REQUEST FOR PERMISSION TO HOLD AN INTERESTED PARTIES MEETING TO DISCUSS ADDING REGULATION SECTION 18662-0, REVISING EXISTING REGULATION SECTIONS 18662-1 THROUGH 18662-8, DELETING EXISTING REGULATION SECTIONS18662-11 THROUGH 18662-14 (WITHHOLDING AT SOURCE) AND REVISING AND RENUMBERING REGULATION SECTION 25401b TO REGULATION SECTION 19002 (CREDIT FOR TAX WITHHELD)

Withholding at source is an essential part of the department'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, encouraging taxpayers to file returns at the end of the year.

California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements (Revenue and Taxation Code (R&TC) section 18662, subdivision (a).) These regulations have not been updated in many years, and do not currently reflect statutory and other changes affecting the withholding statutes themselves. For example, statutory changes such as the addition of real estate withholding, statutory and other legal changes relating to residency and sourcing of income, and the use of different types of business entities, especially pass-through entities, have caused the regulations to need to be updated. They were written at a time when electronic filing and payment were not available, and also need to be updated to align these filing and payment procedures with modern practices.

The text of the existing regulations has been rewritten and reorganized into a simpler, more descriptive order. The attached revised text of these various regulations are intended to be used to foster discussion at the Interested Parties meeting or meetings, and are not intended to represent staff's final version of proposed regulatory language

The revised text contains a Table of Contents, and the regulations begin with definitions and general rules applicable to all withholding at source, then provide specific guidance for the two major withholding areas that FTB administers: Real Estate Withholding, and Withholding on Payments (Nonresident Withholding). Withholding on Payments is then further broken down into the three major program areas currently addressed in FTB Publications: Non-Wage Independent Contractor, Rent and Royalty Guidelines (Pub. 1023); Entertainers and Athletes (Pub. 1024) and Pass-Through Entities (Pub. 1017). Reporting and Remitting Withholding rules have been consolidated into a single section. Finally, existing Regulation section 25410b would be renumbered as Regulation section 19002 and has been revised to add more specific rules for the crediting of withheld amounts.

Background

In 1971, R&TC sections18805 and 26131 (renumbered in 1993 to R&TC section18662) were enacted to require “any person” to withhold on payments of California source income to nonresidents. The current version of the regulations under R&TC section

18662 are substantially similar to the 1971 regulations implementing the original withholding at source requirements.

In 1987, AB 53 (Stats. 1987, Ch.1138), a massive federal conformity bill enacted in response to the 1986 TRA changes, conformed California law to Internal Revenue Code (IRC) section 1445 in former RTC section 18805, subdivision (a)(2), requiring foreign (non-U.S.) real estate sellers to withhold at one-third of the federal 10% rate, 3 1/3%. AB 53 also conformed the R&TC to the foreign partner withholding rules of Internal Revenue Code 1446 in former R&TC 18807, replacing the federal 20% rate with California's maximum personal income tax rate.

By 1988, it became clear at the federal level that the withholding on distributions to foreign partners was not effectively capturing the tax due from the gain on the disposition of property interests by foreign partners, so in the Technical and Miscellaneous Revenue Act of 1988, Congress revised the withholding tax on foreign partners (IRC 1446), changing the withholding on distributions to a requirement that withholding be remitted on the partner's distributive share of effectively connected (U.S. source) income.

California conformed to the foreign partnership federal changes by reference in AB 802 (Stats. 1989, Ch.352). So, in 1989, California law required the withholding of 3 1/3% of the proceeds from foreign (non-U.S.) real estate sellers that were also required to withhold under federal law. California also required withholding on distributive shares for foreign (non-U.S.) partners that were subject to federal withholding.

In 1990, FTB Legislative Proposal 90-015 identified the issue of domestic (U.S.) non-California residents selling California property as a major tax gap issue, and proposed extending the foreign real estate withholding provisions to domestic (U.S.) nonresidents. FTB Legislative Proposal 90-014 amended the law to provide that withholding could be allowed as a credit against tax due on newly authorized group returns of nonresident partners, and provided for interest to be assessed on late remittances of amounts withheld. These changes were incorporated first into SB 2894, and later into SB 2319 (Stats. 1990, Ch. 464), applicable for tax years beginning in 1991. That bill specifically added "partnership income or gains" to items of income subject to FTB's general withholding authority. To avoid double withholding on real estate sales by partnerships with foreign partners, sales of property by all partnerships (California and out-of-state) were excluded from the 3 1/3% real estate withholding provisions on the theory that the withholding at the maximum PIT rate would cover the maximum amount of tax that could become due.

Also in 1990, in conjunction with these statutory changes, FTB exercised its existing general withholding authority to require domestic (U.S.) nonresident partner withholding beginning in 1991. (See FTB Notice 90-5, August 20, 1990.)

In 1993, as part of the general restructuring of the R&TC, the various code sections relating to withholding at source were renumbered and consolidated into Article 5 of Chapter 2 of new Part 10.2 (sections 18861, et. seq.).

For the next ten years, the withholding program was fairly stable. Payments to nonresident individuals and non-California business entities (including non-California partnerships) were subject to a general 7% withholding rate, except that proceeds from the sale or distribution of real property by nonresident individuals and business entities (but not partnerships) were instead subject to a 3 1/3% rate on the proceeds of the sale. Real estate held in the name of a partnership was not subject to withholding on sale because it was anticipated that the 7% rate would be applied when the proceeds from the sale were distributed to any non-California partners.

In 2002, AB 2065 (Stats. 2002, Ch. 488) extended real estate withholding to sales by California resident individuals.

In 2004, AB 1338 (Stats. 2004, Ch. 528) originally proposed an alternative withholding amount (later enacted in 2006), but that bill was amended during the legislative process to delete that alternative withholding provision.

In 2006, AB 2962 (Stats. 2006, Ch. 428) established the alternative withholding amount, allowing sellers to elect to have the gain from the sale withheld at the highest marginal rate applicable to the seller (explained in the AB 1338 analysis as 9.3%, 8.84% or 10.84%), instead of a flat 3 1/3% of the total sales price.

Also in 2006, FTB notified S Corporations of its intent to begin requiring S Corporations to withhold on distributive shares of California source income to nonresident shareholders, and amended Pub. 1017 accordingly.

The attached discussion draft regulations incorporate the various statutory changes above and summarize procedures and publications that have been developed. They change the due dates for withholding on payments to more closely match estimated tax due dates.

Staff requests that the Board authorize one or more interested parties' meetings to receive input on the discussion draft regulations. After input is received from interested parties, staff will report back to the Board and revise the discussion draft language accordingly as proposed draft regulatory language for which staff will seek authorization to proceed to the formal regulatory process under the Administrative Procedure Act.

Regulation section 18662-0 is adopted to read:

§ 18662-0. Table of Contents. – Regulation Sections 18662-1 through 18662-8.

§ 18662-1. Withholding at Source -- Generally.

(a) Types of Withholding.
    (1) Generally.
    (2) Withholding Tax on Wages.
    (3) Withholding Orders for Delinquent Taxes.
    (4) Non-U.S. Partners.
.
(b) Withholding at Source.
    (1) Generally.
    (2) Real Estate Withholding.
    (3) Withholding on Payments.
    (4) Credits for Tax Withheld.
    (5) Reporting and Remitting Witholding.

(c) Other Withholding Required After Notification.

§ 18662-2. Definitions.

(a) Income.
(b) Payee.
(c) Payor.
(d) Withholding Agent.
(e) Partnership.
(f) Partner.
(g) Transferee.
(h) Transferor.
(i) Real Estate Escrow Person.
(j) Buyer.
(k) Seller.
(l) California Business Entity.
(m) Non-California Business Entity.
(n) California Resident Individual.
(o) Nonresident Estates and Trusts.

§ 18662-3. Real Estate Withholding.

(a) General.

(b) Statutory Basis and Rates.

(c) Who Must Withhold – Required Notification and Responsibility.
- (1) Notification.
- (2) Failure to Provide Notification.
- (3) Buyer's Responsibility May be Delegated.

(d) Exemptions From Withholding.
- (1) Total Sales Price $100,000 or Less.
- (2) Seller is a Business Entity With a Permanent Place of Business in California.
  - (A) Certification.
  - (B) Principal Place of Business in California.
  - (C) Business Entities Defined.
- (3) Exempt, Disregarded and Other Entities.
  - (A) Tax-Exempt Entities.
  - (B) Insurance Companies.
  - (C) Disregarded Entities.
  - (D) Trusts.
  - (E) Real Estate Investment Trusts (REIT).
  - (F) Bankruptcy Trusts and Estates.
  - (G) Estates.
  - (H) Conservatorships.
- (4) Principal Residence.
- (5) Loss or Zero Gain.
- (6) Involuntary Conversions.
- (7) Contributed Capital – Transfers to a Controlled Corporation or Partnership.
- (8) IRC section 1031 Exchanges.
  - (A) Simultaneous Like-Kind Exchanges.
  - (B) Deferred Like-Kind Exchanges.
  - (C) Failed Transactions.
- (9) Foreclosure.
- (10) Relocation Companies.

(e) Exemption, Installment Sale and Alternate Withholding Rates.
- (1) Exemption Certificate and Estimated Gain or Loss Certificate.
- (2) Filing and Retention of Exemption Certificate.
- (3) Verification.
- (4) Electing the Alternate Withholding Rate.
- (5) Installment Sales.

(f) Special Rules.
- (1) Multiple Family Units.
- (2) Multiple Sellers/Parcels.
- (3) Sellers on the Title for Incidental Purposes.

(4) Sale of Multiple Parcels When the Total Sale Price of all Properties Exceeds $100,000 but the Sale Price of Each Separate Parcel is Under $100,000.
(5) Leaseholds/Options.
(6) Personal Property Included in Real Estate Transaction.
(7) Cash-Poor transactions.

§ 18662-4. Withholding on Payments (Nonresident Withholding) – General.

(a) Scope of Required Withholding, Rates and De Minimis Amounts.
(1) Nonresident Individuals and Non-California Business Entities..
(2) De Minimis Amounts.
(3) Rate.
(4) Cross-references.

(b) Exceptions.
(1) California Resident Individuals.
(2) California Business Entities.
(3) Tax Exempt Entities.
(4) California estates and trusts.
(5) Banks and Banking Associations.
(6) Payments for Goods.
(7) Services of a nonresident outside California.
(8) Intangible Personal Property.
(9) Motor Carrier Compensation.
(10) Employee Wages (EDD withholding).
(11) Nonresident Corporate Directors.

(c) Entities Specifically Subject to Withholding.
(1) Nonresident individuals.
(2) Non-California Business Entities.
(3) Nonresident Estates and Trusts.
(4) Individuals and Entities failing or refusing to provide information.
(5) Suspended or forfeited corporations.

(d) Withholding Exemption Certificate.
(1) General.
(2) Incomplete or Invalid Certificates.
(3) California Address.
(4) False Certificate.

(e) Information Returns Also Required.

(f) Waivers and Reduced Rates.
(1) Waivers.
(2) Request for Reduced Withholding Amount.

(g) Requirement to File a California Return.

(h) Suspended and Forfeited Corporations.

§ 18662-5. Non-Wage, Independent Contractor, Rents and Royalties (Pub. 1023).

(a) Payments Subject to Withholding.
- (1) Generally.
- (2) Specifically Subject to Withholding.
- (3) Business Situs.
- (4) Tax Treaties – Payments to Foreign Individuals or Entities.
- (5) Payments Made to Reimburse Expenses.
- (6) Services in Connection With the Sale of Goods.

(b) Payments to Independent Contractors.

(c) Payments to Subcontractors.

(d) Rent or Royalty Payments.
- (1) Rent or Lease Payments Made to Nonresidents.
- (2) Types of Rental or Leased Property Subject to Withholding.
- (3) Royalty Payments Made to Nonresidents.

(e) Payments to Corporate Directors.

(f) Seminars and Expert Witnesses.

(g) Income Allocation.
- (1) Nonresident Contractors.
- (2) Reliance on Allocations Provided by Payees.
- (3) Appropriate Denominator for the Ratio When Using an Allocation Based on Time.
- (4) Determining the Portion of the Payment Related to Services When Payments are Made for Goods and Services.
- (5) Allocation of Distributions.

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

(a) Payments Subject to Withholding.
- (1) General.
  - (A) Compensation for Personal Services.
  - (B) Withholding Required Even if Contract States No Withholding.
  - (C) Payments Made to Reimburse Expenses.
- (2) Payments Made to Agents or Promoters.
- (3) Supporting Acts Paid by Headliner.
- (4) Sound and Lights.

(b) Request for Reduced Withholding Amount.

(c) Exceptions.

(d) Venues that Are Not Promoters.

(e) Canceled Performances.

(f) Athletes.
- (1) Duty Days.
- (2) Performance Signing Bonuses.

§ 18662-7. Nonresident Withholding Domestic (U.S.) Pass-through Entities.

(a) General Information and Withholding Requirements.
- (1) General.
- (2) Non-US Partners.

(b) Payments Subject to Withholding.

(c) Entities Subject to Withholding and Residency Status.

(d) Waivers and Reduced Amounts.

(e) Partnerships and Other Pass-Through Entities That Have Been Withheld Upon.
- (1) General.
- (2) Partnerships.
- (3) Limited Liability Companies.
- (4) Estates and Trusts.
- (5) S Corporations.
- (6) Allocation.
- (7) Timing.

(f) Special Pass-Through Entity Rules.
- (1) Interaction With Group Returns.
- (2) Year-End Distributions, Prior-Year Income, Late or Amended Withholding Amounts.
- (3) Examples.

§ 18662-8. Reporting and Remitting Withholding.

(a) General.

(b) Real Estate Withholding.
- (1) Payment Due Dates and Form.
- (2) Reporting.

(c) Withholding From Payments.
- (1) Payment Due Dates.

(2) Foreign Partners – Due Dates.
(3) Reporting.
(4) Electronic and Magnetic Media Requirements.

(d) Interest and Penalties.
(1) Interest.
(2) Penalties.
(A) Information Return Penalties.
(B) Liability of Withholding Agent For Unpaid Withholding.
(C) Special Rules for Real Estate Withholding.
1. Real Estate Notification and Withholding Penalties.
2. Real Estate Information Return Penalties.

(e) Coordination With Information Returns.

(f) Coordination With Group Returns.

Regulation Section 18662-1 is amended to read:

§ 18662-1. ~~Persons Subject to Withholding Requirements~~Withholding at Source-Generally.

~~Every individual who is a resident of or has a place of business in this State, or subject to the jurisdiction of the laws of this state, and every bank located within the limits of this State, and every partnership, corporation, including a nonprofit organization, joint stock company or association, insurance company or Massachusetts trust, organized under the laws of or having a place of business in this State, or subject to the jurisdiction of the laws of this State, in whatever capacity acting, (including leasees or mortgagors of real or personal property, fudiciaries, employers and any officer or department of this State or any political subdivision or agency of this State, or any city organized under a freeholders charter, or any political body not a subdivision or agency of this State) having the control, receipt, custody, disposal, or payment of income of the character described in Reg. 18662-2 derived from sources within this State by individuals who are nonresidents of this State must withhold from such income as provided in Reg. 18662-2 and transmit to the Franchise Tax Board the amount of tax specified in Reg. 18662-3 at the time and place specified in Reg. 18662-8.~~

(a) Types of Withholding

(1) Generally. California law requires withholding from certain payments and payment of those withheld amounts to the State. This regulation covers only withholding at source, and does not apply to wage withholding, withholding on non-U.S. partners, or withholding orders for delinquent taxes.

(2) Withholding Tax on Wages. Withholding taxes on wages is required by Division 6 of the California Unemployment Insurance Code (Sections 13000, et. seq.) and is administered by the Employment Development Department. See Revenue and Taxation Code section 18632. These regulations do not cover withholding taxes on wages.

(3) Withholding Orders for Delinquent Taxes. Withholding Orders for Delinquent Taxes may be issued pursuant to Revenue and Taxation Code section18670 and the Code of Civil Procedure relating to involuntary collection, levies and wage garnishments. These regulations do not cover withholding orders for delinquent taxes.

(4) Non-US Partners. California conforms to federal law (Internal Revenue Code section 1466) with respect to withholding on allocable shares of California source income effectively connected to a California trade or business. See Revenue and Taxation Code section 18666. These regulations do not cover non-U.S. partner withholding. See Treasury Regulations sections 1.1446-0, et. seq., and IRS Publication 515.

(b) Withholding at Source.

(1) Generally. Non-wage withholding is administered by the Franchise Tax Board under Article 5 of Chapter 2 of Part 10.2, Revenue and Taxation Code sections 18661, et. seq. Subject to the exceptions and definitions below, withholding of tax at the source is required from payments derived from California sources, in the case of specified payments or distributions to individuals and corporations and other business entities, or where the payee has failed or refused to provide a valid Taxpayer Identification Number, and is also required from the proceeds of sale of any California real property, unless specific exceptions apply or the Franchise Tax Board has notified the payor to withhold.

(2) Real Estate Withholding. Withholding at source is required from the proceeds of the sale of California real property by both residents and nonresidents of California, and from business entities without a permanent place of business in California, unless certain exceptions are met. See Revenue and Taxation Code section 18662, subdivision (e), and Regulation section 18662-3.

(3)(A) Withholding on Payments. Withholding at source is required from payments made to nonresident individuals, nonresident estates and trusts, and business entities, including corporations, partnerships and limited liability companies, that do not have a permanent place of business in California and are not registered through the California Secretary of State. Withholding is also required for certain payments where the recipient is unknown or unidentified or fails or refuses to provide a valid Taxpayer Identification Number.

(B) Cross-References. See Regulation section 18662-4 for general rules applicable to withholding on payments, and Regulation section 18662-5 for rules relating to payments made to nonresident independent contractors and payments of rents and royalties to nonresidents. See Regulation section 18662-6 for withholding relating to entertainment payments. See Regulation section 18662-7 for payments made to nonresidents (U.S.) by pass-through entities, including partnerships, S corporations and limited liability companies.

(4) Credits for Tax Withheld. See Revenue and Taxation Code section 19002 and Regulation section 19002 for the timing and application of credits of withheld amounts.

(5) Reporting and Remitting Withholding. Rules applicable to the process of reporting and remitting withholding to the Franchise Tax Board are set forth in Regulation section 18662-8.

(c) Other Withholding Required After Notification. In the case of payments of items of income not specified in this regulation, and in the case of persons not making payments of the items of income specified in this regulation but having the control, receipt, custody or disposal of such income, withholding of tax at source is required when such person or entity is notified by the Franchise Tax Board or a duly authorized representative thereof to withhold tax from such income, or as may be otherwise prescribed by the Franchise Tax Board in annual forms and instructions.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation Section 18662-2 is amended to read:

§ 18662-2. ~~Income Subject to Withholding and Requirements for Withholding~~Definitions.

(a) Items of Income. The items of income subject to withholding are interest, dividends, rent, prizes and winnings, premiums, annuities, emoluments, compensation for personal services, and other fixed or determinable annual or periodical gains, profits and income. For purposes of withholding, the term "income" includes all payments or receipts that are included in the information return reporting requirements of Article 4 of Chapter 2 (sections 18631, et. seq., and federal provisions incorporated by reference) of the Revenue and Taxation Code. ~~Withholding of tax at the source is required in the case of payments to nonresidents of compensation for personal services rendered in this State, except for wages subject to withholding under Section 13020 of the Unemployment Insurance Code or exempt therefrom under Section 13009 of the Unemployment Insurance Code or exempt from state withholding under federal law. Withholding at source is also required in the case of rentals or royalties for the use of, or for the privilege of using in this State, patents, copyrights, secret processes and formulas, good will, trademarks, brands, franchises, and other like property of such intangible property having a business or taxable situs as defined in Regs. 17951-1 through 17951-5, 17952 and 17953 in this State, and payments of prizes, premiums, rewards, winnings, etc., to nonresidents participating, or entering cars, horses, etc. in races and other contests in this State.~~

~~In the case of payments to nonresidents of items of income not specified in the second paragraph of this regulation and in the case of persons not making payments to nonresidents of the items of income specified in the first paragraph of this regulation buy having the control, receipt, custody or disposal of such income, withholding of tax at source is required when the person subject to withholding as specified in Reg. 18662-1 is notified by the Franchise Tax Board or a duly authorized representative to withhold tax from such income.~~

~~Compensation for personal services includes wages, salaries and any other remuneration such as, for example, payment of expenses of nonresident employees for services rendered in this State, commissions paid to nonresident salesmen or agents for orders received on sales made in this State, fees for professional services rendered here by nonresidents, and payments to nonresident actors, singers, performers, entertainers, wrestlers, boxers, etc., for performances in this State. Compensation for personal services includes payments to independent contractors, such as leaders, managers, or owners of bands, orchestras, dance teams, circuses, and similar groups of artists, entertainers or performers pursuant to contracts under which such leaders, managers or owners agree to furnish the services of their bands, orchestras, teams, circuses, or other groups within this State.~~

~~Withholding pursuant to this regulation is not required unless and until income payments with respect to each payee by the same payor either exceed $1,500 during the calendar year or the payor is directed to withhold by the Franchise Tax Board.~~

(b) Payee. The term “payee” means the person, including for this purpose corporations, partnerships, fiduciaries and state officers, agencies or political subdivisions, that receives items of income from a payor. It also includes partners, beneficiaries, shareholders or members that receive payments or distributions from a pass-through entity, estate or trust.

(c) Payor. The term “payor” means the person, including for this purpose corporations, partnerships, fiduciaries and state officers, agencies or political subdivisions, that pays an item of income or makes a distribution to a payee.

(d) Withholding Agent. The term "withholding agent" means the person, including for this purpose corporations, partnerships, fiduciaries and state officers, agencies or political subdivisions, charged by the law or by the Franchise Tax Board's order or regulation with the duty to withhold any tax, interest or penalties from payments to the taxpayer and to pay such amounts over to the Franchise Tax Board.

(e) Partnership. The term “partnership” has the same meaning as defined in Revenue and Taxation Code section 17008. For purposes of withholding, both limited liability companies classified as partnerships and limited liability partnerships are treated as partnerships under Regulation sections 18662-0 through 18662-8.

(f) Partner. The term “partner” has the same meaning as defined in Revenue and Taxation Code section 17008. For purposes of withholding, members of both limited liability companies classified as partnerships and limited liability partnerships are generally included in the term “partner” under Regulation sections 18662-0 through 18662-8.

(g) Transferee. The term "transferee" of real property includes the buyer of the property, within the meaning of Revenue and Taxation Code section 18662, subdivision (e), and the escrow person or agent, title agent or exchange accommodator where the context so requires.

(h) Transferor. The term "transferor" of real property includes the seller of the property, within the meaning of Revenue and Taxation Code section 18662, subdivision (e), and the escrow person or agent, title agent or exchange accommodator where the context so requires.

(i) Real Estate Escrow Person. The term "real estate escrow person" is defined in Revenue and Taxation Code section 18662, subdivision (e)(6), as the person, including any attorney, escrow company, or title company, responsible for closing the transaction, or any other person who receives and disburses the consideration or value for the interest or property conveyed.

(j) Buyer. A buyer includes the buyer or any other transferee of property.

(k) Seller. A seller includes the seller or any other transferor of property.

(l) California Business Entity. A California business entity is any business entity (as defined in Revenue and Taxation Code section 23038 and applicable regulations, including general corporations, S corporations, limited liability companies, partnerships, associations, joint ventures, disregarded entities, estates, trusts and various foreign entities) that is incorporated, organized, or formed, and existing, under the laws of this state or is qualified through the Office of the Secretary of State to transact intrastate business. A corporation which has not qualified to transact intrastate business (such as a corporation engaged exclusively in interstate commerce) will be considered as having a permanent place of business in this state only if it maintains an office in this state that is permanently staffed by its employees.

(m) Non-California Business Entity. A non-California business entity is a business entity (as defined in Revenue and Taxation Code section 23038 and applicable regulations, including general corporations, S corporations, limited liability companies, partnerships, associations, joint ventures, disregarded entities, estates, trusts and various foreign entities) that is not incorporated, organized, or formed in California, not qualified to do business in California, not registered with the California Secretary of State, or does not continue to have a permanent place of business in California throughout the tax year.

(n) California Resident. The term “resident” includes every individual who is in California for other than a temporary or transitory purpose, and any individual domiciled in California who is absent for a temporary or transitory purpose. Generally, an individual who comes to California for a purpose extending over a long or indefinite period will be considered a resident. An individual who comes to perform a particular contract of short duration will be considered a nonresident. See Revenue and Taxation Code section 17014 and Regulation section 17014.

(o) Nonresident Estates and Trusts. For withholding purposes, a trust is considered a California trust if at least one fiduciary is a California resident or a California business entity, or if the decedent was a California resident on the date of death. An estate is considered a California estate for withholding purposes when the decedent was a California resident on the date of death. Estates or trusts not establishing that they meet these requirements are treated as nonresident estates or trusts.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-3 is amended to read:

§ 18662-3. ~~Amount to Be Withheld~~ Real Estate Withholding.

(a) General.~~The amount of tax to be withheld shall be computed by applying a rate of 7%, or such lesser rate as authorized in writing by the Franchise Tax Board.~~ Withholding at source is required on proceeds from the sale or exchange of California real estate by California resident individuals and by nonresident individuals and business entities without a permanent place of business in California. The rate of withholding is 3 1/3% of the sales price, but the seller may elect an alternate rate based on the gain required to be recognized from the sale. The requirement to withhold is the responsibility of the buyer, but is generally performed by the Real Estate Escrow Person on the buyer's behalf. No withholding is required if certain exceptions are certified, notably that the property was the seller's principal residence or that no gain will be recognized from the sale. The Franchise Tax Board may audit escrow documents to verify compliance.

(b) Statutory Basis and Rates.

~~At the request of either the payer or payee, the Franchise Tax Board may consider documentation to the effect that the 7% rate will result in overwithholding. After considering such documentation, the Franchise Tax Board may waive the withholding requirements, in whole or in part, or authorize the use of a lower withholding rate. As a further condition for waiver or for authorizing a lower withholding rate, the payee will be required to assure the Franchise Tax Board, by bond, deposit or otherwise, that the source income withholding requirements applicable to the payee as a payor will be complied with.~~Revenue and Taxation Code section 18662, subdivision (e), requires withholding at source from any disposition of California real property at an amount equal to 3 1/3 percent of the sales price of the California real property conveyed, unless an election is made to use an alternative withholding rate based on gain from the sale.

(c) Who Must Withhold – Required Notification and Responsibility

~~The Franchise Tax Board's waivers and Notices to Withhold reflecting a withholding rate less than 7% shall be in writing and shall be mailed to the payor. If the payor has already withhold prior to the receipt of a waiver or Notice to Withhold, the payor may make a payment to the payee of the amount of overwithholding, if any.~~

(1) Notification. Revenue and Taxation Code section 18668, subdivision (e)(1), requires the real estate escrow person to provide written notice about the withholding requirements, unless the buyer is an intermediary or accommodator in a deferred exchange.

(2) Failure to Provide Notification. If the real estate escrow person fails to provide written notification, a penalty may be imposed of $500 or 10% of the

amount required to be withheld, whichever is more, unless it is shown that the failure to notify is due to reasonable cause.

(3) Buyer's Responsibility to Withhold May be Delegated. Once the buyer is notified, it is the buyer's responsibility to withhold. However, the real estate escrow person may assist the buyer to comply with the withholding requirements by performing or arranging for the withholding and remittance of required withholding and may charge a fee for this assistance not to exceed the amount set forth in subdivision (e) of section 18662..

(d) Exemptions From Withholding. No withholding is required if the seller establishes that one of the following exemptions applies:

(1) Total Sales Price of $100,000 or Less. No withholding is required unless the sales price of the property conveyed exceeds $100,000. "Total sales price" is generally the same amount as required for information reporting purposes and shown on the federal form 1099-S. (See Treasury Regulation section 1.6045-4.)

(2) Seller Certifies that it is a California Business Entity. Withholding is required unless the seller certifies that it is a California business entity as defined in Regulation section 18662-2, and that it will continue to have a permanent place of business within California after the sale, or is a bank or a bank operating as a fiduciary for a trust, a tax-exempt entity, or an insurance company, individual retirement account (IRA), qualified pension plan, or charitable remainder trust.

(3) Exempt, Disregarded and Other Entities.

(A) Tax-Exempt Entities. Withholding is not required if the seller is a tax exempt entity under California or federal law (e.g. government agency, Resolution Trust Corporation, or exempt, charitable, religious, or educational organizations.)

(B) Insurance Companies. No withholding is required if the seller certifies that it is an insurance company subject to the gross premiums tax under Section 28 of Article XIII of the California Constitution.

(C) Disregarded Entities. Entities such as a single member limited liability company that has chosen to be disregarded for federal and California income tax purposes are also disregarded for withholding purposes. The single member is considered to be the seller and title to the property is considered to be in the name of the single member for withholding purposes.

(D) Trusts. If the trust is a "grantor" trust, then the seller is the grantor. Usually the grantor of a grantor trust is an individual. All withholding forms should be completed using the individual's (grantor's) information. If the trust is other than a disregarded grantor trust (e.g. an "inter vivos" or "living" trust),

then the seller is the trust. All withholding forms should be completed using the name of the trust and the trust's federal employer identification number (FEIN).

(E) Real Estate Investment Trusts (REIT). For real estate withholding purposes, a REIT is treated as a corporation. Withholding is not required as long as the REIT has a permanent place of business in California.

(F) Bankruptcy Trusts and Estates. Withholding is required when a bankruptcy trust or estate sells the property. There are no exemptions for trusts with a California trustee.

(G) Estates. Withholding is generally required when an estate sells real property. However, if the property being sold qualified as the decedent's principal residence, withholding is not required.

(H) Conservatorships. Withholding is required unless the conservatee qualifies for an exemption. The conservator should complete real estate withholding exemption certificate using the conservatee's information.

(4) Principal Residence. No withholding is required if the seller certifies that the property conveyed was their principal residence within the meaning of Internal Revenue Code section 121, or that the last use of the property was as the transferor's principal residence. Generally, a home will qualify as a principal residence if, during the five-year period ending on the date of sale, the sellers have owned and lived in the property as their main home for at least two years. There are exceptions to the two-year rule if the primary reason they are selling the home is due to a change in the place of employment, health, or other unforeseen circumstance such as death, divorce, or loss of job. See Internal Revenue Code section 121 and Treasury Regulation sections 1.121-1 through 1.121-5. Even if the property does not qualify for exclusion under Internal Revenue Code section 121, the seller may still claim the exclusion from withholding if the property was last used as the seller's principal residence within the meaning of Internal Revenue Code section 121, without regard to the two-year time period.

(5) Loss or Zero Gain. If the seller has either a loss or zero gain for California income tax purposes from the sale, which results when the seller's adjusted basis in the property is more than or equal to the selling price (less selling expenses), then no withholding is required. It is not a loss or zero gain just because there are no proceeds from the sale or because the property is selling for less than it is worth. In computing gain under this exemption, sellers may use passive activity losses that directly relate to the property being sold. They may not use losses that are not directly related to the property, such as passive activity losses or carryforwards from a different property, capital loss carryforwards, stock losses, or net operating losses.

(6) Involuntary Conversions. Withholding is not required when sellers certify that the transfer is the result of an involuntary transfer under Internal Revenue Code section 1033 and that they intend to replace the property with qualified property within the required time period under Internal Revenue Code section 1033.

(7) Contributed Capital - Transfers to a Controlled Corporation or Partnership. Withholding is not required where the transferors certify that the transfer qualifies for nonrecognition treatment under Internal Revenue Code section 351 (property transferred to a corporation controlled by the transferor) or Internal Revenue Code section 721 (property contributed to a partnership in exchange for a partnership interest).

(8) IRC Section 1031 Exchanges. No withholding is required on the initial transfer where the seller certifies that the transfer will qualify as:

(A) A Simultaneous Like-Kind Exchange. However, if the seller receives any proceeds from the sale (boot), withholding is required at 3 1/3% of that amount or the alternative withholding amount, if so elected.

(B) A Deferred Like-Kind Exchange. However, if the seller receives proceeds from the sale (boot) in excess of $1,500, withholding is required at 3 1/3% of that amount or the alternative withholding amount, if so elected.

(C) Failed Transactions. Notwithstanding the certification above, if the transaction fails, does not occur or does not meet the Internal Revenue Code section 1031 requirements, the intermediary or accommodator must withhold at 3 1/3% of the full sales price amount or the alternative withholding amount, if so elected.

(9) Foreclosure. To be excluded from withholding as part of a foreclosure, the transferee must be acquiring the property under one of the following circumstances:

(A) At a sale pursuant to a power of sale under a mortgage or deed of trust.
(B) At a sale pursuant to a decree of foreclosure.
(C) By a deed in lieu of foreclosure.

(10) Relocation Companies. Sales to relocation companies are subject to the same rules as other sales. There is no withholding on the sale if the relocating seller certifies that the property was their principal residence or if they qualify for any other exemption. Otherwise, withholding is required. Relocation companies themselves are subject to the same rules as other non-individuals.

Example 1. A relocation company resells the property to a third party. There is no withholding on the sale if the relocation company meets an exemption. If the relocation company does not meet an exemption, withholding is required.

Example 2. An employer that is treated as owner of the real property under federal law gives a relocation company power of attorney to act on its behalf in the resale of property to a third party. No withholding is required on the sale if the employer certifies that it has a permanent place of business in California. If the employer does not have a permanent place of business in California, withholding is required. The relocation company is not subject to real estate withholding because it is only acting as an agent for the seller.

(e) Exemption, Installment Sale and Alternate Withholding Rate Procedure

(1) Exemption Certificate and Estimated Gain or Loss Certificate. The seller must complete a real estate withholding exemption certificate prior to the close of the real estate transaction to claim exemption from withholding. Failure to provide a completed and signed real estate withholding exemption certificate by the close of the real estate transaction will result in withholding. If the exemption is claimed due to loss or zero gain, the seller must also complete and sign a real estate withholding – computation of estimated gain or loss form.

(2) Filing and Retention of Exemption Certificate. The Franchise Tax Board may specify by forms and instructions whether the exemption certificate and/or the estimated gain or loss certificate must be filed with the Franchise Tax Board, or simply retained by the real estate escrow person for submission, upon request, at a later date to the Franchise Tax Board. If required to be filed immediately, the Franchise Tax Board may specify the conditions for filing and the due date of such filing. Whether or not the certificate is required to be filed with the Franchise Tax Board, the real estate escrow person must retain the form for five years following the closing date of the transaction.

(3) Verification. Real estate escrow persons are only required to verify certifications to the extent that they have actual knowledge of the facts. If they have no actual knowledge of the facts, then they must only verify that the certificate is complete and signed. The real estate escrow person will be relieved of the withholding requirements if they rely in good faith on a completed and signed real estate withholding exemption certificate. Real estate escrow persons should not rely upon an incomplete or unsigned certificate.

Example 1: A seller completes a worksheet calculating the estimated gain or loss and certifies a loss on the transaction. The Franchise Tax Board does not require the real estate escrow person to verify the amounts shown on the worksheet.

Example 2: A seller completes a real estate withholding exemption certificate and certifies that the sale is an installment sale. However, the buyer has not provided a completed and signed installment sale agreement to the real estate escrow person. The real estate escrow person should not accept the real estate withholding exemption certificate and should withhold on this transaction.

Example 3: A seller completes a real estate withholding exemption certificate and certifies that a partnership is selling the property, but the real estate escrow person has actual knowledge that the recorded title of the property is not in the name of the partnership. The real estate escrow person should not accept the real estate withholding exemption certificate and should withhold on this transaction.

(4) Electing the Alternate Withholding Rate. The seller making the election must complete and sign a real estate withholding – computation of estimated gain or loss form, and sign a completed Real Estate Withholding Tax Statement. The signature certifies in writing under penalty of perjury the gain required to be recognized and the alternate withholding amount. The Franchise Tax Board may specify by forms and instructions whether the forms must be filed with the Franchise Tax Board, or simply retained by the real estate escrow person for submission, upon request, at a later date to the Franchise Tax Board. If required to be filed immediately, the Franchise Tax Board may specify the conditions for filing and the due date of such filing. Whether or not the election is required to be filed with the Franchise Tax Board, the seller and the real estate escrow person must retain the form for five years following the closing date of the transaction.

(5) Installment Sales. The real estate escrow person must withhold the full 3 1/3 % of the total sale price or the alternative withholding amount when escrow closes, unless the buyer agrees to withhold on the principal portion of each installment payment. To withhold on the principal portion of each installment payment, the buyer must complete and sign a real estate withholding installment sale agreement. The buyer must give this form to the real estate escrow person. Based on the buyer's written agreement with the Franchise Tax Board , the real estate escrow person will then withhold either 3 1/3 percent of the first installment or an alternative withholding percentage of the first installment. If the buyer does not elect to withhold on each installment payment, either 31/3 percent of the total sales price or the alternative withholding amount certified by the seller must be withheld at the time of the sale.

(f) Special Rules.

(1) Multiple Family Units. If the property sold is a multiple family unit (duplex, triplex, apartment building, etc.) and the seller lived in one of the units as their principal residence, withholding is required only for the portion of the sales price that is not for the principal residence. The sales price should be allocated between the principal residence and the remainder of the units using the same method that the seller used to determine depreciation deductions for the non-principal residence portion of the property. Withholding is still required when the total sales price of the property (all units) exceeds $100,000, even if the portion of the sales price allocable to the non-principal residence portion of the property does not exceed $100,000.

(2) Multiple Sellers/Parcels. When there are multiple sellers, the withholding amount is calculated by applying the withholding rate to each seller's proportionate share of the total sale price.

Example 1: Withholding at 3 1/3% of total sale price

Total sale price $200,000
Sellers' ownership percentages:
A = 20%, B = 30%, C = 50%
Withholding per seller:
A $200,000 x 20% x .0333 = $1,332
B 200,000 x 30% x .0333 = 1,998
C 200,000 x 50% x .0333 = 3,330

Example 2: Alternative withholding method, assuming a maximum tax rate of 9.3% in the year of sale:

Gain on sale $200,000
Seller's ownership percentages:
A = 20%, B = 30%, C = 50%
Withholding for individual seller:
A $200,000 x 20% x .093 = $3,720
B 200,000 x 30% x .093 = 5,580
C 200,000 x 50% x .093 = 9,300

(3) Sellers on Title for Incidental Purposes. If the incidental sellers have no financial ownership, then their ownership percentage is zero and there is no withholding required for them.

Examples of sellers who are on title for incidental purposes are:

Example 1: Father is on title only because he cosigned to help daughter qualify for a loan. If father completes a real estate withholding exemption certificate showing zero percentage of ownership, no withholding is required on father. Daughter is the beneficial owner of the property and is subject to the normal withholding requirements.

Example 2: Son is on title only to receive property upon mother's death. If son completes a real estate withholding exemption certificate showing zero percentage of ownership, no withholding is required on son. Mother the beneficial owner of the property and is subject to the normal withholding requirements.

(4) Sale of Multiple Parcels When the Total Sale Price of all Properties Exceeds $100,000 but the Sale Price of Each Separate Parcel is Under $100,000. Sales of

multiple parcels within the same escrow agreement constitute one transaction for purposes of determining the withholding requirements under this regulation.

(5) Leaseholds/Options. The sale of a leasehold is considered a sale of a real property interest, so withholding is required. The sale of an option to buy real property is also considered a sale of a real property interest, so withholding is required.

(6) Personal Property Included in Real Estate Transaction. If personal property is included in the sales price of the real property, withholding is computed on the full amount. If the price of the personal property is stated separately in the sales contract, the withholding base does not include the personal property amount.

(7) "Cash-Poor" Transactions. The fact that a transaction is cash-poor does not provide an exemption for withholding, and the parties must arrange to pay the withholding that is due. When a tax lien is recorded on the property, the proceeds in the escrow account are first used to pay the required withholding before the proceeds apply to an existing lien, including federal tax liens. If there are insufficient proceeds available to pay off a federal tax lien and the withholding amount that is due, then the parties can arrange to pay the withholding amount outside of escrow.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-4 is amended to read:

§ 18662-4. ~~Withholding of Delinquent Taxes Due from Both Resident and Nonresident Taxpayers.~~ Withholding on Payments (Nonresident Withholding) – General.

~~In addition to withholding from payments of income to nonresident taxpayers in accordance with the requirements of Regs. 18662-1 to 18662-4, the individuals, firms and companies mentioned in Reg. 18662-1 must, upon notice and demand from the Franchise Tax Board or its authorized representatives, withhold from any credits or other personal property or other things of value due any individual, estate or trust, the amount of any tax due under the law from such individual, estate or trust. Furthermore, effective May 30, 1957, firms and companies mentioned in Reg. 18662-1 must, upon notice and demand, withhold from any credits or other things of value the amount of any liability incurred by any person for his failure to withhold upon notice and demand amounts due under the law from a taxpayer. The amounts so withheld must be transmitted to the Franchise Tax Board immediately.~~

(a) Nonresident Individuals and Non-California Business Entities, Rates and De Minimis Amounts.

(1) Nonresident Individuals and Non-California Business Entities. With the exception of withholding on the proceeds of the sale of certain real estate, (see section 18662-3), and backup withholding for unidentified payees, California currently requires withholding at source only from payments to nonresident individuals and non-California business entities. Withholding on payments to resident individuals and California business entities is optional, but if withholding at source is done, it must be done according to the rules applicable to mandatory withholding

(2) De Minimis Amounts. Withholding is optional, not required, on the first $1,500 paid for the tax year.

(3) Rate. The withholding rate is seven percent of the gross payment or distribution amount.

(4) Cross-references. See Regulation sections 18662-5 (non-wage payments), 18662-6 (entertainers and athletes), and 18662-7 (pass-through entities) for specific requirements.

(b) Exceptions. Generally, withholding at source is optional and not required on payments:

(1) To California Resident Individuals as defined in Regulation section 18662-2. Withholding agents may use reasonable methods to determine the California residency of payees.

Example #1: Withholding agents may send their payees a Withholding Exemption Certificate. Payees may use this form to certify their residency status, provided that the certificate is only valid if payees include their taxpayer identification number.

Example #2: Withholding agents can rely on a California street address as an indication of a payee's residency status. If the payee has a California street address, no withholding is required and an exemption certificate is not needed to verify residency status,if the withholding agent reasonably believes such address is not merely a forwarding address. A valid California street address does not include a California Post Office Box, or an "in care of" address. If a change of address occurs, the withholding agent must reevaluate the payee's residency status.

(2) To California Business Entities as defined in Regulation section 18862-2 that are in good standing.

If a non-California business entity payee is doing business in California, and is earning California source income, withholding is required unless the payee meets an exemption to withholding.

If a corporate payee is not qualified through the Office of the Secretary of State and does not have a permanent place of business in this state, but is a member of a combined report filed under Regulation section 25106.5 and included in a group return filed pursuant to that regulation, the key corporation is treated as a guarantor and surety for the other members, so that the corporate payee is deemed to be a California Business Entity.

The following are examples of methods the Franchise Tax Board will consider reasonable for withholding agents to rely on in determining if a corporation has a permanent place of business in California or is qualified to do business in this state for purposes of these withholding regulations:

Example #1: Withholding agents may rely on a completed Withholding Exemption Certificate. A completed certificate, showing the payee's taxpayer identification number and stating that the corporation has a permanent place of business in California (or is included in a group return with a California key corporation), protects the withholding agent from penalties for failure to withhold, unless the withholding agent has actual knowledge that the statement is false.

Example #2: If a corporation is currently incorporated in California or qualified to do business in California with the Office of the Secretary of State, it is a California Business Entity for withholding purposes. Withholding agents can determine if a

corporate payee is a California corporation in good standing or qualified to do business in this state by contacting the Office of the Secretary of State.

(3) To Tax Exempt Organizations that are exempt either under California or federal law.

An organization is an exempt organization for withholding purposes if it meets the requirements of Chapter 4 of Part 11 of the Revenue and Taxation Code (commencing with section 23701) or Subchapter F of the Internal Revenue Code (commencing with section 501).

(4) To California Estates and Trusts as defined in Regulation section 18662-2.

(5) Where the payee is a bank or banking association.

(6) For goods.

(7) For services provided by a nonresident that were not performed in California.

(8) From intangible personal property, such as interest or dividends, unless the property has acquired a business situs in California or the payee has failed or refused to provide a valid taxpayer identification number. See Regulation Section 18662-5 for a discussion of business situs.

(9) Compensation from a motor carrier providing transportation in two or more states, subject to section 11504(b) of Title 49 of the United States Code.

(10) Wages paid to employees. However, wages are subject to wage withholding. Employee wage withholding is covered by the Unemployment Insurance Code and administered by the Employment Development Department.

(11) The payments are made to a nonresident corporate director for director's services. However, information returns for nonresident corporate directors for director's services must be filed in accordance with Revenue and Taxation Code section 18622, subdivision (h)(1). Nonresident directors must file California tax returns if they otherwise meet return filing requirements, or may elect to be included in a group return pursuant to Revenue and Taxation Code section 18536.

(c) Individuals and Entities Specifically Subject to Withholding.

(1) Nonresident individuals.

(2) Non-California Business Entities as defined in Regulation section 18662-2.

(3) Nonresident Estates and Trusts.

(4) Individuals and entities that fail or refuse to provide identifying information, generally where backup withholding is required under the provisions of Internal Revenue Code section 3406, et. seq.

(5) Suspended or forfeited corporations.

(d) Withholding Exemption Certificates.

(1) General. Where the payee otherwise properly certifies that it meets the requirements for an exemption under a Withholding Exemption Certificate, or the nonresident or withholding agent has received written authorization from the Franchise Tax Board waiving the withholding requirement, no withholding is required.

(2) Incomplete or Invalid Exemption Certificates. An incomplete certificate is invalid and the withholding agent should not accept it. If the withholding agent receives an incomplete certificate, the withholding agent is required to withhold tax on payments made to the payee until a valid certificate is received. In lieu of a completed certificate on the preprinted form, the withholding agent may accept as a substitute certificate a letter from the payee explaining why the payee is not subject to withholding. The letter must contain all the information required on the certificate in similar language, including the under penalty of perjury statement and the payee's taxpayer identification number. The withholding agent may accept facsimiles or photocopies of the withholding forms.

(3) California Address. Withholding agents may accept a complete certificate when an individual certifies residency but does not show a California address, unless the withholding agent believes the certification is fraudulent. The Franchise Tax Board may provide procedures for retaining and/or filing certificates by forms and instructions. Whether or not a copy of the certificate is required to be filed, the withholding agent must retain a copy of the certificate or substitute for at least five years after the last payment to which the certificate applies, and provide it upon request to the Franchise Tax Board.

(4) False Certificate. A withholding agent who knowingly accepts a false certificate is subject to the liabilities and penalties relating to failure to withhold. The certification does not need to be renewed annually. The certification remains valid until the payee's status changes. The withholding agent should evaluate the need for securing a new certificate when any indication of a change in residency status occurs, such as a change of address, etc.

(e) Information Returns Also Required. Even though withholding at source may be required, any information return required under any other provision of law is also required. The Franchise Tax Board may provide the form and manner of filing withholding statements and information returns by forms and instructions, including

circumstances where they may be filed together on a single document or may be filed electronically.

(f) Waivers and Reduced Amounts. In some cases, the Franchise Tax Board will authorize a waiver or reduced withholding amount.

(1) Waivers. In general, the payee must show either that a specific exemption to withholding applies or that withholding would be a hardship and the payee has a history of timely filing and payment. Requests for waivers must be submitted before the payment is made so the Franchise Tax Board can issue a determination letter before the withholding is due. Requests shall be made in the form and manner that the Franchise Tax Board shall provide by forms and instructions. Withholding is required unless the Franchise Tax Board issues a determination letter authorizing a waiver.

(2) Request for Reduced Withholding Amount. Payees in some circumstances can request a reduced withholding amount to reflect expenses and costs or other special circumstances that would justify a reduced amount. Requests shall be made in the form and manner that the Franchise Tax Board shall provide by forms and instructions.

(g) Requirement to File a California Return. Withholding does not relieve the taxpayer of the obligation to file a California return. For individuals, a California return is required if a nonresident individual has any income from California sources and has any California tax liability. (See Revenue and Taxation Code section 18501.) Business entities must file returns if they are subject to franchise or income tax, are doing business in California, or have any California source income for the year. No refund or credit of withholding can be made to an individual or entity that fails to file a tax return for the year. (See Revenue and Taxation Code section 19307.)

(h) Suspended and Forfeited Corporations. Withholding is required from any payment to or by a suspended or forfeited corporation, if the payee has knowledge of, or has reason to know of, the suspension or forfeiture.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-5 is amended to read:

§ 18662-5. ~~Remedies of Taxpayer~~Non-Wage, Independent Contractor, Rents and Royalties, Beneficiaries of Estates and Trusts.

~~If, as a result of the action of a withholding agent in transmitting the tax to the Franchise Tax Board, taxpayer's tax is overpaid, the taxpayer is entitled to file a claim for the refund or that overpayment, and to appeal to the Board of Equalization or to an action in the courts, to the same extent as if the taxpayer himself had made the overpayment. Refund claims must be filed within four years after the last day prescribed for the filing of the taxpayer's return, or within one year after the payment of the tax by the withholding agent, whichever period expires the later. Interest is to be allowed in all such cases, to be computed at 6 percent per year from the 15th day of the fourth month following the close of the taxable year for which such amounts were withheld. The taxpayer cannot hold the withholding agent liable for any payment made to the Franchise Tax Board pursuant to Reg. 18662-1 to 18662-5, unless the amount withheld is refunded to the withholding agent.~~

(a) Payments Subject to Withholding.

(1) Generally. As explained in Regulation section 18662-4, withholding agents are required to withhold from all payments or distributions of California source income made to a nonresident when the payments or distributions are greater than $1,500 for the calendar year, unless the withholding agent receives authorization for a waiver or a reduced withholding amount from the Franchise Tax Board. As a general rule, payments of income that must be reported on a federal form 1099-MISC are payments of the type that may be subject to California withholding at source if the recipient is a nonresident individual or a non-California business entity.

(2) Specifically Subject to Withholding. The following California source income is specifically subject to withholding:

(A) Payments made for personal services performed in California. The source of income from personal services is the location where the services are performed, and not where the nonresident lives, the location where the contract for services is entered into, or the place of payment.

(B) Payments received for a covenant not to compete in California.

(C) Payments releasing a contractual obligation to perform services in California.

(D) Income from options received as a result of performing personal services in California.

(E) Bonuses paid for services performed in California.

(F) Rents and royalties from assets located in California.

(G) Taxable prizes and awards paid in California or paid for competitions or contests in California, including game shows, races, auto, horse and dog racing.

(H) Distributions of California source taxable income to nonresident beneficiaries from an estate or trust, including both cash and non-cash distributions.

(I) Any other amount of California source income for which a state or federal information return is required to be filed.

(3) Business Situs. Income from intangible personal property such as stocks, bonds, notes, etc., is not income from California sources unless the property has acquired a business situs in California. A California business situs is acquired when the property is employed as capital in California. A California business situs is also acquired when the possession and control of the property has been localized in connection with a business, trade, or profession in California so that its substantial use and value attach to and become an asset of that business. The entire income, including the gain from the sale of such an asset, is income from California sources. Examples include an intangible asset pledged as security for a loan connected to a California business or a bank account maintained to pay expenses related to business activities in California. (See Regulation section 17952.)

(4) Tax Treaties – Payments to Foreign Individuals or Entities. California does not conform to federal law relating to income protected by U.S. tax treaties. California source income is taxable and subject to withholding. Nonresident aliens are required to report income from California sources on Form 540NR, California Nonresident or Part-Year Resident Income Tax Return. The payee may request a waiver or reduced withholding rate if the statutory amount will result in over-withholding. See Regulation section 18662-4 for additional information regarding waivers and reduced withholding rates.

(5) Payments Made to Reimburse Expenses. If the reimbursement is separately accounted for and is not subject to federal information return (Form 1099) reporting, withholding is not required on payments to reimburse nonresidents for expenses relating to services performed in California (corporate payees, for purposes of this exception, should be treated as individual persons). When the reimbursed expenses do not meet these requirements, withholding agents should withhold on the total payment.

(6) Services in Connection With the Sale of Goods. Withholding is required on the portion of the sale that relates to services provided in California. A Nonresident Income Allocation Worksheet may be used to distinguish the portion of payments made for goods from the portion for services.

(b) Payments to Independent Contractors. See California Unemployment Insurance Code sections 13000, et. seq., for the definition of "employee" subject to wage withholding. Individuals other than employees who perform personal services in California are independent contractors subject to withholding for purposes of this regulation.

(c) Payments to Subcontractors. The withholding agent is required to withhold when making payments directly to nonresident subcontractors for services performed in California. When the withholding agent makes payments to more than one contractor, the withholding agent should provide each contractor with a Nonresident Income Allocation Worksheet, and a Withholding Exemption Certificate, to determine if withholding is required. If the withholding agent knows of only one contractor, then the withholding agent should use the information provided by the contractor-of-record. If the contractor is a resident and provides an exemption certificate, no withholding is required. However, if the contractor-of-record is a nonresident, withholding is required on the total payment. Withholding is not required on payments to general contractors who are California residents. However, general contractors must withhold on payments made to nonresident subcontractors for services performed in California.

(d) Rent or Royalty Payments.

(1) Rent or Lease Payments Made to Nonresidents. Withholding on rent or lease payments to nonresidents is required when all of the following criteria are met:

(A) The payments are made in the course of the lessee's business. (Tenants of residential property are not required to withhold on payments made to nonresident owners.)
(B) The rented or leased property is located in California.
(C) The total payments of California source income to the lessor by the lessee exceed $1,500 for the calendar year.

(2) Types of Rental or Leased Property Subject to Withholding. Withholding is only required when the payers of rent are renting or leasing property in the course of their business from a non-California owner. Although withholding is not required from tenants of residential real property, income derived from real property, such as land and buildings, as well as income derived from tangible personal property located in California, such as machinery equipment, vehicles, aircraft, etc., is California source income and is subject to California tax. This includes rents, lease payments and the gain on the sale of such property.

(3) Royalty Payments Made to Nonresidents. California requires withholding agents to withhold on royalties paid for the right to use natural resources located in California, including, but not limited to, oil, gas, other minerals, geothermal, and timber. Withholding is also required on royalty or residual payments made to nonresidents for services originally performed in California and for payments of royalties derived from a business or activity with a business situs in California. See Regulation section 17951-2.

(e) Payments to Corporate Directors. (1) Withholding Not Required. Revenue and Taxation Code section 18662, subdivision (g), exempts wages, salaries, fees or other compensation paid by a corporation for services performed in California for that corporation to a nonresident corporate director for director services, including attendance at a board of directors' meeting, from withholding at source. Nonresident directors must file California tax returns reporting this California source income, unless they elect to be included in a group return under Revenue and Taxation Code section 18536

(2) Filing of Information Return. An entity paying wages, salaries, fees or other compensation to a nonresident director must file an information return with the Franchise Tax Board and provide the payee with a payee statement. To meet this requirement the paying entity must file a federal information return (Form 1099-MISC) with the Internal Revenue Service and provide a copy of that form to the payee.

(f) Seminars and Expert Witnesses. Withholding is required on payments that are compensation for services performed in California by a nonresident, including seminar speakers and expert witnesses.

(g) Income Allocation.

(1) Nonresident Contractors. When nonresident contractors perform services within California as well as outside of California, reasonable methods may be used by the withholding agent to determine what portion of the services are provided within California. In addition to the two approved methods below, withholding agents may use other reasonable methods approved by the Franchise Tax Board.

Method 1: The withholding agent may request that the payee complete a Nonresident Income Allocation Worksheet to determine the amount of California source income subject to withholding. The withholding agent uses the information provided to determine if withholding is required, and, if required, what portion of the payment is subject to withholding.

Example: A withholding agent sends a Nonresident Income Allocation Worksheet to an out-of-state independent contractor (vendor) before making a payment for services. The total contract amount is $100,000. The nonresident vendor returns a Nonresident Income Allocation Worksheet, certifying that $60,000 is for services

performed in California and $40,000 is for work performed in another state. The amount of withholding would be:

$60,000 California source income X 7% Withholding rate = $ 4,200. (Note: If the amount subject to withholding ($60,000 in the example above) is equal to or less than $1,500, no withholding is required.)

Method 2: The withholding agent may rely on the nature of the work performed to indicate where the services are performed.

Example: A construction company building a shopping center is most likely performing services where the shopping center is located. A good faith effort by the withholding agent to comply with the withholding rules will satisfy this requirement.

(2) Reliance on Allocations Provided by Payees. Withholding agents may generally rely on allocations provided by payees on a properly completed and signed Nonresident Income Allocation Worksheet to establish reasonable cause for the abatement of penalties. Withholding agents suspecting that a Nonresident Income Allocation Worksheet has been fraudulently completed should provide a copy of the form to the Franchise Tax Board and include an explanation as to why they believe the form is fraudulent. The withholding agent may generally rely on the information provided by the vendor until the Franchise Tax Board issues notification to revise the allocation or withdraw the exemption. See Regulation section 18622-8 for retention and filing requirements for Nonresident Income Allocation Worksheets.

(3) Appropriate Denominator for the Ratio When Using an Allocation Based on Time. Compensation for personal services performed by nonresident independent contractors will normally be allocated to California based on working days in California to total working days in and out of California ("duty days" for professional athletes – see Regulation section 18662-6).The number of days covered by the vendor's contract can only be used when the vendor is:

(A) Hired for the exclusive use of the withholding agent for the entire contract period,
(B) Required to be available to work each day at the discretion of the withholding agent during the contract period, and
(C) Being paid whether or not providing services.

Days spent acquiring knowledge, skills, or necessary experience as a condition of employment are not considered work days. Professionals and others who bill by the hour should allocate compensation based on the number of billable hours worked in California to the total number of billable hours related to the particular service.

(4) Determining the Portion of the Payment Related to Services When Payments are Made for Goods and Services. Withholding agents must use a reasonable method. One reasonable method is to use the same allocation of goods and services that is used for sales and use tax purposes in the sales contract. The portion of the payment **not** subject to sales or use tax would be considered payment for services and subject to withholding. If a payment is not subject to California sales or use tax, but is subject to another state's sales or use tax, withholding agents may also use the allocation for the other state to determine the portion relating to services and subject to withholding.

Generally, under sales and use tax laws, charges for labor or services for installation are not subject to sales or use tax. Payments for installation would be subject to withholding. Charges for designing, consulting, performing feasibility studies, evaluating bids and providing training services are also considered service activities if they are separately stated and not part of the sale of tangible personal property. Payments for repairs would be subject to withholding, except for parts that are separately stated on the invoice. As payments for mandatory maintenance contracts or warranties are subject to sales tax, even if the cost of the maintenance contract or warranty is separately stated, the payments would not be subject to withholding. However, payments for optional maintenance contracts or warranties are not subject to sales tax so would be subject to withholding. One exception is transportation charges, so that even if the payment for transportation charges is not subject to sales or use tax, withholding is not required.

(5) Allocation of Distributions. Allocation of distributions between California and non-California source income based on past year's allocations for withholding purposes may be made by the trustee of a trust. If the trustee does not know the amount of California source income included in a distribution, the trustee may use the previous year's ratio of California source income to total income to allocate the distribution.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-6 is amended to read:

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

~~The term "withholding agent" means the person, including corporations, partnerships, fiduciaries and state officers, agencies or subdivisions, charged by the law or by the Franchise Tax Board's order or regulation with the duty to withhold any tax, interest or penalties from payments to the taxpayer and to pay such amounts over to the Franchise Tax Board.~~

~~Withholding agents will be required to reimburse the Franchise Tax Board for all taxes, penalties or interest which have been due from taxpayers and have not been withheld as required, unless the delinquent withholding agent can establish that such failure to withhold was due to reasonable cause, or unless the amounts which were not withheld as required shall have been paid to the Franchise Tax Board prior to the day on which such reimbursement is demanded by the Franchise Tax Board. See Reg. 18662-6 for provisions for collecting liability incurred by a withholding agent who has incurred such liability for failure to withhold amounts due from a taxpayer upon notice and demand.~~

(a) Payments Subject to Withholding.

(1) General.

(A) Compensation for Personal Services. Payments to nonresident actors, singers, performers, entertainers, wrestlers, boxers, etc., for performances in this State, are subject to withholding. Compensation for personal services includes payments to independent contractors, such as leaders, managers, owners of bands, orchestras, dance teams, circuses, and similar groups of artists, entertainers or performers pursuant to contracts under which such leaders, managers or owners agree to furnish the services of their bands, orchestras, teams, circuses, or other groups within this State when payment for such performance, etc., is made to an agent or business entity instead of being made directly to the performer. Withholding is required when making payments to nonresident entertainers, including, but not limited to actors, singers, bands, orchestras, plays, dance teams, wrestlers, boxers, and speakers. This includes payments to agents, owners, or business entities for performances, or for the service of performers, athletes, speakers, and similar types of amusement or sporting activity carried on in this State. The Franchise Tax Board generally receives performance information from the withholding agent before performances occur, but withholding is required even if the venue or performer is not contacted by the Franchise Tax Board.

(B) Withholding Required Even if Contract States No Withholding. Withholding agents are required to withhold tax even when the nonresident entertainer's contract states that there shall be no withholding from

compensation. California law requires the withholding agent to withhold, and the withholding agent is legally responsible for the withholding amount.

(C) Payments Made to Reimburse Expenses. If the reimbursement is separately accounted for and is not subject to federal Form 1099 information reporting, withholding agents are not required to withhold on payments to reimburse a nonresident entertainer for expenses relating to services performed in California. When the reimbursed expenses do not meet these requirements, the withholding agent should withhold on the total payment.

(2) Payments Made to Agents or Promoters. Withholding is required if the compensation paid to nonresident entertainers is made to their California agents or promoters. If the withholding agent receives a Notice to Withhold Tax at Source, withholding is required even though the payment is not made directly to the nonresident entertainer. Withholding is required even if the agent or promoter meets one of the exceptions listed above. Since the entertainer performed the service, the entertainer is required to report their compensation for the performance and is entitled to the withholding credit in proportion to the performer's share of the income withheld upon. If compensation is earned by the entertainer and withholding is paid to the agent, the withholding agent must provide the name and taxpayer identification number (i.e., SSN, FEIN, or Corp number) on a Notice to Withhold Tax at Source for the performing entity and not the agent and/or promoter.

(3) Supporting Acts Paid by Headliner. If withholding agents receive a Notice to Withhold Tax at Source for a supporting act, but the supporting act is paid directly by the headliner, they should provide the Franchise Tax Board with the necessary information to allow the Franchise Tax Board to notify the headliner. The Franchise Tax Board will send the headliner a Notice to Withhold Tax at Source to withhold on the supporting act and will send the withholding agents a written withdrawal of the original notice.

(4) Sound and Lights. Withholding is required on payments made for sound and light services if payable to a nonresident.

(b) Request for Reduced Withholding Amount. Withholding is required on the total (gross) payment, unless an exemption or reduced withholding amount is authorized. Entertainment industry taxpayers can request a reduced withholding amount by filing a written request (Notification of Performance Withholding for Nonresident Entertainers) at least 10 business days prior to the nonresident's performance or California activity date. The Franchise Tax Board will then determine, based on the information and documentation submitted, if withholding at the statutory 7% rate on the entire payment from the performance or activity will result in over-withholding. If so, the Franchise Tax Board may authorize deductions from the gross amount to compute a withholding base that more accurately represents the nonresident entertainer's estimated tax liability when the 7% withholding rate is applied. If the Franchise Tax Board authorizes a

reduced amount, the Franchise Tax Board will then notify the withholding agent of the withholding required for the specific performance by sending the withholding agent a Notice to Withhold Tax at Source. If the withholding agent does not notify the Franchise Tax Board of the performance and/or the Franchise Tax Board does not notify the withholding agent of a waiver or reduced withholding rate, the withholding agent must withhold 7% from payments made to nonresident entertainers. (See Regulation section 18662-4.)

(c) Exceptions. Withholding is not required if the entertainer (not the agent) meets one of the exceptions listed in Regulation section 18662-4:

(1) The entertainer is a California resident.
(2) The entertainer is a business entity (corporation, partnership or limited liability company) that is qualified to do business in California or has a permanent place of business in California.
(3) The entertainer is an organization that has current tax-exempt status under either California or federal law.
(4) The total payments of California source income to the entertainer are equal to or less than $1,500 for the calendar year.
(5) The services provided by the entertainer are not performed in California.
(6) The entertainer or the withholding agent receives a withholding waiver from the Franchise Tax Board .

(d) Venues That Are Not Promoters. A lessor of a venue receiving a Notice to Withhold Tax at Source from the Franchise Tax Board for a performance they are not promoting should contact the Franchise Tax Board and provide the necessary information to allow the Franchise Tax Board to notify the correct promoter who the withholding agent will be. The Franchise Tax Board will send the correct promoter a Notice to Withhold Tax at Source for the performance and will send the venue/lessor a written withdrawal of the original notice.

(e) Canceled Performances. If a withholding agent receives a Notice to Withhold Tax at Source when no payment is made to the nonresident entertainer because the performance was canceled, the withholding agent should write “Canceled” on the Notice to Withhold Tax at Source, and return all copies of the form to the Franchise Tax Board , with an explanation that withholding was not done because the performance was canceled and no payment was made. The Franchise Tax Board may request additional information to validate the canceled performance.

(f) Athletes.

(1) Duty Days. A "duty day" is defined as "any day services are performed under the contract from the beginning of an official preseason activity until the last game played". The "duty days" in California are then divided by the total "duty days" to create a ratio, which is in turn multiplied by the total compensation. The result is deemed to be the California source income.

(2) Performance and Signing Bonuses. Performance bonuses should be included in the income to be allocated within and without California if any of the conditions to receive the bonus were met or partially met while performing services in California. The signing bonus issue is dealt with on a case-by-case basis with an examination of the wording of the contract. If services must be performed to receive or keep the signing bonuses and if any of those services are performed or partially performed in California, then the signing bonus should be included in the compensation to be allocated within and without California.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-7 is amended to read:

§ 18662-7. ~~Certificates of Residence~~Nonresident Withholding -- Domestic (U.S.) Pass-Through Entities.

~~(a) If a payee claims exemption from withholding pursuant to this regulation on the grounds that the payee is a California resident, the payee shall execute a Certificate of Residence in a form prescribed by the Franchise Tax Board. The original and one copy of the executed certificate will be filed by the payee with the payor. The payor must transmit the original certificate to the Franchise Tax Board before making any payments to the payee. If the payee's resident status continues, the retained certificate shall relieve the payor from withholding on such payee for the remainder of the calendar year or until otherwise directed by the Franchise Tax Board's Notice to Withhold, whichever date is sooner.~~

~~(b) If a payee's status during the year changes from nonresident to resident, a Certificate of Residence should be filed with the payor, in accord with subsection (a). If the change is from resident to nonresident status, a Certificate of Nonresidence and Claim for Personal Exemption Credit on a form prescribed by the Franchise Tax Board may be filed by the payee with the payor.~~

(a) General Information and Withholding Requirements.

(1) General. S corporations and other pass-through entities (general and limited partnerships, limited liability companies,) must withhold on distributions of current or prior year income to domestic nonresident S corporation shareholders, limited liability company members, and partners. Withholding is optional on the first $1,500 in distributions during the calendar year. Withholding is a prepayment of California state income or franchise tax for nonresident shareholders, partners or members. The income recipient must file a California tax return to claim a credit for withholding. The withholding rate is 7% of California source income distributed.

(2) Non-US Partners and members. Non-US partners and limited liability company members are not subject to this regulation. California conforms to federal law with respect to withholding on foreign (non-U.S.) partners. See Revenue and Taxation Code section 18666, Internal Revenue Code section 1446, and Treasury Regulations section 1.1446-0, et. seq.

(b) Payments Subject to Withholding. Distributions are subject to withholding to the extent they represent California source income. For purposes of this section, "California source income" does not include return of capital, income sourced in another state, or other income not subject to tax by California.) It also does not include income earned by partners in "investment partnerships" within the meaning of Revenue and Taxation Code sections 17955 or 23040.1.

(c) Individuals and Entities Subject to Withholding and Residency Status. Generally, withholding is required on payments to individuals who are nonresidents of California and business entities that are not incorporated in California, qualified to do business in California or have a permanent place of business in California. Withholding is required unless the recipient established California residency for an individual or a permanent place of business for a business entity. See Regulation section 18662-4.

(d) Waivers and Reduced Amounts. The Franchise Tax Board will consider waiver requests or requests for reduced withholding amounts on a case-by-case basis, in unusual circumstances where the individual or entity recipients demonstrate a compliant filing history, and where withholding from the payment would cause hardship or where there will be no tax liability resulting from the payment. See Regulation section 18662-4.

(e) Partnerships and Other Pass-Through Entities That Have Been Withheld Upon.

(1) General. As a general rule, pass-through entities that have been withheld upon may use some or all of the withholding to satisfy entity-level tax, but must pass-through any remaining withholding as a credit to shareholders, partners or members according to their respective ownership interest in the entity. See Regulation section 19002.

(2) Partnerships. As partnerships have no tax liability except for the annual tax paid by limited partnerships, which annual tax is due on the original due date of the return for the year, any withholding can only be claimed against the entity's own liability up to the amount of the annual tax that is still due and unpaid at the time the return is filed. Partnerships may not receive a refund of withholding. The withholding in excess of the tax due must be allocated to the partners. (Even if the partnership will owe tax, the partnership can still choose to allocate the entire withholding to its partners instead of using a portion to offset the tax due.)

(3) Limited Liability Companies. Limited liability companies can either allocate the entire withholding credit to its members or elect to use a portion of the credit to offset any limited liability company tax (including nonconsenting nonresident tax) or fees still due, and allocate any excess to its members. Limited liability companies may not receive a refund of withholding.

(4) Estates and Trusts. Withholding on estates and trusts must follow the income. If the related income is not being distributed in the current year to the beneficiaries, the related income must be shown and the withholding credit must be claimed on the tax return filed for the taxable year. If the related income is being distributed in the current year, the withholding credit must be allocated to the beneficiaries.

(5) S Corporations. As S corporations are subject to California franchise tax at the entity level, S corporations can elect to allocate all or a portion of the

withholding credit to the S corporation shareholders, or to claim the withholding on the S corporation tax return. S corporations may not receive a refund of withholding. In order for an S corporation to claim any of the amount withheld as a credit against its own franchise tax, it must include a schedule in the body of its original return showing the amount claimed against the franchise tax and explaining how the remainder of the credit (if any) was allocated.

(6) Allocation. The withholding must be allocated to all partners, members, S corporation shareholders, or beneficiaries, whether they are residents or nonresidents of California, in proportion to their ownership or beneficial interest in the pass-through entity.

(7) Timing. As explained in Regulation section 19002, withholding is treated as paid 25% on each estimated tax payment due date, unless the taxpayer elects to treat all withholding at source for the year as paid on the date withheld. Therefore, to avoid a penalty for underpayment of estimated tax, entities that are subject to the minimum franchise tax for the year must pay the full amount by the due date (generally, April 15th of the tax year for calendar year taxpayers), unless before that date they have received a statement from the withholding agent showing sufficient withholding during the year to cover the minimum franchise tax.

(f) Special Pass-Through Entity Rules.

(1) Interaction With Group Returns. Unless an exemption is applied for and granted, withholding is required on distributions of income to partners and members of group returns filed pursuant to Part 10.2 of the Revenue and Taxation Code. A credit is allowed against the tax shown on the group return for withholding amounts attributable to members of the group. Limited liability companies that are required to include the income of certain members pursuant to Revenue and Taxation Code section 18633.5, subdivision (e), are also allowed a credit for withholding attributable to this income under Revenue and Taxation Code section 18633.5, subdivision (e)(1).

(2) Year-End Distributions, Prior Year Income, Late or Amended Withholding Amounts. As a general rule, the withholding from a payment or distribution applies to the same tax year that the income from that payment or distribution is reportable. If a distribution of prior year income is made after the end of the calendar year in which the income was earned, but before the due date for the statement required to be provided to the payee, the withholding may be reported as if the withholding had been done in the just-completed calendar year. If the distribution of prior year income is after the due date for reporting withholding of the year following the calendar year in which the income was earned, the payment and statement should be remitted as a separate amount on or before the quarterly due date for distributions made in that month, clearly designated as a prior year distribution.

(3) Examples.

Example 1: A nonresident partner's share of the partnership's California source income for calendar year 2007 is $100,000. The partnership distributes $50,000 in November 2007 and $50,000 in January 2008. The partnership withholds on both distributions. The withholding from the $50,000 distributed in November 2007 should be reported on a 2007 tax year form (or electronically, designating the payment to apply to the 2007 tax year) by January 15, 2008. The $50,000 paid in January may be reported on that same form at the same time, as if it had been paid on December 31, or alternatively, must be reported on a separate 2007 tax year form due April 15, 2008. If other distributions are made in the first quarter of 2008 of 2008 tax year income, those must be on a separate 2008 form remitted April 15, 2008.

Example 2: The partnership does not make the second distribution in Example 1 until May 2008. Unless an exemption certificate is filed requesting an exemption from withholding for previously reported income, the second distribution is also subject to withholding. The November 2007 withholding is shown on 2007 forms, (or electronically, designating the payment to the 2007 tax year) due on or before January 15, 2008. The May 2008 distribution of 2007 income is shown on a tax year 2007 form but the form is not due until June 15, 2008. However, to allow the partner to file the 2008 tax return and claim the entire withholding credit, the reporting and remittance should be filed as soon as possible after the distribution.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 18662-8 is amended to read:

§ 18662-8. ~~Time and Place for Filing Returns of Tax Withheld~~Reporting and Remitting Amounts Withheld.

~~If a Notie to Withhold has been issued for a particular engagement, tax withheld shall be remitted by the 20th day of the month following the month of the close of that engagement. In such cases, the original copy of the Notice to Withhold will serve as a Return of Tax Withheld at Source (Form 592) as well as the Statement of Tax Withheld at source (Form 591). Remittance shall then be made to the office of the Franchise Tax Board which issued the notice to Withhold at Source.~~

~~When a Notice to Withhold is not issued, a Return of Tax Withheld at Source (Form 592) is due on the 20th day of the month following the month in which the total amount withheld during the calendar year and not remitted exceeds $2,500. Any amounts withheld and not previously remitted because the total did not exceed $2,500 must be submitted by January 31 following the close of the calendar year. In all cases when a Notice to Withhold has not been issued, Returns of Tax Withheld at Source (Form 592) together with Copy A of the Statement of Tax Withheld at Source (Form 591) shall be remitted to the Franchise Tax Board, Sacramento, CA 95867.~~

(a) General. The Franchise Tax Board shall prescribe annual forms and instructions for the reporting and remitting of withholding amounts.

(b) Real Estate Withholding.

(1) Payment Due Dates and Form. Real estate withholding is due by the 20th day of the calendar month following the month escrow closes. For example, if escrow closes on January 3d, payment is due on or before February 20th. If February 20th falls on a weekend or holiday, the payment may be remitted on the next business day without penalty. Payment or withholding on Section 1031 like-kind exchanges is due on the 20th day of the calendar month following the month in which the exchange was completed or failed. For simultaneous exchanges, the exchange is completed in the month escrow closed. For deferred exchanges, the exchange is completed in the month the last leg of the exchange is completed. For failed exchanges, the exchange failed in the month when the proceeds were distributed to the seller after a determination that that the exchange would not meet the IRC section 1031 exchange requirements. Remittance shall be in the form and manner as the Franchise Tax Board may annually prescribe in forms and instructions.

(2) Reporting.

(A) In General. Real estate withholding should be reported to the Franchise Tax Board either by paper form for paper payments (where allowable) or electronically along with the remittance, according to procedures annually announced by the Franchise Tax Board for information returns.

(B) Information Returns. An information return shall be provided to the payee aggregating all withholding for the tax year by January 31st of the year following the calendar year, and may be required to be filed with the Franchise Tax Board, in the form and manner that the Franchise Tax Board may prescribe in forms and instructions. The payee may be required to attach a copy of the information return to the appropriate tax return to be filed with the Franchise Tax Board in order to claim a credit for the withheld amount.

(c) Withholding From Payments.

(1) Payment Due Dates. Withholding on payments is due under the same schedule as required for calendar year estimated tax. Withholding from payments made January 1st through March 31st is due April 15th. For payments made April 1st through May 31st, June 15th; June 1st through August 31st, September 15th; and September 1st through December 31st, January 15th of the next year. Remittance shall be in the form and manner as the Franchise Tax Board may annually prescribe in forms and instructions, either electronically or by paper check.

(2) Foreign Partners – Due Dates. California follows federal procedures for foreign partners. (See Regulation section 18662-2.) Therefore, the due dates for payments are the same as the federal due dates, as prescribed in federal regulations, forms and instructions.

(3) Reporting.

(A) In General. Withholding on payments should be reported to the Franchise Tax Board either by paper form for paper payments (where allowable) or electronically along with the remittance according to procedures annually announced by the Franchise Tax Board for information returns. The name and Taxpayer Identification Number (TIN) of each payee should be provided so that the payment can be properly posted to the payee's account. The Franchise Tax Board may by forms and instructions prescribe how to report withholding where the payee fails to provide a TIN, or has applied for a TIN and has not yet received it at the time the withholding must be remitted.

(B) Information Returns. An information return shall be provided to the payee aggregating all withholding for the tax year by January 31st of the year following the calendar year, and may be required to be filed with the Franchise Tax Board, in the form and manner that the Franchise Tax Board may prescribe in forms and instructions. The payee may be required to attach a copy of the information return to the appropriate tax return to be filed with the Franchise Tax Board in order to claim a credit for the withheld amount.

(4) Electronic and Magnetic Media Requirements. Payments and reports shall be made electronically as required by the Franchise Tax Board in annual forms and instructions. Any reference to forms or payments in these regulations shall be deemed to refer to corresponding electronic filings and payments where appropriate.

(d) Interest and Penalties.

(1) Interest. Revenue and Taxation Code section 18668, subdivision (b), allows the Franchise Tax Board to compute and assess interest on any amount not paid on or before the due date required by regulations, at the rate established pursuant to Revenue and Taxation Code section 19521, computed from the due date to the date paid. This interest is not a penalty, but compensation for the use of the funds from the date the withheld funds were due to the date remitted.

(2) Penalties.

(A) Information Return Penalties. Revenue and Taxation Code section 19183 incorporates numerous federal information return penalties by reference. Withholding remittance statements and payee statements are information returns, and so failures to file those returns may subject the withholding agent to information return penalties.

(B) Liability of Withholding Agent for Unpaid Withholding. Revenue and Taxation Code section 18668, subdivision (a), provides that a withholding agent is liable for the amount that should have been withheld.

(C) Special Rules for Real Estate Withholding.

1. Real Estate Notification and Withholding Penalties. The penalty for not properly notifying buyers is the greater of $500 or 10 percent of the required withholding. The penalty for failing to withhold is the greater of $500 or 10 percent of the required withholding. If the failure to withhold was due to reasonable cause, the Franchise Tax Board will withdraw the penalty.

2. Real Estate Information Return Penalties. A $15 penalty may be charged if withholding agents file a correct Real Estate Information Return within 30 days after the due date. The penalty is $50 if a correct Real Estate Information Return is filed more than 30 days after the due date or if a correct Real Estate Information Return is never filed.

If the noncompliance is due to an intentional disregard of the requirements, the amount increases to the greater of $100 or 10 percent of the required withholding. The penalty is for each Real Estate

Information Return Form that the withholding agent does not file correctly before the due date.

A $50 penalty can be charged if the withholding agent does not provide the sellers with correct copies of Real Estate Information Returns by the due date. If the noncompliance is due to an intentional disregard of the requirements, the amount increases to the greater of $100 or 10 percent of the required withholding. The penalty is for each Real Estate Information Return that is not furnished. A Real Estate Information Return is considered correct when all applicable fields are completed, the information is correct, and the correct version of the form is used. The pre-printed year must match the year the transaction occurred. For sales, this is the year escrow closed. For installment payments, this is the year of the installment payment. For exchanges, this is the year the last leg of the exchange was completed or when it was determined that the exchange would not meet the Internal Revenue Code section 1031 requirements and any cash or cash equivalent was distributed to the seller. If the seller knowingly executes a false exemption certificate, the penalty is the greater of $1,000 or 20 percent of the required withholding.

(e) Coordination With Information Returns. Information returns (generally federal Forms 1099) are required to be filed in most cases where payment is sufficient to require California withholding. The Franchise Tax Board may by forms and instructions prescribe when separate information returns and withholding statements must be provided to the recipient and/or to the Franchise Tax Board, and when the withholding information may be provided on the information return.

(f) Coordination With Group Returns. Generally, withholding at source is allowed as a credit against the tax shown on a group nonresident return. See Regulation section 18662-7.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference cited: Section 18662, Revenue and Taxation Code.

Regulation section 25401(b) is renumbered and amended to read:

§ ~~25401(b)~~19002. Credit for Tax Withheld.

(a) The tax deducted and withheld under Article 5 (commencing with Section 18661) of the Revenue and Taxation Code or Section 13020 of the Unemployment Insurance Code~~Section 26131~~ is allowable as a credit against the tax of the recipient for the taxable year with respect to which the amount was withheld~~imposed by the Bank and Corporation Tax Law~~. If the tax has actually been withheld at the source~~as required by Reg. 26131-2~~, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Franchise Tax Board. For the purpose of the credit, the recipient of the income is the ~~corporation~~taxpayer who received amounts which were subject to withholding~~as required by Reg. 26131-2~~.

(b) The tax withheld ~~under Reg. 26131-1~~during any calendar year shall be allowed as a credit against the tax ~~imposed by the Bank and Corporation Tax Law~~for the ~~income~~taxable year of the recipient of the income which begins in that calendar year. If such recipient has more than one ~~income~~taxable year beginning in that calendar year, the credit shall be allowed against the tax for the last ~~income~~taxable year so beginning.

(c) Payments to Pass-Through Entities. Tax deducted and withheld from payments to pass-through entities must be passed through to the entity's partners, members or shareholders according to their ownership interest in the pass-through entity, except that all or a portion of the withholding may be claimed as a credit against the entity's tax due for the taxable year. (See Regulation section 18662-7.) No refund of tax deducted and withheld from payments to pass-through entities is allowed. Any credit passed through must be claimed by the partners, shareholders or members on their own tax return.

(d) Special Rule for Pass-Through Entity Year-End Distributions. Tax withheld from payments made after the close of the taxable year can be applied as payments to the taxable year to the extent those payments represent income required to be included in the return for that taxable year.

(e) Date of Credit.

(1) For purposes of computing the statute of limitations on refund claims, the date of all withholding payments is deemed to be the original due date of the return.

(2) For estimated tax penalty purposes, the date the withholding is credited to the account is the date withheld. For individuals, withholding is treated as paid 25% on each estimated tax payment due date, unless an individual taxpayer elects to treat all withholding at source for the year as paid on the date withheld. (See Internal Revenue Code section 6654, subsection (g).)

(3) For interest and penalty purposes, the date of withholding payments is the date such payments are remitted to the Franchise Tax Board.

Note: Authority cited: Section ~~26442~~19503, Revenue and Taxation Code.
Reference: Section ~~25401b~~19002, Revenue and Taxation Code.