

# TITLE 18. FRANCHISE TAX BOARD

## (Notice published November 16, 2018)

### NOTICE OF PROPOSED RULEMAKING

As required by section 11346.4 of the Government Code, the Franchise Tax Board ("FTB" or "the Board") hereby gives notice of its intention to amend California Code of Regulations, Title 18 ("18 CCR"), Sections 18662-0 through 18662-6, and Section 18662-8, relating to nonresident and real estate withholding.

## PUBLIC HEARING

FTB has not scheduled a public hearing on this proposed action. However, the Board will hold a hearing if it receives a written request for a public hearing from any interested person, or his or her authorized representative, no later than 15 days before the close of the written comment period indicated below. The request should be submitted to the FTB officer named below. In addition, Government Code Section 15702, subdivision (b) provides for consideration by the three-member Board of any proposed regulatory action if any person makes such request in writing.

## WRITTEN COMMENT PERIOD

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the Board. The written comment period closes at **5:00 p.m. on January 8, 2019**. The Board will consider only comments received at the Board offices by that time. The Board encourages submission of comments in electronic form, rather than in paper form. Comments may be submitted by email to [David.Muradyan@ftb.ca.gov](mailto:David.Muradyan@ftb.ca.gov).

Submit comments in paper form to:

David Muradyan, Tax Counsel III  
Legal Division MS A260  
Franchise Tax Board  
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Rancho Cordova, CA 95741-1720  
Fax: (916) 843-0487

## AUTHORITY & REFERENCE

California Revenue and Taxation Code ("RTC") Section 19503 authorizes the Board to adopt these amended regulations. The proposed amendments to the withholding regulations implement, interpret, and make specific provisions in RTC Section 18662.

# INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

## Summary of existing laws and regulations related directly to the proposed rulemaking

Withholding at source is an essential part of the FTB's Tax Gap Compliance Initiative. The ultimate goal of withholding is to facilitate fair and efficient tax compliance and administration by requiring payers to remit a portion of payments due to payees directly to FTB to pay amounts approximating the tax due with respect to the income from the payment. Thus, withholding at source benefits the state by reducing the risk that the income and resulting tax will not be reported and paid, and encourages the filing of returns to report taxable income and claim credit for the withheld amounts.

RTC Section 18662 sets forth the general withholding requirement structure for nonresident and real estate withholding, and authorizes FTB to issue regulations to implement the withholding at source statutory requirements. The corresponding regulations at 18 CCR Sections 18662-0 through 18662-6 and Section 18662-8 ("Withholding Regulations") provide more specific guidelines with respect to California's nonresident and real estate withholding procedures.

## Effects of the proposed rulemaking

The effect of the proposed amendments to the Withholding Regulations is to make various technical revisions, including changes to terminology, in the current regulatory language. A summary of the primary changes follows:

### **Nonwage and Real Estate Withholding**

The proposed amendments to the Withholding Regulations would clarify the process by which a waiver is requested using FTB Form 588, Nonresident Withholding Waiver Request. Specifically, the proposed amendments would amend 18 CCR Section 18662-4, subsection (e)(1) to allow payees, their representatives, or withholding agents on behalf of payees to request a waiver using FTB Form 588, whereas previously, the regulation could be narrowly construed to allow only payees to request this waiver. The proposed amendments to the Withholding Regulations would also clarify the threshold requirements (Part IV, Withholding Computation) for FTB Form 589, Nonresident Reduced Withholding Request, to ensure that this form would only be used for reduced withholding. Specifically, the proposed amendment to 18 CCR Section 18662-4, subsection (e)(2) would require that reduced withholding requests pursuant to FTB Form 589 must have the total amount of expenses be at or below 50 percent of the gross California source payment, to ensure that the form is used for its intended purpose.

The proposed amendments to the Withholding Regulations will also amend the definitions in 18 CCR Section 18662-2, by adding the term "Remitter," which would be defined as a person who would be responsible to remit any tax withheld on any disposition from the sale or exchange of California real estate by California resident and nonresident individuals, and

non-California Business entities. The FTB has used the term "withholding agent" broadly to refer to persons who withhold. However, in real estate transactions, the person who is responsible for withholding is the buyer, and the person who actually performs the withholding is the real estate escrow person. Thus, this amendment clarifies that the remitter (typically, the escrow officer), and not the buyer, is the person responsible for sending the payment to the FTB.

The proposed amendments to the Withholding Regulations will amend relevant portions of 18 CCR Section 18662-3 by adding certain fields to FTB Form 593, including "ownership percentage." This change would make the audit process more accurate because when the FTB is dealing with multiple sellers, FTB has a difficult time ascertaining the ownership percentages of each respective seller. The result is that FTB often needs to contact the appropriate party involved to obtain such information. By adding a field covering "ownership percentage" to FTB Form 593, the form will capture information that FTB could otherwise receive by less efficient means.

The proposed amendments to the Withholding Regulations will also amend relevant portions of 18 CCR Section 18662-3 to effectuate the consolidation of the following forms into FTB Form 593: FTB Form 593-C, Real Estate Withholding Certificate, FTB Form 593-E, Real Estate Withholding Computation of Estimated Gain or Loss, and FTB Form 593-I, Real Estate Withholding Installment Sale Acknowledgement. The proposed amendments would merge FTB Form 593-C, FTB Form 593-E and FTB Form 593-I into FTB Form 593 for consolidation purposes, as there was a significant amount of information repeated throughout these forms. The proposed consolidation will reduce the burden on the escrow industry, as it will reduce the number of forms for real estate transactions from four to one. Moreover, this consolidation of forms will assist sellers/transferees in their real property transactions, as there will now be one form for all real estate transactions, and one voucher—rather than having four different forms depending on the type of real estate transaction.

The proposed amendments to the Withholding Regulations will also amend 18 CCR Section 18662-3, subsection (d)(3)(B)(1), to clarify that the person responsible for withholding during an installment sale is the buyer/transferee—not the real estate escrow person. The existing Withholding Regulations at 18 CCR Section 18662-3, subsection (d)(3)(B)(1) inadvertently imposed a withholding requirement for installment sales on the real estate escrow person—rather than the buyer/transferee. However, under both RTC sections 18662, subdivision (e)(3) and 18668, subdivision (e)(1), and under 18 CCR Section 18662-3, subsection (a), once the real estate escrow person provides the transferee/buyer with written notice of the transferee's/buyer's withholding requirements, the requirement to withhold is on the buyer/transferee—not on the real estate escrow person. Thus, this proposed amended subsection changes the phrase "real estate escrow person" to the word "buyer/transferee."

The proposed amendments to the Withholding Regulations will also amend 18 CCR Section 18662-6 by adding subsection (a)(2)(B), to clarify that if the entertainer's agent or promoter is incorporated in California or qualified to do business in California with the California Secretary of State (SOS), the entertainment venue is not required to withhold if the entertainer's agent or promoter certifies to a withholding exemption on FTB Form 590,

Withholding Exemption Certificate. As a result of this proposed amendment, as further set forth in proposed amended 18 CCR Section 18662-6, subsection (a)(2)(B), the entertainment venue may rely on a printout from the SOS's public website, showing the entertainer's agent or promoter's business entity number, that the business entity has a permanent place of business in California and that the business entity is in good standing.

## **Pass-Through Entity Withholding Forms**

In addition to nonresident and real estate withholding amendments, there are proposed amendments to the Withholding Regulations related to domestic pass-through entity (PTE) withholding filing requirements. With respect to domestic PTEs, the proposed amendments to the Withholding Regulations amend 18 CCR Sections 18662-4, subdivision (d), 18662-8, subdivision (c)(1)(B) and 18662-8, subdivision (c)(2)(B) – which would change the filing scheme from a quarterly filing withholding scheme to an annual one. Consistent with the proposed regulations, FTB also proposes amendments to create a new annual reconciliation form and a new PTE voucher form to effectuate this transition from the quarterly filing withholding scheme to an annual one. The new form will be FTB Form 592-PTE, Pass-Through Entity Annual Withholding Return, which will be used specifically by domestic PTEs that, as withholding agents, withhold tax at source on lower tier PTEs. The new voucher will be FTB Form 592-Q, Payment Voucher for Pass-Through Entity Withholding (Voucher) for quarterly payments. Withholding from payments (using FTB Form 592-Q voucher) will still be quarterly, similar to the Form 592, Resident and Nonresident Withholding Statement, but the new PTE Form (FTB Form 592-PTE) will be filed on January 31 of the year following the year for which such withholding was required to be remitted to FTB. (The January 31 date is also the due date for federal Form W-2, Wage and Tax Statement, and Form 1099.)

## **Objectives of the Proposed Regulation**

The changes made in the proposed amendments to the Withholding Regulations provide additional clarity and transparency for taxpayers, tax practitioners, withholding agents, and the public on the treatment of specified income subject to state withholding requirements. The proposed amendments to the Withholding Regulations facilitate effective state tax administration by providing definitions and additional clarification regarding income subject to state withholding.

As noted above, one of the primary objectives of the proposed amendments to the Withholding Regulations is to reduce the burden on the escrow industry, which will be accomplished by the consolidation of the real estate withholding forms, reducing the number of forms for real estate transactions from four to one. The changes made by the amendments to the Withholding Regulations are intended to make the nonresident and real estate withholding process simpler and less burdensome.

## **Anticipated Benefits from the Proposed Regulation**

The changes made in the proposed amendments to the Withholding Regulations provide additional clarity and transparency for taxpayers, tax practitioners, withholding agents, and the public. The revised regulations also retain the flexibility to respond to individual

circumstances and new or changed responsibilities. As detailed above, one of the primary changes effectuated through the proposed amendments is the consolidation of the real estate withholding forms, which will reduce the burden on the escrow industry, as it will reduce the number of forms for real estate transactions from four to one. In addition, the consolidation of forms will assist sellers/transferees in their real property transactions, as there will now be one form for all real estate transactions, and one voucher—rather than having four different forms depending on the type of real estate transaction. This will benefit taxpayers by making the withholding process simpler and less burdensome.

The proposed amendments would also benefit taxpayers, tax practitioners, those required to remit withholding, and the state by making various technical changes that provide clarity to current withholding regulations, including changes to terminology in the current regulatory language. The proposed amendments are expected to reduce taxpayer compliance costs and confusion, including the direct costs of preparing and reviewing tax documents. In addition, the proposed amendments which impact the withholding remittance by nonresident individuals and non-California businesses due to the reduction in allowed expenses are anticipated to result in a small beneficial change in the timing of payments to the state.

### **Consistency and Compatibility with Existing State Regulations**

During the process of developing this regulation, the FTB, pursuant to Government Code Section 11346.5, subdivision (a)(3)(D), has conducted a search of any similar state regulations and has concluded that this regulation is neither inconsistent nor incompatible with any existing state regulations.

## **DISCLOSURES REGARDING THE PROPOSED REGULATORY ACTION**

The Board has made the following initial determinations:

Mandate on local agencies and school districts: *None.*

Cost or savings to any state agency: *The FTB has determined the proposed regulation amendments may result in costs or savings to the FTB but, they will not be significant. The FTB estimates an acceleration of state General Fund tax payments of between \$1.2 million and \$1.5 million per fiscal year.*

Cost to any local agency or school district which must be reimbursed under Part 7, commencing with Government Code section 17500, of Division 4: *None.*

Other non-discretionary cost or savings imposed upon local agencies: *None.*

Cost or savings in federal funding to the state: *None.*

Cost impacts on a representative private person or business: The FTB is not aware of any

cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

Significant statewide adverse economic impact directly affecting business including the ability of California businesses to compete with businesses in other states:

The FTB reviewed each of the proposed amendments to 18 CCR Sections 18662-0 through 18662-6 and Section 18662-8 for potential adverse economic impact affecting business and found that only the proposed amendment to 18 CCR Section 18662-4, subdivision (e) affecting the filing of FTB Form 589 which clarifies the withholding threshold requirements would have a measurable economic impact. The remaining proposed amendments are predominantly consolidation of forms and grammatical or technical changes. The amendment to 18 CCR Section 18662-4 would limit the share of expenses used to reduce withholding to 50 percent of the source payment. Based on discussion with staff in the FTB's Legal and Filing divisions and a review of recent Form 589 data for entities that would be affected by the 50 percent expense limitation, it is estimated that the timing of payments under the proposed regulation would be affected and would accelerate between \$1.2 million and \$1.5 million per fiscal year for both non-California businesses and non-resident individuals, but does not change total tax owed. Data suggests the average increased withholding would be a small share of total income for these business entities, in most cases, as they are predominately entities with high incomes. Therefore the FTB has determined in an economic impact statement and relies on the conclusion therein, that the adverse economic impact on business will not be significant.

Potential Cost impact to directly affected private persons/businesses:

There are no costs to businesses or individuals when measuring the impact of the proposed amendments to the regulations by tax year as tax liability would remain unchanged. In addition, as those affected are non-residents, any measurable statewide impact is further reduced. The impact on businesses and individuals would occur because of increased withholding remittances created when a withholding event is triggered. This in turn would be offset by reduced final payments remitted, or an increase in refund due, when a business or individual files their final tax return. Thus for any tax year the cost impact would be negligible.

If measured by calendar year, there would be a decrease in cash available during the year the withholding event occurs for a non-resident individual or non-California business. As explained above, in the following calendar year when a final tax return is filed the final payment remitted would be decreased, or the refund due increased, by the amount of the increased withholding. Thus for any 18 month period, the cost impact would be negligible.

Effect on small business:

The FTB has determined that the proposed amendments to the Withholding Regulations will not have a significant impact on business. A majority of the proposed regulations are intended to make various technical changes and or to provide clarity to the current withholding regulations, including changes to terminology in the current regulatory language.

Significant effect on housing costs: None.

## RESULTS OF THE ECONOMIC IMPACT ASSESSMENT

Pursuant to Government Code section 11346.3, subdivision (b), the Board has determined in the economic impact assessment that (1) there is no expected impact on the creation or elimination of jobs within California as a result of the proposed amendments; (2) there is no expected impact on the creation, or elimination in the number of existing businesses within California as a result of the proposed amendments; (3) there is no expected impact on the expansion of businesses currently doing business within California as a result of the proposed amendments; and (4) the benefits to the health and welfare of California residents include providing affected taxpayers with clarity and the proper guidance, addressing new situations that have arisen, and ensuring that taxpayers, their representatives, and those required to remit withholding have guidance on issues surrounding real estate and nonwage withholding (which can reduce taxpayer compliance costs as well as confusion).

## CONSIDERATION OF ALTERNATIVES

In accordance with Government Code Section 11346.5, subdivision (a)(13), the Board must determine that no reasonable alternative it considered or that has otherwise been identified and brought to the attention of the Board would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The Board invites interested persons to present statements or arguments with respect to alternatives to the proposed amendments to the regulations during the written comment period or if a hearing is requested at the scheduled hearing.

### CONTACT PERSONS

Inquiries concerning the proposed administrative action may be directed to:

David Muradyan, Tax Counsel III  
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Franchise Tax Board  
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Rancho Cordova, CA 95741-1720  
Telephone: (916) 845-4540  
Email: [David.Muradyan@ftb.ca.gov](mailto:David.Muradyan@ftb.ca.gov)

The backup contact person for these inquiries is:

Christy Keith  
Legal Division MS A260

Franchise Tax Board  
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Please direct requests for copies of the proposed text (the "express terms") of the regulations, the initial statement of reasons, the modified text of the regulations, if any, or other information upon which the rulemaking is based to Ms. Keith at the above address or send the request by email to [Christy.Keith@ftb.ca.gov](mailto:Christy.Keith@ftb.ca.gov).

## AVAILABILITY OF INITIAL STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS, AND RULEMAKING FILE

The Board will have the entire rulemaking file available for inspection and copying throughout the rulemaking process at its office at the above address. As of the date this notice is published in the Notice Register, the rulemaking file consists of this notice, the proposed text of the regulations, and the initial statement of reasons. Copies can be obtained on the Franchise Tax Board's website at [ftb.ca.gov](http://ftb.ca.gov) or by contacting Ms. Keith at the address, phone number or email address listed above.

## AVAILABILITY OF CHANGED OR MODIFIED TEXT

After considering all timely and relevant comments received, after the close of the comment period, the Board may adopt the proposed regulations substantially as described in this notice. If the Board makes substantive modifications sufficiently related to the proposed text, it will make the modified text (with the changes clearly indicated) available to the public for at least 15 days before the Board adopts the regulations as revised. Copies of the modifications will be published on the Board's website at [ftb.ca.gov](http://ftb.ca.gov) and mailed to anyone who submitted written comments to the Board, and to anyone that has expressed an interest in receiving the modification information. Please send requests for copies of any modified regulations to the attention of Ms. Keith at the address, phone number or email address indicated above. The Board will accept written comments on the modified regulations for 15 days after the date on which they are made available.

## AVAILABILITY OF THE FINAL STATEMENT OF REASONS

Upon its completion, copies of the Final Statement of Reasons will be published on the Board's website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and may also be obtained by contacting Ms. Keith at the above address, phone number or email address.

## AVAILABILITY OF DOCUMENTS ON THE INTERNET

Copies of the Notice of Proposed Action, the Initial Statement of Reasons, and the text of the regulations in underline and strikeout can be accessed through our website at



[www.ftb.ca.gov](http://www.ftb.ca.gov).