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Technical Advice Memorandum: 2016-02

Requested By:	Withholding Services and Compliance, Filing Compliance Bureau, Filing Division
Requested Date:	02.20.15
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SUBJECT: Statute of Limitations Period for Refunding Failure to Withhold Liability Imposed Against Withholding Agents

QUESTIONS PRESENTED

1. Whether the one-year and four-year statutes of limitation periods under Revenue and Taxation Code ("RTC") section 19306 apply both to information returns and withholding agents, and therefore, limit the period in which a withholding agent can be allowed a refund or credit of the failure to withhold liability imposed under RTC section 18668(a)?

2. Assuming that the four-year limitation period applies, whether the period starts to run from the due date of the original information return (on either Franchise Tax Board ("FTB") Form 592, Resident and Nonresident Withholding Statement ("FTB Form 592") or FTB Form 593, Real Estate Withholding Tax Statement ("FTB Form 593")), the due date of the withholding agent's original tax return, or the due date of the payee's original tax return?

3. If no information return (on FTB Form 592 or FTB Form 593) is filed, when does the statute of limitations period begin to run for a withholding agent to claim a refund or credit of the failure to withhold liability imposed under RTC section 18668(a)?

CONCLUSION

1. Yes, RTC section 19306 applies to both information returns and withholding agents, and therefore, limits the period in which FTB may allow a refund or credit to a withholding agent of the failure to withhold liability imposed under RTC section 18668(a).

2. The four-year limitation period is calculated based on the due date of the original information return (on FTB Form 592 or FTB Form 593).

3. If no information return is filed, the statute of limitations period for a withholding agent claiming a refund or credit of the failure to withhold liability imposed under RTC section 18668(a) begins to run on the due date of the original information return that was required to be filed with respect to that withholding amount.

ANALYSIS AND DISCUSSION

1. The Statute of Limitations Period Under RTC Section 19306 Applies to Withholding Agents

Before discussing whether RTC section 19306 applies to withholding agents and information returns, it is important to note the typical fact pattern in these types of cases, which generally involve some variation of the following:

A nonresident individual or a non-California business entity receives California source income subject to withholding; the withholding agent fails to withhold tax at source and fails to file an information return on FTB Form 592.[1] Sometime thereafter, FTB audits the withholding agent and assesses the failure to withhold liability and information return penalty (plus interest) under RTC section 18668(a) and section 18662-8(d)(2) of title 18 of the California Code of Regulations ("Cal. Code Regs."). The withholding agent remits to FTB the failure to withhold liability and information return penalty (plus interest), and the nonresident payee subsequently files a return and pays the tax. The withholding agent then requests a refund of the failure to withhold liability because the nonresident payee has paid the tax.

Thus, the issue is whether RTC section 19306 applies to both information returns and withholding agents, and therefore limits the period in which FTB may allow a refund or credit of the failure to withhold liability imposed against a withholding agent under RTC section 18668(a).

a. The FTB Has Broad Authority to Administer and Enforce the RTC

RTC sections 19501 and 19503 grant FTB broad authority to administer, enforce and interpret the RTC through rules and regulations. FTB's "statutory duty . . . is broadly defined, i.e., to 'enforce' and 'administer' the income tax powers of the state. To these ends, the Board is given the power to prescribe such 'rules and regulations' as are 'necessary' and 'reasonable.'" (*Sklar v. Franchise Tax Bd.* (1986) 185 Cal. App. 3d 616, 623.) Furthermore, "the Board's discretionary determinations can only be challenged if they are unreasonable or arbitrary." (*Chase Brass & Copper Co. v. Franchise Tax. Bd.* (1977) 70 Cal. App. 3d 457, 468.)

b. Failure to Withhold Liability Imposed on Withholding Agents

The term "withholding agent" generally means "any person required to deduct and withhold any tax under Section 18662," (see RTC section 17035), including "the person that has the control, receipt, custody, disposal, or payment of an item of income of a person subject to withholding." (See Cal. Code Regs., tit. 18, section 18662-2(y).)

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[1] This example involves a situation where a nonresident individual or a non-California business entity receives California source income where FTB Form 592 is involved. The guidance given in this TAM is equally applicable to those situations where there is a failure to withhold tax at source on a disposition from the sale or exchange of California real estate by a California resident to nonresident individuals and/or non-California business entities, where FTB Form 593 is involved.

A withholding agent generally is liable for the amount that should have been withheld (i.e., the failure to withhold liability), together with any applicable information return penalties and interest, unless it is shown that the failure to withhold was due to reasonable cause, or unless the withholding agent shows that the taxpayer paid the tax. (RTC section 18668(a); Cal. Code Regs., tit. 18, section 18662-8(d)(2)(C).)

c. *Applicability of RTC Section 19306 to Withholding Agents and Information Returns*

RTC section 19306(a) provides:

> No credit or refund shall be allowed or made after a period ending four years from the date the *return* was filed (if filed within the time prescribed by *Section 18567 or 18604*[2] *whichever is applicable*), four years from the last day prescribed for filing the return (determined without regard to any extension of time for filing the return), or after one year from the date of the overpayment, whichever period expires later, unless before the expiration of that period a claim therefor is filed by the taxpayer, or unless before the expiration of that period the Franchise Tax Board allows a credit, makes a refund, or mails a notice of proposed overpayment on a preprinted form prescribed by the Franchise Tax Board. (Emphasis added.)

In turn, RTC section 18567(a) states, in relevant part:

> The Franchise Tax Board may grant a reasonable extension of time for filing *any return*, declaration, statement or other document *required by* Part 10 (commencing with Section 17001) *or this part* in the manner and form as the Franchise Tax Board may determine. (Emphasis added.)

The phrase "or this part" referred to in RTC section 18567(a) is Part 10.2 (Administration of Franchise and Income Tax Laws), and includes RTC sections 18662 through 18668, which are the withholding statutes.[3] RTC sections 18662 through 18668, and the regulations promulgated thereunder (specifically, Cal. Code Regs., tit. 18, sections 18662-0 through 18662-6 and section 18662-8) require the filing of information returns.[4] Accordingly, the term "return" in RTC section 19306 includes information returns that are required to be filed by the withholding statutes and regulations.[5]

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[2] RTC section 18604 is inapplicable in the typical fact pattern addressed by this Technical Advice Memorandum ("TAM"), as it applies to returns filed by corporations.

[3] RTC sections 18662 through 18668 are contained in Article 5, of Chapter 2, of Part 10.2.

[4] Cal. Code Regs., tit 18, section 18662-8(d)(2)(A) provides that RTC section 19183 incorporates federal information return penalties by reference, that FTB Form 592 and FTB Form 593 (among other forms) are information returns, and that failure to file those returns may subject the withholding agent to information return penalties as specified in Cal. Code Regs., tit 18, section 18662-8.

[5] While not directly on topic as the issue there involved whether information returns would be considered "returns" under Internal Revenue Code ("IRC"), section 6501—which is the limitations statute on assessments (as opposed to the limitations statute on refunds or

Under RTC section 18662(a), a withholding agent is liable for the amount that was required to be withheld, and applicable information return penalties and interest, unless it is shown that the failure was due to reasonable cause, or the withholding agent shows that the taxpayer paid the tax. The withholding regulations provide more guidance in this respect. Specifically, when the withholding agent pays the failure to withhold liability (for unpaid withholding) and information return penalties plus interest, and when the nonresident payee subsequently files a return and pays the tax, the failure to withhold liability[6] may be reversed upon written request by the withholding agent. (Cal. Code Regs., tit. 18, section 18662-8(d)(2)(C).)[7]

Because Cal. Code Regs., tit. 18, section 18662-8 explicitly permits a withholding agent to request reversal of the unpaid withholding liability, and because as determined above, the term "return" in RTC section 19306 also includes information returns that are required to be filed by withholding agents, RTC section 19306 applies and therefore limits the period in which FTB may allow a refund or credit of the failure to withhold liability imposed against a withholding agent under RTC section 18668(a). Specifically, for the claim

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credits, which is the case here)—a Legal Advice Issued to Program Managers (from the National Office of the Office of Chief Counsel) concluded that the term "return" in IRC section 6501 includes "information returns," which would mean that the Internal Revenue Service ("IRS") would have to assess information return penalties under IRC section 6721 within three years of filing of the particular information return forming the basis of the penalty (such as IRS Forms 1099 or W-2). (PMTA-2013-04 (Assessment Period of Limitations for Assessable Penalties under IRC sections 6721 and 6722, Legal Advice from National Office of the Office of Chief Counsel and issued to IRS personnel who are national program executives and managers, dated April 4, 2013, available at https://www.irs.gov/pub/lanoa/pmta_2013-04.pdf). RTC section 19183(a)(1), which as noted above is referenced by the withholding regulations, states that the penalty for failure to file an information return (such as FTB Form 592) shall be determined in accordance with IRC section 6721, the section to which the aforementioned Legal Advice pertained.

[6] The withholding agent remains liable for any information return penalties plus interest. (Cal. Code Regs., tit. 18, section 18662-8(d)(2)(C).)

[7] On the federal side, IRC section 1464 states that "[w]here there has been an overpayment of tax under this chapter ["this chapter" refers to Chapter 3 which is titled "Withholding of Tax on Nonresident Aliens and Foreign Corporations"] any refund or credit made under chapter 65 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent." In turn, Treasury Regulation section 1.6414-1, a regulation promulgated by the Treasury Department under a section of the IRC in *chapter 65*—referenced in IRC section 1464 above—provides withholding agents options with respect to obtaining refunds on overpayments. One option is through IRC section 6402, which states that:

> [i]n the case of any overpayment, the Secretary, *within the applicable period of limitations,* may credit the amount of such overpayment, including any interest allowed thereon, against *any liability* in respect of an internal revenue tax on the part of the *person who made the overpayment* and shall . . . refund any balance to such person.

(IRC section 6402(a) (emphasis added).) Thus, the federal statutes and regulations make it clear that the federal statute of limitation period (IRC section 6511) applies with respect to withholding agents trying to obtain a refund on overpayments.

to be allowed, a withholding agent must file a claim for refund within the later of; (1) four years of the due date of the original information return; (2) four years from the actual filing date of the information return, if filed on or before the extended due date; or (3) one year from the date of the overpayment.[8]

2. The Four-Year Limitations Period Is Based on the Due Date of the Original Information Return (on FTB Form 592 or FTB Form 593).

The four-year limitations period is based on the due date of the original information return (on FTB Form 592 or FTB Form 593) that should have been filed with respect to the withholding amount. Specifically, RTC section 19306(a) provides in part:

> [n]o credit or refund shall be allowed or made after a period ending four years from the date the return was filed . . ., [or] *four years from the last day prescribed for filing the return* (determined without regard to any extension of time for filing the return). . . . (Emphasis added.)

Since an information return (on FTB Form 592 or FTB Form 593) constitutes a "return" under RTC section 19306, it follows that the four-year limitation period is based on due date of the original information return (i.e., "four years from the last day prescribed for filing the return"), determined without regard to any extension of time for filing the return.

The original due date and thus the last day prescribed for filing an information return on FTB Form 592 depends on the specific period in which the withholding (on payments) occurred, as follows:[9]

Specific Period[10]	Due Date
January 1 through March 31, 2015	April 15, 2015
April 1 through May 31, 2015	June 15, 2015
June 1 through August 31, 2015	September 15, 2015
September 1 through December 31, 2015	January 15, 2016

Thus, if the withholding occurred sometime during January 1 through March 31, 2015, then the original due date and thus, the last day prescribed for filing the information return on FTB Form 592, would be April 15, 2015. Accordingly, the statute of limitations period for this tax year would expire on April 15, 2019, which is four years from

[8] As noted above in the introduction part of Section 1 above, in this scenario, the payee/taxpayer will have already filed a return as that is required under RTC section 19307. (See Cal. Code. Regs., tit. 18, section 19002(a).)

[9] To demonstrate the due dates for the various periods, the year used here is 2015. The recently promulgated withholding regulations state that "[f]or purposes of computing the 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." (Cal. Code. Regs., tit 18, section 19002(d)(1).)

[10] This information can be found on the instructions to FTB Form 592. (See 2015 Instructions for FTB Form 592, page 1, Section C, available at https://www.ftb.ca.gov/forms/2015/15_592.pdf.)

the due date of the original information return (which is the last day prescribed for filing the information return), meaning that any claim for refund that a withholding agent files after that date would be barred by the statute of limitations.

The original due date and thus, the last day prescribed for filing an information return on **FTB Form 593**, is 20 days following the end of the month in which the transaction (where a withholding was required) occurred.[11] Thus, if a transaction for which a withholding was required occurred on January 31, 2015, the last day prescribed for filing the information return on FTB Form 593 would be February 20, 2015. Accordingly, the statute of limitations period for this tax year would expire on February 20, 2019, which is four years from the due date of the original information return (which is the last day prescribed for filing the information return), meaning that any claim for refund that a withholding agent files after that date would be barred by the statute of limitations.

It should be noted that if the withholding agent filed an information return (on FTB Form 592 or FTB Form 593), a claim for refund would have to be filed within four years from the date the information return was filed.

3. <u>If No Information Return (on FTB Form 592 or FTB Form 593) Is Filed, the Statute of Limitations Period for a Withholding Agent to Claim a Refund or Credit of the Failure to Withhold Liability Imposed under RTC Section 18668(a) Begins to Run on the Due Date of the Original Information Return that Was Required to Be Filed With Respect to that Withholding Amount.</u>

As previously stated in the response to Question #2, the statute of limitations period for a withholding agent to claim a refund or credit of the failure to withhold liability imposed under RTC section 18668(a) begins to run on the due date of the original information return (which is the last day prescribed for filing the information return).[12] Accordingly, a withholding agent claiming a refund or credit of the failure to withhold liability imposed under RTC section 18668(a) must file the claim for refund within four years from the due date of the original information return (which is the last day prescribed for filing the information return).

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[11] This information can be found on the instructions to FTB Form 593. (See 2015 Instructions for FTB Form 593, page 1, Section D, available at https://www.ftb.ca.gov/forms/2015/15_593.pdf.)

[12] As stated in the response to Question #2, the original due date and thus the last day prescribed for filing an information return on **FTB Form 592** depends on the specific period in which the withholding (on payments) occurred. The original due date and thus the last day prescribed for filing an information return on **FTB Form 593** is 20 days following the end of the month in which the transaction (where a withholding was required) occurred.