(---) -------- March 12, 1991

FTB Notice 91-1
410:BRL:CN-91-035

Re: QUESTIONS AND ANSWERS ON WITHHOLDING ON SALES OF REAL PROPERTY BY NONRESIDENTS

Legislation enacted in 1990 (S.B. 2319, Stats. 1990, Ch. 2319; A.B. 3086, Stats. 1990, Ch. 846) made various changes to withholding requirements with respect to dispositions of California real property interests by nonresidents. Some common questions and answers regarding real property withholding requirements are set forth below:

A. GENERAL INFORMATION

1. Q. What is real estate withholding?

A. Real estate withholding is not an additional tax on the sale of real estate. When property located in California is sold, California source income in the amount of the gain is generated at the time of sale. Real estate withholding is merely a form of prepayment of the amount of tax due to the state. This serves many purposes. It primarily is intended to ensure that the taxes owed on the sale will be paid. It also helps prevent taxpayers from being subject to underpayment of estimated tax liabilities for failure to pay their taxes due during the year.

Real estate withholding is very similar to wage withholding. When employees earn wages throughout the year, wage withholding is taken out of their paychecks because the tax is due as the income is earned. At the end of the year, the actual tax liability is computed, the amounts withheld are taken as a credit against that tax liability, and any excess of amounts withheld are refunded. If there were not enough taxes withheld during the year, additional taxes may be owed, and the taxpayer could be subject to underpayment penalties if amounts were underwithheld during the year.

Sellers who are subject to withholding on the sale of property get a credit for the amount withheld on their California income tax returns when the returns are filed at the end of the year.

2. Q. How can the seller determine whether to apply for a reduced amount of withholding?

A. The seller can determine if the 3 1/3 percent withholding rate results in excess withholding by computing what the estimated California tax liability will be from the sale. For example:

NOTE: ((---)) = Indicates obsolete information.

Gain on Sale:	$90,000	Selling Price:	$250,000
x Top California Tax Rate:	9.3%	x Withholding Rate	3.33%
California Tax Liability	$8,370	Amount to be Withheld	$8,325

If the amount required to be withheld is substantially in excess of the seller's California tax liability, the seller may request a reduced amount of withholding from FTB using FTB Form 597-A.

3. Q. If the amount withheld and sent to FTB is in excess of the seller's actual tax liability, can an early refund be applied for?

A. The law does not provide for an early refund of taxes withheld on the sale of real estate. Sellers must claim the amount withheld on their California tax return for that year. Generally, sellers must use the same income (taxable) year for their California return as they use for federal purposes.

4. Q. What if real property is being sold in conjunction with personal property? Is withholding required on the personal property?

A. If the contract for sale includes an agreement which allocates the sales price between personal and real property, withholding is only required on the price of the real property. If the contract does not allocate the sales price between the two, withholding is required on the entire amount.

B. WITHHOLDING REQUIREMENTS

1. Q. When is withholding required?

A. Withholding is required when purchasing California real property when the proceeds from the sale are either being disbursed to a seller with a last known street address outside of California (or the address required to be shown on the Federal Form 1099-S is outside of California), or when the proceeds are being sent to a financial intermediary of the seller.

2. Q. Are there any exceptions to withholding?

A. Yes. The buyer is required to withhold unless:

1. The seller has a California homeowner's property tax exemption on the property conveyed, or

2. The sales price of the California real property does not exceed $100,000, or

3. Written notification of the withholding requirements has not been provided, or

4. The seller is a bank acting as a fiduciary for a trust, or

5. The property is being acquired in a foreclosure by a corporate mortgagee (this exception does not apply to foreclosures by individuals), or

6. The seller is a partnership, or

7. The seller is a resident of California or a corporation with a permanent place of business, or qualified to do business, in this state. An FTB Form 590 - Withholding Exemption Certificate, completed by the seller, will meet the requirements of this exception.

3. Q. Who is responsible for withholding on sales of California real estate by a nonresident seller?

A. The buyer is responsible for the withholding and is liable for penalties for failure to withhold.

The real estate escrow person is required to provide written notification to the buyer of the California withholding requirements. This notification must instruct the buyer to withhold 3 1/3% of the sales price of the California real property. The notification must be made when the authorization for the disbursement of the transaction's funds instructs that the funds be disbursed (or the 1099-S is being sent) to a seller with a last known street address outside the boundaries of this state or to the financial intermediary of the seller.

4. Q. When will withholding first be required?

A. Withholding is required for any transaction where title transfers on or after January 1, 1991.

5. Q. What if the proceeds from the sale are being sent to a California post office box?

A. The seller is required to provide the real estate escrow person with a last known street address. If none is provided, or if this address is outside of California, withholding is required. If the proceeds are being sent to a California Post Office box, and the seller has signed an affidavit that he or she is a California resident, no withholding is required.

6. Q. Is a wire transfer to a financial institution considered to be to a "financial intermediary"? If so, is an affidavit of residency (Form 590), completed by the seller, acceptable to relieve the buyer from the withholding requirements?

A. Yes. A wire transfer to a bank, etc. would be considered to be a transfer to a financial intermediary. If the seller is a resident of California, a signed FTB Form 590 would provide relief from the withholding requirements.

C. WAIVERS

1. Q. Is withholding always required if none of the exceptions are met?

A. No. The seller may request a waiver or a reduced withholding amount by submitting a written request on FTB Form 597-A to the Franchise Tax Board (FTB). The request should include the seller's name, social security number, (or if a corporation, the FEIN) and all pertinent facts to support the request.

Generally, a reduced amount will be authorized only if there is little or no gain on the transaction.

If a response from FTB to the seller's request has not been received at the time title is transferred, the parties may direct the real estate escrow person to hold in trust for 45 days the statutory amount to be withheld. At the end of the 45 days, the real estate escrow person shall send the amount withheld to FTB unless FTB has authorized a reduced amount.

If a rush request is needed, a facsimile (FAX) machine is available. You may coordinate the request by calling (916) 369-4900*. If a

*Go to ftb.ca.gov and search for wvcp contact.

request is sent via FAX, the requestor should not mail the original to FTB, as it may cause duplicate work on the same request.

2. Q. When should the waiver be requested?

A. A waiver can be requested as soon as the contract for sale is agreed upon. It is in the seller's best interest to request a waiver as soon as possible.

3. Q. There are some concerns about the forms used to request a waiver (Form 597-A) or to remit the withholding to FTB (Form 597). For example, the 597-A asks for the transfer date, when this is not always known with certainty. How do we complete the forms if we are uncertain of the answer?

A. Complete the forms to the best of your knowledge and ability. If you have any questions about how to complete the forms, you may contact the Withhold at Source Unit. If you don't know the exact date of the transfer, use the approximate date and enter the word "approximate" next to it.

D. FILING REQUIREMENTS

1. Q. When should withholding amounts be sent to FTB, absent a waiver request?

A. Withholding is due to be sent to FTB by the twentieth day of the month following the month in which the transaction occurred. Use Copy A of FTB Form 597 to report and remit the withholding due.

2. Q. When is withholding due if a waiver has been requested?

A. If, at the date of transfer, the authorization for a reduced rate, waiver or denial has been received from FTB, the amount authorized by FTB is required to be sent to FTB by the twentieth day of the month following the month in which the transaction occurred.

If the seller has not requested a reduced rate or a waiver, or the response to their request has not been received from FTB, by the date title is transferred, the seller may request that the funds be held in trust for up to 45 days, pending an answer to the request. At the end of 45 days, the escrow person must send in the statutory amount (if no

response has been received), or a reduced amount which has been authorized by FTB.

3. Q. What form should be sent in with the amount withheld?

A. Copy A of FTB Form 597 is required to be filed with the Franchise Tax Board. Copies B and C are to be given to the seller (Copy C is to be filed with the California tax return), and Copy D is to be retained by the buyer or other withholding agent.

4. Q. How many FTB Forms 597 should be filed when both a husband and a wife are the sellers?

A. Normally, just one Form 597 should be filed in this situation. If the husband and wife wish to have the amount withheld applied to separate accounts, they should contact the FTB Withhold at Source Unit to make arrangements.

5. Q. When there are multiple buyers, who is responsible for withholding?

A. If two or more persons are joint buyers, each is "jointly and severally" obligated to ensure that withholding is made on the entire amount. If one of them withholds and transmits the full required amount to FTB, the obligation of each will be met.

6. Q. Is the real estate escrow person required to report sales which are not covered by the withholding requirements?

A. Yes. The regular 1099-S requirements continue to apply. The 1099-S requirements continue to apply even if withholding is done and a Form 597 is submitted.

E. TRUST FUND REQUIREMENTS

1. Q. If the parties elect to have the funds withheld placed in trust for 45 days, is it mandatory that the closing agent hold the funds?

A. No. Typically, closing agents will set up the trust fund as part of their normal procedures when withholding is required.

2. Q. How are the funds to be held? What type of account? (i.e. separate, interest bearing, etc.).

A. Keeping the withheld funds in any type of legally allowable trust will satisfy the statutory requirements.

3. Q. Who pays the $25.00 fee? Can it come out of the funds withheld?

A. The fee that the real estate escrow person can charge (up to a maximum of $25.00), is negotiable as is any other escrow fee. The fee is not to be deducted from withholding funds.

F. PENALTIES

1. Q. Are there any penalties for failure to withhold?

A. Yes. Revenue and Taxation Code Section 18815 provides for penalties for failure to withhold. Both the buyer who fails to withhold when properly notified and the real estate escrow who fails to provide written notification of the withholding requirement to the buyer are subject to penalties. The penalty is:

1. $500, or

2. 10% of the amount which was required to be withheld, whichever is greater.

In addition, FTB imposes a penalty on sellers who file false affidavits stating that they are not subject to the withholding requirements. The penalty is the greater of $1,000 or 20 percent of the amount required to be withheld.

2. Q. What interest and penalties could the closing agent incur for failing to remit the funds within the 45-day trust period?

A. The law provides for interest and penalties for late payments of withholding. Interest is calculated from the due date to the date paid. Penalties include both late payment and underpayment of tax penalties.

3. Q. There appear to be no penalties imposed if a failure to withhold is due to reasonable cause. What constitutes reasonable cause?

A. "Reasonable cause" is a standard exception to the imposition of most penalties imposed under the Revenue and Taxation Code and the Internal Revenue Code. Generally, reasonable cause exists where the failure to comply occurs despite the exercise of ordinary business care and prudence. The same standards of reasonable cause will apply with respect to penalties imposed in the real estate withholding area as currently apply in other areas such as penalties imposed for failure to file income tax returns.

4. Q. If the real estate escrow person improperly fails to inform the buyer of the withholding obligation, and/or the buyer fails to withhold when required, will penalties always be assessed against these parties.

A. If the real estate escrow person fails to notify the buyer of the withholding obligation, and/or the buyer fails to withhold, FTB will not assess penalties for these parties if the seller files a California return when required and pays the amount of taxes due on the transaction.

5. Q. Will there be a grace period for the real estate escrow person?

A. The real estate escrow person is required to provide notification on appropriate transactions beginning January 1, 1991. However, a six month implementation period will be in effect and the real estate escrow person will not be liable for penalties prior to July 1, 1991, provided that any failure to withhold was not due to an intentional disregard of the withholding requirements.

G. FOREIGN (NON-U.S.) NONRESIDENT SELLERS

1. Q. Will foreign nonresidents (nonresident aliens) be treated in the same manner as out of state sellers who live within the U.S.?

A. Foreign nonresidents living outside the U.S. are treated the same as nonresidents who live within the U.S. However, if a foreign nonresident requests a waiver or reduced rate from the IRS, generally a duplicate request does not need to be made with FTB. See question #2 below.

2. Q. If the sale is by a foreign person, is it necessary for the seller to request a California waiver, or will the FTB accept a federal withholding certificate authorizing a reduced amount or waiver for federal purposes? Will California withholding continue to be 1/3 of the amount authorized by IRS?

A. Generally, it is not necessary to request a California waiver. FTB will accept a federal certificate which authorizes a reduced amount or waiver as long as it was not granted due to a payment arrangement with the IRS, whereby the seller agrees to pay the withholding outside of escrow to the IRS. Withholding will continue to be 1/3 of the reduced federal amount. It must be sent to FTB with Copy A of FTB Form 597 within 20 days from the date of the federal certificate.

H. PARTNERSHIPS AND CORPORATIONS

1. Q. Is withholding required in the case of a partnership selling real property?

A. No withholding is required if the title to the property being sold is listed in the partnership name. Partnerships are subject to separate withholding requirements. See FTB Form 598, and the related instructions.

2. Q. Is withholding required in the case of a corporation selling real property?

A. Yes, unless the corporation continues to have a permanent place of business with a street address in California after the sale, or one of the other exceptions applies.

3. Q. Is withholding required:

a. on the sale of a partnership interest in a partnership which holds California real estate?

b. if California property is being distributed by a non-California corporation to a shareholder?

c. if California property is being contributed by a non-California shareholder to a corporation?

d. when a nonresident partner contributes California property to a partnership or exchanges property for a partnership interest?

e. when a non-California partnership distributes California property to a partner?

A. No. As a general rule, withholding is required only in situations where a federal form 1099 must be filed. Currently, no withholding is required in the situations outlined above.

I. NOTICE

1. Q. Some transfers are done without an escrow. How are the buyers to be notified in these situations?

A. Any person defined as a real estate escrow person is required to notify the buyer of the withholding requirements. The definition of a real estate escrow person includes other types of persons involved in real estate transactions, such as attorneys, or any other person who receives and disburses the consideration or value for the interest or property conveyed.

2. Q. How can notification be given to the buyer?

A. Most written methods of notification will be acceptable.

3. Q. Is the real estate escrow person only required to give notice, or to ensure that withholding is done if required? How far must they go to verify information.

A. It is the real estate escrow person's responsibility to give notice of the withholding requirements to the buyer. Once the buyer has been notified, it is the buyer's responsibility to make sure that the withholding is done. However, if the real estate escrow person knowingly accepts false information (such as a falsely completed FTB Form 590), he or she could be responsible for penalties.

4. Q. Is notice required for each transaction, or can it be sent to potential clients at the beginning of each year? Must the notice go into detail of the law, or can it merely point the buyer in the direction of the law?

A. Notice must be provided for each separate transaction, and must inform the buyer that they may be required to withhold if the three conditions are met:

1. Sales price greater than 100,000;

2. No Homeowner's Exemption, and

3. Proceeds going outside the state or to a financial intermediary.

J. HOMEOWNER'S EXEMPTION

1. Q. How does the buyer determine if there is a "Homeowner's Property Tax" exemption? Can they rely on a property tax statement?

A. Under the law as enacted, if the seller had a Homeowner's Property Tax exemption on the property conveyed during the year of sale, no withholding is required. The buyer can rely on the seller's current property tax statement to determine if there was an exemption.

2. Q. If a property goes through probate and is distributed to a nonresident without losing its homeowner's exemption, would withholding be required when the nonresident decided to sell the property?

A. If the property has a homeowner's exemption on it, no withholding is required.

K. MULTIPLE SALES BY ONE NONRESIDENT

1. Q. Is withholding required on a purchase of multiple parcels of California real property from a nonresident where the total proceeds of all properties exceed $100,000 but the sales price of each separate piece of property is under $100,000?

A. Yes. Purchases of multiple pieces from one seller would constitute one transaction for determining the withholding limitations. However, if the nonresident seller is selling multiple properties to multiple different buyers, each property is taken separately in determining if withholding is required. But if the sale of multiple properties

constitutes one transaction, the total sales prices of all properties are added together for purposes of the $100,000 limitation.

L. MULTIPLE SELLERS

1. Q. For joint owners who are not married, where one or more sellers are nonresidents and the other owners are residents, how is the amount of withholding determined? How should each nonresident seller report the withheld amount on the personal income tax return reporting the sale?

A. If the transaction involves one or more nonresident sellers, withholding is required if the total sales price of the property exceeds $100,000. Withholding is required on the total sales price. If this results in over-withholding, the sellers should request a reduced rate of withholding authorization from FTB.

For example, if there are three sellers, and two are nonresidents, withholding would be computed on the total gross sales price and allocated to the two nonresidents equally.

Two or more sellers may request a special allocation percentage from FTB. In these situations, FTB will consider the facts and circumstances in the case, and may issue separate withholding authorization notices.

2. Q. If a husband and wife are separated, but both own the property being sold, and one is a nonresident, is withholding required? Would this answer change with co-owners regardless of their marital status?

A. If the property being sold has the homeowner's property tax exemption on it, no withholding is required. If the property does not, and one of the owners is a nonresident, withholding is based on the full sales price. Either seller may then request a reduced rate of withholding based on their ownership percentage. This answer does not change due to the marital status of the co-owners.

M. MISCELLANEOUS SALES

1. Q. Will the new law pertain to a tenant's sale or assignment of a lease-hold interest?

A. No.

2. Q. Will the new law pertain to involuntary transfers such as condemnations? If yes, who has the responsibility for withholding and reporting?

A. Yes. The person or entity who obtains title to the property is responsible for the withholding.

3. Q. What provisions will be made for installment sales?

A. The statute requires withholding in the amount of 3 1/3 % of the sales price of California real property conveyed. There is no exception for installment sales. Therefore, if no waiver is granted, 3 1/3% of the entire sales price should be withheld.

The FTB will normally allow a deferral of withholding due in accordance with the installment sale agreement, payable in quarterly (if less than $1,000.00 withheld during the period) or monthly installments. Sellers should request special arrangements in the same manner as indicated for waivers.

4. Q. What if the sale is part of a tax-deferred exchange?

A. All like-kind exchanges involving nonresident sellers, buyers or accommodators must request a waiver, assuming that the transaction does not fall into one of the exceptions from withholding (purchase price, homeowner's exemption).

5. Q. Is withholding required on sales to or from a relocation service?

A. Relocation services are subject to the same rules as other buyers and sellers. In the most common situation, a California personal residence is sold to a relocation service. The relocation service then sells the property.

B. Usually, when the relocation company buys the property from the person being relocated, title stays in the name of the original seller until the relocation company resells the property. Prior to the resale, the relocation company actually owns the property and is subject to any gains and losses which may occur on the resale.

C. Generally, there would be no withholding on the first sale, as the property would qualify under either the homeowner's exemption or the residency status of the seller. On the second sale, a waiver would be required to avoid withholding if the relocation service is a non-California entity, even though title to the property is still held in the name of the relocated employee. Therefore, the residency of the relocated employee is no longer a factor in determining if withholding is required on the sale by the relocation company.

6. Q. What if the property is in probate? How is residency determined?

A. If California property is sold by a nonresident estate, withholding is required unless the transaction meets one of the exceptions outlined previously. As a general rule, if the decedent was not a California resident, withholding is required unless one of the exceptions applies or a waiver is obtained. If an affidavit that the decedent was a California resident (FTB Form 590 is acceptable) is supplied, no withholding is required and no waiver is needed. However, the estate may be required to withhold on distributions of income or gains to any nonresident beneficiaries.

7. Q. Is withholding required on the sale of a mobile home?

A. If the mobile home is subject to (real) property taxes, withholding is required. If it is only subject to personal property taxes, withholding is not. Withholding is also required on any land sold on which the mobile home is located.

8. Q. Is withholding required in a cash-poor transaction, where the buyer is putting little or no money down?

A. Yes, withholding is required. The seller may need to arrange to pay the withholding due, as it approximates the amount of tax due at the time of the sale.

9. Q. Is withholding required on a sale by a trust?

A. California trusts are subject to their own withholding requirements for distributions of California trust income to their nonresident beneficiaries. Therefore, a buyer is not required to withhold on the sale of real property by a California trust.

Withholding is required on the sale if no trustee of the trust is a resident of California. A waiver may be granted by FTB if the nonresident trustee can show that they are filing California trust returns and withholding on distributions made to the nonresident beneficiaries.

10. Q. Is withholding required in a foreclosure situation from a nonresident?

A. Withholding is automatically waived if the property is being acquired in a foreclosure by a corporate mortgagee. If the property is being acquired in a foreclosure by anyone other than a corporate mortgagee, a waiver must be requested before the withholding can be waived.

11. Q. Is withholding required on the sale of property by a tax-exempt entity, such as a church or an insurance company?

A. If the property is being sold by an entity which is exempt from income and franchise taxes under California law, no withholding is required, and no waiver needs to be obtained from FTB.

N. RESIDENCY OF SELLER - AFFIDAVIT

1. Q. May the real estate escrow person rely on an affidavit that the seller is a resident or is a corporation with a permanent place of business in California? If yes, what form will be required?

A. Yes. An FTB Form 590 can be used for this purpose. The signed FTB Form 590 should be retained by the buyer or other withholding agent. The buyer will be relieved of the withholding requirements if they relied in good faith on a completed and signed FTB Form 590 (or facsimile) or other form containing the same information.

A seller who becomes a nonresident of California prior to the close of escrow must notify the buyer that the FTB Form 590 is no longer valid. If this notification is not made, the buyer will not be subject to any penalties if the buyer relied in good faith on the FTB Form 590.

2. Q. What if the seller is moving out of California and gives an out of state forwarding address? Is withholding required?

A. Yes. Withholding is required, as long as the real estate was not the seller's personal residence, as evidenced by a current Homeowner's Exemption.

3. Q. If there was no Homeowner's Property Tax exemption claimed, but the seller was a resident of California, and the property was their personal residence, can an affidavit from the seller be accepted as proof it was their personal residence?

A. If withholding is otherwise required, and there was no Homeowner's Property Tax exemption on the property conveyed, a waiver must be requested from FTB if the property was the seller's personal residence and they wish to obtain a waiver from withholding.

4. Q. In cases where withholding is required because the proceeds are going to a financial intermediary, can an affidavit from the seller that they are a California resident be accepted, or is a waiver required?

A. If the seller has provided an affidavit that they are a resident of California (FTB Form 590 is acceptable), no withholding is required, and no waiver is needed.

5. Q. Is withholding required if a seller completes a Form 590, stating that they are a California resident, but then moves outside the state prior to the date title is transferred and informs the buyer that the Form 590 is now invalid?

A. Yes. Withholding is required if, at the date of transfer, the buyer knows that the Form 590 is invalid. If the sellers are nonresidents at the time of the sale and the property sold was their principal residence, they may request a waiver from withholding using FTB Form 597-A if they are purchasing a replacement residence of equal or greater value.

O. WHERE TO GET MORE INFORMATION

1. Q. Where can I get more information on the withholding requirements and residency status? Where can I obtain Nonresident Income Tax Forms and withholding forms?

A. Franchise Tax Board Withholding at Source Unit, Post Office Box 651, Sacramento, CA 95812-0651, or by phone at (916) 369-4900*.

*Go to ftb.ca.gov and search for wvcp contact.

DRAFTING INFORMATION

This notice was written by the staff of the Franchise Tax Board Withhold at Source Unit. For further information regarding this notice, contact the Franchise Tax Board Withhold at Source Unit at P.O. Box 651, Sacramento CA, 95812-0651. The telephone number for the Withhold at Source Unit is (916) 369-4900*.

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