest

We charge interest on balances due to us and we pay interest on balances due to you. (If you are a corporation, interest is computed in accordance with R&TC Section 19341.) If you pay the full amount within 15 days of the notice date, we do not assess interest for the time between the notice date and the payment date. Interest is not a penalty; it is a charge for the use of money (R&TC Section 18668(b)).

Statute of Limitations

California law provides time limits for us to assess additional tax. This time limit is known as the statute of limitations (SOL). If you fail to file an information return, then there is no time limit for us to assess a tax. Once you file an information return, or we receive a payment, the SOL applies. We cannot allow a credit or refund after four years from the original due date of the information return, four years from the date you filed the information return (if you filed within the extension period), or one year from the date you made an overpayment, whichever is later, unless you file a claim for refund within the allowed time frames. (R&TC Section 19306)

What to Do When You Do Not Agree With Our Audit Findings

R&TC Section 18668(f) does not allow for a notice of proposed deficiency assessment. You must pay a withholding assessment upon notice and demand, and you cannot protest a withholding assessment. While we strive to explain our findings during the course of the audit, we understand you may disagree with our withholding assessment. Following a withholding assessment, we will review any additional information you provide that shows the liability or penalty should be reduced or withdrawn. For example, to reduce the failure to withhold liability, the withholding agent can provide proof that the payee, for which the withholding agent became liable, actually filed their income tax return and paid the income tax subject to withholding. Through this process, we are able to resolve the majority of our cases. If, after our efforts to resolve your issue(s), you continue to disagree with our final withholding assessment, then you must pay the balance due and file an appeal.

Claims

A claim for refund allows you to request a reduction of a current or prior year tax liability and is resolved according to the Taxpayer Bill of Rights (TBOR).

When we receive a claim, we must first determine if the claim is valid. R&TC Section 19322 provides that every claim for refund be in writing, be signed by the taxpayer or the taxpayer's authorized representative, and state the specific grounds upon which it is founded. In addition, the amount you claim must be paid to qualify as a valid claim.

For us to issue a refund, you must timely file the claim. If you do not timely file the claim, then we cannot allow a refund, and we will send you a *claim denial letter* to explain why we did not allow the claim.

Appeal

If we deny a claim for refund, your next available option is to file an appeal with the Office of Tax Appeal (OTA) or to bypass the OTA appeal process and file an action directly with the California Superior Court.

If we deny or partially deny a claim for refund, then you have 90 days after we mail the notice of denial to file an appeal in writing with the OTA or bring action in California Superior Court.

In addition, if we fail to act on the claim within six months, then you can deem the claim denied and file an appeal with OTA or bring action in California Superior Court as if the claim was formally denied. If the OTA renders a decision, it is final and binding on us, but not on you.

Either of us can appeal a California Superior Court decision to the California Appellate Court or the California Supreme Court and ultimately to the U.S. Supreme Court.

Taxpayer Advocate Office

Rights as a Taxpayer

The California Taxpayers' Bill of Rights (R&TC Sections 21001-21028) requires that we adequately protect the rights, privacy, and property of all California taxpayers during the process of assessing and collecting taxes. Our goal is to make certain we protect your rights. We want you to have the highest confidence in the integrity, efficiency, and fairness of our state tax system. FTB 4058, *California Taxpayers' Bill of Rights*, includes information on state taxpayers' rights. Get FTB 4058 at ftb.ca.gov or call us at 800.338.0505 (select Personal Income Tax), or mail us at FRANCHISE TAX BOARD, PO BOX 942840, SACRAMENTO CA 94240-0040.

Taxpayers' Rights Advocate Review

You may contact the Taxpayers' Rights Advocate if you have an ongoing state income tax problem that you have been unable to resolve through normal channels. Contacting the Taxpayers' Rights Advocate, however, is not an appeal and does not extend the period of time for filing one. You have the right to an independent administrative review if we notify you that we may levy your income or assets, file or record a notice of lien, reject your request for an installment agreement, or terminate your existing installment agreement. You must submit your request for review within 30 days of the date of Final Notice Before Levy or within 30 days of the date of the Notice of State Tax Lien. (R&TC Sections 19008(e), 19225, and 21015.5) You may contact Executive and Advocate Services for additional information or to submit your request for review. To request an independent administrative review, call: 800.883.5910, fax: 916.843.6022, or mail: Executive and Advocate Services MS A381, PO Box 157, Rancho Cordova CA 95741-0157.

Contact Us

Web: Go to ftb.ca.gov and search for **withhold audit**

Mail: STATE OF CALIFORNIA
FRANCHISE TAX BOARD
WITHHOLDING SERVICES AND COMPLIANCE MS F182
PO BOX 942867
SACRAMENTO CA 94267-0651

Phone: 888.792.4900
916.845.4900 from outside the United States

TTY/TDD: 800.822.6268 for persons with hearing or speech impairments