Background
The second interested parties meeting (IPM) for proposed draft language adding California Code of Regulations, Title 18, Section 18662-7, Domestic Pass-Through Entity Withholding Regulation (Regulation), was held on September 8, 2017. At the second IPM, Franchise Tax Board (FTB) staff elicited and received public comments on proposed draft language for the Regulation. The FTB posted a summary of the second IPM, available online on the FTB's website at the Regulatory Activity page.

On March 19, 2019, after considering comments made at the second IPM and during the comment period, FTB staff issued a 90-day notice, and revised proposed draft Regulation language with a discussion of the revisions. These documents are available online at the FTB's website.

On October 8, 2019, amendments to California Code of Regulations, Title 18, Sections 18662-0 through 18662-8 excluding the Regulation (Final Regulations), became operative pursuant to Government Code section 11343.4, subdivision (b)(3) (Register 2019, No. 41).

Finally, on June 25, 2020 FTB staff issued a 30-day notice, and revised proposed draft Regulation language. These documents are available online at the FTB's website.

Purpose
The purpose of this 45-day notice is to elicit comments on newly revised proposed changes to the Regulation and new proposed amendments to the Final Regulations (hereinafter together referred to as Proposed Regulations) as described below. Please submit written comments regarding the Proposed Regulations language by 5:00 p.m. on July 23, 2021.

Following the close of this 45-day comment period, FTB staff intends to present the Proposed Regulations language to the 3-member Franchise Tax Board to request permission to proceed with the formal Administrative Procedures Act (APA) regulatory process.

Discussion
The modifications to the Proposed Regulations are summarized as follows. First, FTB staff proposes to amend the Final Regulations for purposes of consistency with the Regulation, to more closely reflect federal language for foreign partner withholding, to clarify the withholding rules relating to trusts and estates, and non-substantive proposed amendments for purposes of consistency and clarity. FTB staff also proposes other amendments that are specific to each Final Regulation, as described in more detail below.
Additionally, FTB staff proposes additional changes to the Regulation as it appeared on June 25, 2020 including, deleting definitions and subsections, and adding Form 592-PTE language from Final Regulation section 18662-4.

Finally, FTB staff proposes deleting the applicability date provision previously proposed in the Regulation, and instead intends to prescribe a later date in a written instrument filed with the Proposed Regulations under California Government Code section 11343.4, subdivision (b)(2). FTB staff proposes a later effective date of January 1st of the first calendar year following the filing of the Proposed Regulations with the Secretary of State Regulation or January 1st if the Proposed Regulation are filed with the Secretary of State on January 1st.

Proposed Amendments to Final Regulations

1. **Consistency with Regulation.** FTB staff proposes to amend the Final Regulations to add language relating to domestic pass-through entity withholding from the Regulation. The purpose for these proposed amendments is to ensure that all withholding regulations operate together.

2. **Foreign Partner Withholding.** FTB staff proposes to amend Final Regulation section 18662-1, subsection (a)(1)(C), Final Regulation section 18662-4, subsection (a), and other Final Regulation language relating to foreign partner withholding. As set forth in Revenue and Taxation Code (RTC) section 18666, Internal Revenue Code (IRC) section 1446 applies for amounts representing California source income unless otherwise provided. The purpose of these proposed amendments to the Final Regulations is to more closely reflect the language of the foreign partner withholding rules under RTC section 18666 and IRC section 1446. Examples of such proposed changes include, deleting language relating to "limited liability companies" or "members," replacing references to "foreign entity" with references to "foreign partner," and replacing references to "withholding on payments" with references to "withholding on partnership’s effectively connected taxable income that is allocable to a foreign partner." The purpose of each proposed amendment is to more closely reflect the language in IRC section 1446.

3. **Trusts and Estates.** FTB staff proposes to amend the Final Regulations to specify withholding requirements for trusts and estates. Specifically, FTB staff proposes an amendment to Final Regulation section 18662-4, subsection (a) stating withholding is required on payments to non-California complex trusts, simple trusts, grantor trusts, and estates, and on complex trust and estate distributions of California source income paid to nonresident beneficiaries. The purpose of this proposed amendment is to clarify the withholding rules relating to trusts and estates.
4. **Non-Substantive Changes.** FTB staff proposes to amend the Final Regulations for purposes of clarity and consistency, such as deleting text stating "[Reserved]", renumbering or relabeling subsections, amending references, and removing superscript, changing the format for consistency with the Office of Administrative Law (OAL), among other changes.

5. **Other Proposed Amendments Specific to Final Regulation Section 18662-2.** Proposed amendments to Final Regulation section 18662-2 include proposed substantive changes that are made for consistency with the Regulation, foreign partner withholding, and trusts and estates, and non-substantive changes, as described above. In addition, FTB staff proposes to amend the Final Regulations to add definition subsections from the Regulation at subsection (b), to Final Regulation section 18662-2, relating to definitions for all withholding regulations. The purpose of these proposed additions is for the definitions relating to the Proposed Regulation to apply to all withholding regulations, rather than to the Regulation alone. Specifically, FTB staff proposes to amend or add the following in Final Regulation section 18662-2:

   a. **California Business Entity.** FTB staff proposes to amend Final Regulation section 18662-2, subsection (b), "California Business Entity," to delete the word "exclusively." The purpose of this deletion is to broaden the example to include a corporation engaged in interstate commerce, rather than a corporation engaged exclusively in interstate commerce.

   b. **California Trust or Estate.** FTB staff proposes to amend Final Regulation section 18662-2, subsection (e), "California Trust or Estate," to add language for determining whether trust and estate income is taxable in California.

   c. **Distributive Share of Income.** FTB staff proposes to add Final Regulation section 18662-2, subsection (f), "Distributive Share of Income." Previously, the definition of distributive share of income was contained in the Regulation at subsection (b)(1). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) Additionally, FTB staff proposes the following changes to the definition of distributive share of income as it appeared in the June 25, 2020 proposed draft Regulation at subsection (b)(1):

      i. FTB staff proposes to delete the reference to Chapter 9 of Part 10 of the RTC, Estates, Trusts, Beneficiaries, and Decedents. The purpose of this proposed deletion is to define the pass-through income subject to withholding for simple trusts in the definition of distributable net income, not in the definition of distributive share of income.
ii. FTB staff proposes to add language to describe how to determine the amount subject to withholding by a pass-through entity on a nonresident owner's distributive share of California source income. In the June 25, 2020 proposed draft Regulation, this language appeared at subsection (b)(2).

d. **Distributable Net Income.** FTB staff proposes to add Final Regulation section 18662-2, subsection (g), "Distributable Net Income." The purpose of this addition is to define the share of pass-through income subject to withholding for simple trusts. The proposed language describes how to determine the amount subject to withholding by a simple trust on a nonresident beneficiary's share of the simple trust's California source income, as reported on California Schedule K-1.

e. **Lower Tier Pass-Through Entity.** FTB staff proposes to add Final Regulation section 18662-2, subsection (k), "Lower Tier Pass-Through Entity." Previously, the definition of lower tier pass-through entity was in the Regulation at subsection (b)(3). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) No further changes are proposed for the definition.

f. **Non-California Upper Tier Pass-Through Entity.** FTB staff proposes to add Final Regulation section 18662-2, subsection (n), "Non-California Upper Tier S Corporation." Previously, the definition of non-California upper tier pass-through entity was in the Regulation at subsection (b)(4)(B)(2). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.)

g. **Non-California Upper Tier S Corporation.** FTB staff proposes to add Final Regulation section 18662-2, subsection (o), "Non-California Upper Tier S Corporation." Previously, the definition of non-California upper tier S corporation was in the Regulation at subsection (b)(4)(B)(1). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.)

h. **Nonresident Owner.** FTB staff proposes to add Final Regulation section 18662-2, subsection (p), "Nonresident Owner." Previously, the definition of nonresident owner was contained in the Regulation at subsection (b)(4). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) Additionally, FTB staff proposes the following changes to the definition of nonresident owner as it appeared in the June 25, 2020 proposed draft Regulation:

i. FTB staff proposes to add language that specifies that nonresident owner is defined for the purposes of domestic pass-through entity withholding.
ii. FTB staff proposes to delete Regulation, subsections (b)(4)(A), "Nonresident Individual," and (b)(4)(B), "Non-California Business Entity." The purpose of deleting the definitions subsections for nonresident individual and non-California business entity is because the definitions already exist in Final Regulation section 18662-2.

iii. FTB staff proposes to delete Regulation subsections (b)(4)(B)(1), "Non-California Upper Tier S Corporation," and (b)(4)(B)(2), "Non-California Upper Tier Pass-Through Entity," and proposes to add each subsection as a definition subsection under Final Regulation section 18662-2, subsection (n) and (o).

iv. FTB staff proposes to add language to clarify that, rather than including all nonresident beneficiaries of a trust or estate as nonresident owners, beneficiaries of a simple trust are considered nonresident owners for purposes of pass-through entity withholding and the withholding regulations. Previously, the definition of nonresident owners included nonresident beneficiaries of a trust or estate. The purpose of this proposed additional language is to clarify the withholding regulations relating to trusts and estates.

v. FTB staff proposes to add language to clarify that a nonresident owner also includes complex trusts, grantor trusts, simple trusts, or estates. The purpose of this change is to clarify that any trust or estate can be considered an owner of a pass-through entity. This is contrasted with the rule for beneficiaries described above, which is limited to simple trusts.

i. **Person.** FTB staff proposes to amend Final Regulation section 18662-2, subsection (z), to replace the phrase "...as well as business entities" with "fiduciaries, partnerships, limited liability companies, and corporations." The purpose of this proposed change is to amend the language to more closely reflect language under RTC section 17007.

j. **Pass-Through Entity.** FTB staff proposes to add Final Regulation section 18662-2, subsection (s), "Pass-Through Entity." Previously, the definition of pass-through entity was contained in the Regulation at subsection (b)(5). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) Additionally, FTB staff proposes the following change to the definition of pass-through entity as it appeared in the June 25, 2020 proposed draft Regulation:

   i. FTB staff proposes to add language to clarify that, with regard to the withholding regulations relating to trusts and estates, a simple trust
is considered a pass-through entity. Previously, the definition included estates or trusts. However, grantor trusts, complex trusts, and estates are not considered pass-through entities for purposes of the withholding regulations.

k. **Pass-Through Entity Owner.** FTB staff proposes to add Final Regulation section 18662-2, subsection (t), "Pass-Through Entity Owner." Previously, the definition of Pass-Through Entity Owner was contained in the Regulation at, subsection (b)(6). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) Additionally, FTB staff proposes the following changes to the definition of pass-through entity owner as it appeared in the June 25, 2020 proposed draft Regulation:

i. FTB staff proposes to add language to clarify that, with regard to the withholding regulations relating to trusts and estates, beneficiaries of a simple trust are considered pass-through entity owners. Previously, the definition of pass-through entity owner included beneficiaries of any trust or estate.

ii. FTB staff proposes to add language to clarify that a pass-through entity owner also includes complex trusts, grantor trusts, simple trusts, or estates. The purpose of this change is to clarify that any trust or estate can be considered an owner of a pass-through entity. This is contrasted with the rule for beneficiaries described above, which is limited to simple trusts.

l. **Upper Tier Pass-Through Entity.** FTB staff proposes to add Final Regulation section 18662-2, subsection (dd). Previously, the definition of upper tier pass-through entity owner was contained in the Regulation at subsection (b)(8). (See the June 25, 2020 revised proposed draft Regulation language available online at the FTB's website.) No further changes are proposed for this definition.

6. **Other Proposed Amendments Specific to Final Regulation Section 18662-3.** Proposed amendments to Final Regulation section 18662-3 include proposed non-substantive changes, as described above. In addition, FTB staff proposes to amend, add, or delete the following in Final Regulation section 18662-3: **Penalties for Failure to Provide Notice.** FTB staff proposes to amend subsection (c)(2) relating to the imposition of the penalty on real estate escrow persons for failure to provide the required notice by changing the term "may" to "shall." Accordingly, the changes are being made to ensure that subsection (c)(2) is consistent with RTC section 18668, subdivision (e)(1), which makes the imposition of the penalty mandatory, not permissive.
7. **Other Proposed Amendments Specific to Final Regulation Section 18662-4.** Proposed amendments to Final Regulation section 18662-4 include proposed substantive changes that are made for consistency with the Regulation, foreign partner withholding, trusts and estates, and non-substantive changes, as described above. In addition, FTB staff proposes to amend, add, or delete the following in Final Regulation section 18662-4:

   a. **Nonresident Individuals and Non-California Business Entities.** FTB staff proposes to amend Final Regulation section 18662-4, subsection (a)(1) to delete "estates or trusts" and "foreign (non-U.S.) entities." The purpose for this proposed deletion is to provide separate subsections specifically describing the withholding rules for each.

   b. **Non-California Complex Trusts, Simple Trusts, Grantor Trusts, or Estates and Nonresident Beneficiaries of Complex Trusts and Estates.** FTB staff proposes to add Final Regulation section 18662-4, subsection (a)(2) to specify the requirement to withhold on payments of California source income made to non-California complex trusts, simple trusts, grantor trusts, and estates, and to withhold on complex trust and estate distributions of California source income paid to nonresident beneficiaries. The purpose for this proposed addition is to provide clarity for the withholding rules relating to trusts and estates.

   c. **Nonresident Owners of Pass-Through Entities.** FTB staff proposes to add Final Regulation section 18662-4, subsection (a)(3) to specify the requirement to withhold on nonresident owners' distributive share of pass-through entity California source income under the Regulation. The purpose for this proposed addition is to incorporate the Regulation requirements in the general requirements under Final Regulation section 18662-4.

   d. **Foreign Partners.** FTB staff proposes to add Final Regulation section 18662-4, subsection (a)(4) to describe the foreign partner withholding requirement as set forth in RTC section 18666. The purpose for this proposed addition is to accurately describe the withholding rules in RTC section 18666 and to ensure the Final Regulation section 18662-4 applies to foreign partner withholding.

   e. **Nonresident Aliens.** FTB staff proposes to add Final Regulation section 18662-4, subsection (a)(5) to describe the nonresident alien withholding requirement, which is currently described in Final Regulation section 18662-5, subsection (a)(4). The nonresident alien withholding requirements are more appropriate in Final Regulation section 18662-4, which relates to nonresident withholding rules, rather than Final
Regulation section 18662-5, which relates to other types of payments and withholding obligations.

f. California Business Entities. In addition to proposed changes for consistency with the Regulation as described above, FTB staff proposes to add a paragraph that describes the general rule for California Business Entities in Final Regulation section 18662-4, subsection (b)(2). This purpose for this proposed amendment is to clarify the general rule for California business entities.

g. California Trusts and Estates. In addition to proposed changes for consistency with the Regulation as described above, and other non-substantive proposed amendments, FTB staff proposes to add language specifying complex trusts, simple trusts, and grantor trusts as the trusts that may be treated as a California trust under Final Regulation section 18662-4, subsection (b)(4).

h. Information Returns Also Required. FTB staff proposes to amend Final Regulation section 18662-4, subsection (d) to replace "may also" with "shall." The purpose for this proposed amendment is for the language to reflect the requirements of RTC section 19183.

i. Suspended and Forfeited Corporations. In addition to proposed changes for consistency with the Regulation as described above, FTB staff proposes to delete the phrase "if the payer has knowledge of, or has reason to know of, the suspension or forfeiture," in Final Regulation section 18662-4, subsection (g), to clarify that withholding of tax at source is required from any payment to a corporation, regardless of its status.

j. FTB Form 592. FTB staff proposes to amend types of income described in the check box under Final Regulation section 18662-4, subsection (i) to reflect the requirements to withhold on payments to a Non-California grantor trust, simple trust, complex trust, or estate, and to withhold on distributions to a domestic nonresident beneficiary. The purpose for this proposed amendment is to more specifically describe the types of income required to be withheld upon relating to trusts and estates. FTB staff also proposes to replace "distributed" with "allocated" to clarify the difference between "distributions paid" and the requirement to "allocate" withholding paid on behalf of a payee.

k. FTB Form 592-PTE. FTB staff proposes to delete Final Regulation section 18662-4, subsection (j), relating to information described in FTB Form 592-PTE, and to move the subsection to the Regulation at subsection (i). Since Form 592-PTE is filed only for pass-through entities required to withhold or required to allocate withholding paid on the pass-through
entity's behalf under the Proposed Regulation, it is more appropriate for the Form 592-PTE information and subsection to exist in the Proposed Regulation.

I. **FTB Form 588.** FTB staff proposes to amend types of income described in the check box under Final Regulation section 18662-4, subsection (l) to reflect the requirements to withhold on payments to a Non-California grantor trust, simple trust, complex trust, or estate, and to withhold on distributions to a domestic nonresident beneficiary. The purpose for this proposed amendment is to clarify the types of income required to be withheld upon relating to trusts and estates. FTB staff also proposes to replace "distributed" with "allocated" to clarify the difference between "distributions paid" and the requirement to "allocate" withholding paid on behalf of a payee. FTB staff also proposes renaming subsection (l), subsection (k) due to the deletion of former subsection (j) relating to FTB Form 592-PTE, as described above.

m. **FTB Form 589.** FTB staff proposes to delete types of income described in the check box under Final Regulation section 18662-4, subsection (m) that relate to trust or estate distributions and distributions to domestic nonresident partners, members, beneficiaries, or S corporation shareholders. The purpose for this proposed deletion is to allow deductions consistent with tax law. FTB staff also proposes renaming subsection (m), subsection (l) due to the deletion of former subsection (j) relating to FTB Form 592-PTE, as described above.

8. **Other Proposed Amendments Specific to Final Regulation Section 18662-5.** Proposed amendments to Final Regulation section 18662-5 include proposed substantive changes that are made for consistency with the Regulation, foreign partner withholding, trusts and estates, and non-substantive changes, as described above. In addition, FTB staff proposes to amend, add, or delete the following in Final Regulation section 18662-5:

a. **Payments to Nonresident Aliens or Foreign Entities.** FTB staff proposes to delete Final Regulation section 18662-5, subsection (a)(4), relating to nonresident aliens or foreign partners. The nonresident alien and foreign partner withholding requirements are more appropriate in Final Regulation section 18662-4, which relates to nonresident withholding rules, rather than Final Regulation section 18662-5, which relates to other types of payments and withholding obligations.

b. **Rent or Lease Payments to Nonresidents.** FTB staff proposes to amend Final Regulation section 18662-5, subsection (d) to clarify language relating to a nonresident owner. The purpose of this proposed amendment is to differentiate between nonresident owners of California real estate for purposes of Final Regulation section 18662-5, subsection (d) and
nonresident owners of pass-through entities for purposes of the Regulation.

c. **Allocation of Distributions.** FTB staff proposes to amend Final Regulation section 18662-5, subsection (h)(5) to add "complex trust" to the title, and "complex" to modify the trust language in the subsection. The purpose of these additions is to clarify that allocation of distributions between California and non-California source income based on past year allocations apply to complex trusts, rather than to all trusts.

9. **Other Proposed Amendments Specific to Final Regulation Section 18662-8.** Proposed amendments to Final Regulation section 18662-8 include proposed substantive changes that are made for consistency with the Regulation, foreign partner withholding, trusts and estates, and non-substantive changes, as described above. In addition, FTB staff proposes to amend or add the following to Final Regulation section 18662-8:

a. **FTB Form 592-V.** FTB staff proposes to amend the types of income described in the check box at subsection (j) to reflect the requirements to withhold on payments to a Non-California grantor trust, simple trust, complex trust, or estate, and the requirements to withhold on distributions to a domestic nonresident beneficiary. The purpose for this proposed amendment is to clarify the types of payments relating to trusts and estates subject to withholding.

b. **FTB Form 592-B.** FTB staff proposes to amend types of income described in the check box at subsection (o) to reflect the requirements to withhold on payments to a Non-California grantor trust, simple trust, complex trust, or estate, and the requirement to withhold on distributions to a domestic nonresident beneficiary. The purpose for this proposed amendment is to clarify the types of payments relating to trusts and estates subject to withholding.

c. **Information Return and Payee Statement Penalties – Changing "may" to "shall".** FTB staff proposes to amend the following subsections relating to imposition of the information return and/or payee statement penalty, by changing the term "may" to "shall":

   i. (b)(2)(B) (pertaining to information returns)
   ii. (c)(2)(E) (pertaining to payee statements)
   iii. (d)(2)(A) (pertaining to information returns and payee statements)
   iv. (d)(2)(B) (pertaining to information returns)
   v. (d)(2)(D)(ii) (pertaining to information returns)

The changes are proposed to ensure that Final Regulation section 18662-8 is consistent with RTC section 19183, subdivisions (a)(1) and (b)(1). Specifically, RTC section 19183, subdivision (a)(1) provides that a
"penalty shall be imposed for failure to file correct information returns. . . ."
Similarly, RTC section 19183, subdivision (b)(1) provides that a "penalty shall be imposed for failure to furnish correct payee statements . . . ."
Accordingly, the proposed changes herein will ensure that the language in Final Regulation section 18662-8 is consistent with its statutory counterpart.

d. Information Return and Payee Statement Penalties – General. FTB staff proposes to amend subsection (d)(2)(A) to provide necessary references and information related to the RTC with respect to the following: (1) imposition of the information return and/or payee statement penalty, including in cases where there's intentional disregard of the withholding requirements, (2) periodic adjustments of the information return and/or payee statement penalty amount, and (3) abatement of the information return and/or payee statement penalties due to reasonable cause. This subsection also sets forth the current information return and payee statement penalty amounts and, as set forth above, provides that this amount will be adjusted periodically pursuant to RTC section 19183. RTC section 19183, subdivisions (a)(1) and (b)(1) provide that the information return and payee statement penalties "shall be determined in accordance with" Internal Revenue Code sections 6721 and 6722, respectively. In turn, Internal Revenue Code sections 6721 and 6722 set forth the penalty amounts depending on when the information return and/or payee statement was correctly filed, and these amounts are updated and revised pursuant to RTC Code section 19183, subdivisions (a)(3) and (b)(3). Accordingly, these changes are done to make the language in Final Regulation section 18662-8, consistent with its statutory counterparts.

e. Real Estate Information Return Penalties. FTB staff proposes to amend subsection (d)(2)(B)—which pertains specifically to real estate information returns—in the same manner and for the exact reasons as set forth in the paragraph immediately preceding this one (paragraph (d) titled "Information Return and Payee Statement Penalties – General."). The only difference is that paragraph (d) above covers all information returns and payee statements, whereas this paragraph (paragraph (e)) is specific to only real estate information returns, but the reasons are identical.

f. Liability of Withholding Agent for Required Withholding. FTB staff proposes to amend subsection (d)(2)(C) to clarify that the term "penalties" as used in that subsection refers to information return and/or payee statement penalties.

g. Special Rules for Real Estate Withholding: Real Estate Notification and Withholding Penalties. FTB staff proposes to amend subsection (d)(2)(D)(i) to provide appropriate statutory references to the notification requirements imposed on real estate escrow persons. Specifically, under RTC Code section 18668, subdivisions (d) and (e), the real estate escrow person is liable for the greater of $500 or 10 percent of the required
withholding when the real estate escrow person fails to provide to the buyer/transferee (other than a buyer/transferee that is an intermediary or accommodator in a deferred exchange) written notification of the withholding requirements, unless it is shown that the failure to notify is due to reasonable cause. In addition, under RTC Code section 18668, subdivision (d), whenever any buyer/transferee is required to withhold any amount and the buyer/transferee has received written notification of the withholding requirements from the real estate escrow person, the buyer/transferee is liable for the greater of $500 or 10 percent of the required withholding amount, unless it is shown that the failure to withhold is due to reasonable cause. Accordingly, subsection (d)(2)(D)(i) is revised so that Regulation 18662-8 and the language contained therein is consistent with its statutory counterparts.

h. Special Rules for Real Estate Withholding: Real Estate Information Returns and False Exemption Certificates. FTB staff proposes to amend subsection (d)(2)(D)(ii) to provide clarity with respect to the conditions under a remitter may be subject to a penalty (failure to file a complete, correct, and timely FTB Form 593), and removes superfluous information that was already covered in subsection (d)(2)(B) above. In addition, with respect to situations where the seller/transferor knowingly certifies to a false exemption on FTB Form 593, FTB proposes to change the penalty imposition of "the greater of $1,000 or 20 percent of the required withholding" from "may" to "shall" to be consistent with RTC section 18668, subdivision (e)(5), which provides that "[a]ny transferor who for the purpose of avoiding the withholding requirements of subdivision (e) of Section 18662 knowingly executes a false certificate pursuant to that section is liable for twice the amount specified in subdivision (d)."

Accordingly, FTB staff proposes to also ensure that this subsection is consistent with RTC section 18668, subdivision (e)(5)'s requirement regarding the intent of the transferor/seller (i.e., that the penalty applies only to those who execute a false certificate "for the purpose of avoiding the withholding requirements. . . .") As such, FTB staff has proposed to add Revenue and Taxation Code section 18668, subdivision (e)(5)'s language to this subsection.

Revisions to Regulation

1. Regulation at, subsection (a). FTB staff proposes to delete "withholding" and replace with "that withholds," to clarify the meaning of the subsection.

2. Remove Definitions from Regulation and Place In Final Regulation Section 18662-2 and In Separate Subsections in Regulation. FTB staff proposes to delete the subsections containing definitions in the Regulation, subsection (b) as they appeared in the June 25, 2020 proposed draft Regulation, and add the definitions to the Final Regulation section 18662-2. The purpose of these
proposed deletions is for the definitions relating to the Regulation to apply to all withholding regulations, rather than to the Regulation alone. Please see discussion of each new proposed change made to these definitions as they appeared in the June 25, 2020 proposed draft Regulation in above discussion of proposed amendments to Final Regulation section 18662-2. Notably, the definition of pass-through entity no longer includes all trusts and estates; instead it now includes simple trusts, and therefore simple trusts will be required to withhold as a pass-through entity under the Proposed Regulation. In addition, FTB staff proposes the following:

a. *Income from California Sources Subject to Withholding.* FTB staff proposes to move the Regulation subsection (b)(2) language as it appeared in the June 25, 2020 proposed draft Regulation, to a separate subsection in the Regulation, now at subsection (b). The purpose for this proposed change is because "Income from California Sources Subject to Withholding" is not a definition. FTB staff also proposes to delete the first sentence as it appeared in the June 25, 2020 proposed draft Regulation because it has proposed to add that sentence to Final Regulation section 18662-2, subsection (f), the definition of distributive share of income. See, "Distributive Share of Income," discussion above. The sentence proposed to be deleted describes how to determine a nonresident owner's distributive share of California source income. Therefore, it is more appropriately located in the definition of "Distributive Share of Income," in Final Regulation section 18662-2, subsection (f).

b. *Tax Rate of Withholding.* FTB staff proposes to move the Regulation subsection (b)(7) language as it appeared in the June 25, 2020 proposed draft Regulation, to a separate subsection in the Regulation, now at subsection (c). The purpose for this proposed changed is because "Tax Rate of Withholding" is not a definition. Additionally, FTB staff proposes to delete the phrase "...include the 1 percent mental health tax rate and additional tax rates imposed by Proposition 30" as it appeared in subsection (b)(7)(A), (b)(7)(B)(2), and (b)(7)(B)(3) of the June 25, 2020 proposed draft Regulation. FTB staff proposes to replace the phrase described above with the phrase "...include the additional tax imposed by Revenue and Taxation Code section 17043." The purpose for this revision is cite to the authority for the imposition of the mental health tax rate such that the entire Code section applies, including potential future amendments. FTB staff also proposes deleting the phrase relating to Proposition 30 because it already applies under RTC section 17041.

3. **Add FTB Form 592-PTE to the Regulation at subsection (i).** FTB staff proposes to move FTB Form 592-PTE, from Final Regulation section 18662-4, subsection (j) to the Regulation. Since Form 592-PTE is filed only for pass-through entities required to withhold or required to allocate withholding paid on the pass-through
4. **Information Return Penalty and Liability Language.** FTB staff proposes to delete "late filing penalty" and add "information return penalty" in the Regulation at subsection (d), and Example 4. The purpose for this proposed change is to reflect the information return penalty, which is different than the late filing penalty. FTB staff also proposes to add a sentence stating the information return penalty is to be determined in accordance with Regulation section 18662-8, subsection (b)(2)(A).

5. **Applicability Date.** FTB staff proposes to delete the applicability date provision and instead prescribe a later date in a written instrument filed with the Proposed Regulations under California Government Code section 11343.4, subdivision (b)(2). Regulation subsection (i) as it appeared in the June 25, 2020 draft Regulation provided that the provisions of the Regulation will be applicable commencing with the first full quarter beginning after the effective date of the Regulation. FTB staff now proposes a later effective date of January 1st of the first calendar year following the filing of the Proposed Regulations with the Secretary of State or January 1st if the Proposed Regulations are filed with the Secretary of State on January 1st. The purpose of this proposed change is to alleviate administrative burdens on the Withholding Services and Compliance Section at FTB, while still addressing the quarterly withholding payment timing issue this subsection was originally designed to resolve.

6. **Non-Substantive Changes.** FTB staff proposes to amend the Regulation for purposes of clarity and consistency, such as consistently using "shall" rather than "is required to" or "must," deleting references to "[Reserved]", renumbering or relabeling subsections, amending references, and removing superscript, changing the format for consistency with OAL, among other changes.

Written comments regarding the Proposed Regulations will be accepted until 5:00 p.m. on July 23, 2021. All inquiries and written comments concerning this notice should be directed to Leah Thyberg per the below contact information.

Email: FTBRegulations@ftb.ca.gov  
Telephone: (916) 845-3617  
Facsimile: (916) 843-8820  
Mailing Address: Franchise Tax Board  
Legal Division (MS A260)  
Attn: Leah Thyberg  
P.O. Box 1720  
Rancho Cordova, CA 95741-1720
This notice and the Proposed Regulations language also will be made available at the Regulatory Activity page of the Franchise Tax Board's website.

COST IMPACTS OF PROPOSED RULEMAKING

The department encourages submission of information from interested parties during the pre-APA process in order to assess the economic impact of a proposed rulemaking action on businesses (including small businesses), employees, jobs or occupations, competitiveness of California businesses, reporting requirements, or individuals.