



Bill Analysis

Author: Patterson

Sponsor:

Bill Number: AB 2120

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Introduced: February 6, 2020

Attorney: Shane Hofeling

Related Bills: See Legislative
History

SUBJECT

Interest Abatement for Withholding Payments

SUMMARY

This bill would, under the Administration of Franchise and Income Tax Law (AFITL), allow for the abatement of interest assessed on late non-wage withholding payments if it is shown that the failure to pay is due to reasonable cause and not willful neglect.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to provide interest relief to withholding agents (WA) that show that their failure to pay timely was due to reasonable cause and not willful neglect.

ANALYSIS

This bill would allow the Franchise Tax Board (FTB) the authority to abate interest assessed on untimely non-wage withholding payments if it is shown that the WA's failure to pay timely is due to reasonable cause and not willful neglect.

Effective/Operative Date

If enacted by September 30, 2020, this bill would become effective and operative January 1, 2021. If enacted after September 30, 2020, this bill would become effective and operative January 1, 2022.

Federal/State Law

Non-wage withholding is a prepayment of income tax (similar to wage withholding). Generally, under federal law, a percentage of income paid to a nonresident alien or a foreign corporation for services or for the gain on the sale of real property must be withheld. The withholding obligation is imposed on the "withholding agent," who is the person that is normally responsible for the disbursement of the funds. The WA is frequently the person paying for the services or purchasing the property, but can also be an attorney, escrow person, broker, or other intermediary.

A penalty is imposed on WAs if they fail to withhold on payments to a nonresident alien or foreign corporation. The amount of the federal penalty is equal to the amount of tax the taxpayer ultimately fails to pay, but cannot exceed the amount that should have been withheld. Therefore, the penalty can be assessed only once the Internal Revenue Service (IRS) determines the amount of tax the taxpayer failed to pay. The penalty is excused if the failure to withhold is due to reasonable cause.

Interest is assessed on any amount due, from the original due date to the date of payment. If a tax liability is reduced or abated, then any assessed penalty and interest would also be reduced or abated accordingly. However, the IRS does not abate interest due to reasonable cause.

California law is similar to federal law except California law also imposes non-wage withholding requirements on the sale of California real property by any individual. Like federal law, generally, the WA is the person paying for the services or distributing the money. Generally, the amount of the penalty and interest imposed on the WA is calculated in a method similar to federal law. (For sales of California real property, the buyer of the real property is generally the WA. The penalty amount for buyers of real property located in California is calculated in a different manner. The penalty is the greater of \$500 or ten percent (10%) of the amount required to be withheld.)

If a tax liability is reduced or abated, then any assessed penalty and interest would also be reduced or abated accordingly. In addition, the FTB may reduce interest in certain instances if there are delays caused by the acts of the FTB. However, the FTB does not abate interest due to reasonable cause.

Implementation Considerations

Department staff has identified the following implementation considerations. Additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The Fact Sheet for this bill discusses the required seven percent (7%) withholding on payments collected by property management companies in California for rents from California properties owned by nonresidents. However, this bill would provide abatement of interest, based on reasonable cause and not willful neglect for late withholding payments for *all* non-wage required withholding. For example, this bill would also permit abatement of interest for reasonable cause for nonresident partner withholding, payments to out-of-state contractors, the gain on sale of California property, etc. If this is contrary to the author's intent, this bill should be amended.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 2529 (Chu, 2017/2018) would have created an income tax withholding requirement for like-kind exchanges of real property when California property is exchanged for property located outside of California. AB 2529 failed to pass the Assembly Revenue and Taxation Committee.

SB 352 (Stone, 2017/2018) would have modified the withholding requirement relating to sales of real property under the AFITL. SB 352 failed to pass the Senate Appropriations Committee.

PROGRAM BACKGROUND

The department's withhold at source program requires withholding of tax from non-wage payments of income derived from California sources received by nonresident contractors, investors, beneficiaries of estates and trusts, partners, and individual resident and nonresident sellers of California real property. The obligation to withhold is generally borne by the party paying the item of income to the taxpayer-recipient. This program is distinct from withholding on employee wages, which is administered by the Employment Development Department.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

This bill, as introduced February 14, 2020, would have a revenue impact to the general fund, but the amount is unknown.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Due to the lack of available data, it is difficult to predict the frequency and dollar amount of interest that would be impacted by this bill. Therefore, we cannot provide an annual estimate. However, it is estimated that for every \$1,000,000 of penalties issued, the estimated revenue loss from interest abatement would be approximately \$1,000.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

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