

DISCUSSION TOPICS

Franchise Tax Board – Second Interested Parties Meeting
Withholding at Source, Regulation Sections 18662-0 through 18662-6, 18662-8, and 19002
Meeting Date: July 14, 2011

A. Withholding at Source and the Withholding Regulations Project

Franchise Tax Board (FTB) staff is nearing completion of its four-year project to revise and update the existing withholding regulations under Revenue and Taxation Code sections 18662 and 19002. FTB staff seeks public input on the third public draft of the proposed regulations.

Withholding of tax at source (referred to as "withhold at source" or "withholding at source") is an essential part of FTB's Tax Gap compliance initiative. Withholding's "pay as you go" process helps taxpayers by ensuring that tax is collected as income is received. It helps the state by ensuring that tax is paid as it is incurred on specific transactions and performance of services, encouraging taxpayers to file returns at the end of the year.

B. The Goal of the Proposed Regulations

The existing withholding regulations have not been updated in over 20 years. The existing regulations do not currently reflect a significant number of statutory and other changes affecting the withholding statutes. The existing regulations are not currently organized in a useful framework, given the number of legislative amendments and new statutes that have been adopted over the years, and given the new processes adopted by FTB staff. Regulatory action is necessary because the current FTB withholding regulations are not well-suited to piecemeal amendment but instead require a complete reorganization and restructuring.

The proposed withholding regulations are promulgated to create a comprehensive set of procedural regulations that cover FTB's current withholding processes, excepting those processes specifically identified as not included in the regulations. The proposed regulations are intended to provide additional clarity and transparency for taxpayers, tax practitioners, withholding agents, and the public. The new regulations also retain the flexibility to respond to individual circumstances and new or changed responsibilities.

C. Purpose of Second Interested Parties Meeting

Given the scope of the project, FTB staff invites oral and written comments on this updated, third draft of the proposed withholding regulations. At the meeting, FTB staff will discuss the meeting documents, provide a general overview of each section, and will request public comments on each section.

What will you see in the new draft? FTB staff has reformatted and renumbered sections, moved certain paragraphs, and changed certain titles for greater clarity and transparency. Some content and format have changed to conform it to new withholding laws, match the regulations to FTB's current practices, and to meet the requirements of the new Withholding at Source System (WASS).

FTB staff proposes to repeal the current text of Regulation section 18662-7 and reserve this section for a future interested parties meeting to discuss the withholding rules for domestic (U.S.) pass-through entities. This -7 portion of the regulations will be considered in a separate rulemaking project.

In addition, FTB staff proposes to repeal Regulation sections 18662-11 through 18662-14. As set forth in the cross-reference chart (Exhibit B), the content of Regulation sections 18662-11 through 18662-13 has been incorporated into other sections of the draft regulations. The content of section

18662-14 (interpleader by withholding agent over conflict in federal and state tax liens) has not been incorporated into these draft regulations.

D. Meeting Documents

FTB staff has prepared several documents to assist the public in its review of these regulations. The following documents are provided:

- [Exhibit A, Purpose and Scope of the Regulations, and Revisions Since November 2007, and Exhibit B, Cross-Reference Chart of Proposed Regulations to Existing Regulations](#)
- [Exhibit C, Third Draft of the Proposed Withholding Regulations](#)

E. Overview of the Four- Year Project

1. In mid-2007, in anticipation of system modernization, FTB staff began to revise and update the withholding regulations and to bring them into conformity with then-current law and FTB practice. For example, beginning in 2007, FTB implemented a quarterly withholding process, which changed due dates to report and remit withholding to match the estimated tax due dates, and required withholding agents to identify payments on behalf of taxpayers to allow immediate posting of the credit to the taxpayers' accounts.
2. In late 2007, the Department of Finance approved an FTB Feasibility Study Report and the funding for the WASS project, a technology modernization project designed to provide increased operational efficiencies, reliability, scalability, and security in support of FTB's mission critical withholding programs. The WASS project is scheduled for implementation in September 2011. Future enhancements will also provide greater transparency to the taxpayer by offering greater web based options for the external customer.
3. On June 27, 2007, FTB staff received approval from the three-member Franchise Tax Board to [proceed with an interested parties meeting on the proposed amendments to the withholding regulations](#). FTB staff included the first draft of the proposed regulations in the Board materials.
4. The first interested parties meeting was held on August 13, 2007. Prior to the meeting, various documents were provided to the public: [a topic list, an outline of the history of California withholding, the first draft of the regulations, and draft forms and instructions for 2008](#). FTB staff also invited questions and comments. FTB staff received oral and written questions and comments on the draft regulations before, during, and after the meeting.
5. [A report of the first interested parties meeting](#) was included in the materials for the Board meeting of November 28, 2007. The report included responses to comments received from the public, and suggested amendments to the draft regulation text to address those concerns, as appropriate. FTB staff included the [second draft of the proposed regulations](#) in the Board materials and [requested permission to proceed to the formal public hearing process](#) under the Administrative Procedures Act, which was granted.
6. During 2008 through 2009, the Legislature enacted a number of statutory amendments which changed the withholding requirements. Some of these related to real estate installment sales (Stats. 2008, ch. 305), real estate withholding (Stats. 2008, ch. 305), the maximum withholding rate (Stats. 2008 3rd Ex. Sess, ch.18), and backup withholding (Stats. 2009 4th Ex.Sess, ch. 18), to name a few.

F. Comment Period to August 12, 2011

Due to the numerous statutory changes described above, rather than proceeding pursuant to the November 28, 2007, Board approval directly into the formal public hearing process under the Administrative Procedures Act, FTB staff decided that substantial further revisions to and reorganization of the Board-approved draft regulations should occur through the Interested Parties Meeting process. As a result of these numerous and substantial changes to the second draft of the proposed regulations, FTB staff has determined that rather than providing a marked-up version of this second draft compared to the [third draft being published here](#), interested parties are encouraged to carefully review this third draft as if it were a completely new draft of the proposed regulation language. FTB staff will accept comments, written or oral, to this third draft until August 12, 2011, in order to ensure that interested parties have an adequate period to carefully review this newest third draft and provide comments on these revisions.