

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 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 withheld 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 required 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. Eligible business entities with a single owner, such as a single member limited liability company, that is disregarded for federal and California income tax purposes are also disregarded for withholding purposes. The owner of the disregarded entity 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 a trust is a "grantor" trust, it is ignored for tax purposes and the seller for withholding purposes 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 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, as incorporated by and modified by the California Revenue and Taxation Code 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 seller or 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. Where California law differs from federal law, due to changes made to federal law after the specified incorporation date in the Revenue and Taxation Code, or specific modifications under section 17152, the California provisions will apply. The Franchise Tax Board shall explain these differences in annual publications, forms and instructions.

(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 may 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 may not rely the real estate withholding exemption certificate and is required to 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 may not rely on the real estate withholding exemption certificate and is required to 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 3 1/3 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 proceeds.

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

Total sale proceeds \$200,000

Sellers' ownership percentages:

A = 20%, B = 30%, C = 50%

Withholding per seller:

A $\$200,000 \times 20\% \times .0333 = \$1,332$

B $200,000 \times 30\% \times .0333 = 1,998$

C $200,000 \times 50\% \times .0333 = 3,330$

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 $\$200,000 \times 20\% \times .093 = \$3,720$

B $200,000 \times 30\% \times .093 = 5,580$

C $200,000 \times 50\% \times .093 = 9,300$

(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 from 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 may be used to satisfy 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.