

## THIRTY-DAY NOTICE OF PROPOSED AMENDMENTS

### California Code of Regulations, Title 18 Division 3, Chapter 2.6, Subchapter 2 Article 5, Withholding

Proposed Amendments As Discussed in the Thirty-Day Notice  
Dated June 25, 2020  
Are Shown in Bold and Underline

Regulation 18662-7 is adopted to read:

#### 18662-7. Domestic Pass-Through Entity Withholding.

(a) General. A pass-through entity is required to withhold tax on behalf of a nonresident owner in an amount equal to the nonresident owner's tax rate of withholding multiplied by the nonresident owner's distributive share of the pass-through entity's California source income. A pass-through entity withholding tax on behalf of an owner that is a non-California upper tier S corporation is also required to withhold tax on behalf of each resident or nonresident owner of the non-California upper tier S corporation owner.

#### (b) Definitions.

(1) Distributive Share of Income. For purposes of this **subsection regulation**, distributive share of income shall be computed under Chapters 9 through 11 of Part 10 of the Revenue and Taxation Code; and Chapters 4.5 and 17 of Part 11 of the Revenue and Taxation Code.

(2) Income from California Sources Subject to Withholding. The amount subject to withholding by a pass-through entity is calculated based upon the pass-through entity's California source income and as reported on California Schedule K-1, disregarding any limitations on those items that may apply at the partner's level. A nonresident owner's distributive share of a pass-through entity's California source income is determined in the manner described in Regulation section 25137-1 for nonresident corporate partners and Regulation section 17951-4 for all other nonresident owners.

(3) Lower Tier Pass-Through Entity. A lower tier pass-through entity is a pass-through entity with California source income that has a pass-through entity owner.

(4) Nonresident Owner. A nonresident owner includes partners, members, and shareholders that are nonresidents of California, in addition to beneficiaries of an estate or trust that are nonresidents of California. A nonresident owner includes owners that are nonresident individuals and owners that are non-California business entities, including, but not limited to, such entities as pass-through entities, publicly traded partnerships, master limited partnerships, estates or trusts, corporations, and suspended or forfeited corporations.

- (A) Nonresident Individual. A nonresident individual is as defined in Regulation section 18662-2(j) and Regulation section 18662-4.
- (B) Non-California Business Entity. A non-California business entity is as defined in Regulation section 18662-2(i) and includes non-California business entities that are doing business in California within the meaning of Revenue and Taxation Code section 23101 and receiving California source income, as explained in Regulation section 18662-4(b)(2).
1. Non-California Upper Tier S Corporation. A non-California upper tier S corporation is a non-California business entity that is an S corporation and an upper tier pass-through entity.
  2. Non-California Upper Tier Pass-Through Entity. A non-California upper tier pass-through entity is a non-California business entity that is a pass-through entity other than an S corporation and an upper tier pass-through entity.
- (5) Pass-Through Entity. For purposes of this regulation, a pass-through entity includes a partnership (as defined by Revenue and Taxation Code section 17008 and Regulation section 18662-2(o)), estate or trust, and S corporation.
- (6) Pass-Through Entity Owner. A pass-through entity owner includes partners, members, or S corporation shareholders that own an interest in a pass-through entity, and beneficiaries of an estate or trust. A pass-through entity owner includes individuals and non-California business entities, including, but not limited to, such entities as pass-through entities, publicly traded partnerships, master limited partnerships, estates or trusts, corporations, and suspended or forfeited corporations.
- (7) Tax Rate of Withholding. The pass-through entity shall withhold at the rate specified below with respect to each nonresident owner.
- (A) Nonresident Individual Owner. The tax rate applicable to each nonresident individual owner's distributive share shall consist of the highest marginal tax rate or rates in effect under Revenue and Taxation Code section 17041. The highest marginal tax rate or rates under Revenue and Taxation Code section 17041 include the 1 percent mental health services tax rate and additional tax rates imposed by Proposition 30.
- (B) Pass-Through Entity Nonresident Owner That is a Non-California Business Entity. The tax rate applicable to the distributive share of each nonresident owner that is itself a non-California business entity owner of the pass-through entity shall be the following:
1. Pass-Through Entity Owner That is a Corporation. The tax rate applicable to the distributive share of each nonresident owner that is itself a non-California corporate owner of the pass-through entity shall consist of the tax rate in effect under Revenue and Taxation Code section 23151(f)(2); or, if applicable, the tax rate in effect under Revenue and Taxation Code section 23186.

2. Pass-Through Entity Owner That is an Upper Tier S Corporation. The tax rate applicable to the distributive share of each nonresident owner that is itself a non-California upper tier S corporation owner of the pass-through entity shall consist of the tax rate in effect under Revenue and Taxation Code section 23802. Additionally, the tax rate applicable to the distributive share of each resident or nonresident owner of a non-California upper tier S corporation shall consist of the highest marginal tax rate in effect under Revenue and Taxation Code section 17041. The highest marginal tax rate or rates under Revenue and Taxation Code section 17041 include the 1 percent mental health tax rate and additional tax rates imposed by Proposition 30.
3. Pass-Through Entity Owner That is an Upper Tier Pass-Through Entity Other Than an S Corporation. The tax rate applicable to the distributive share of each nonresident owner that is itself a non-California upper tier pass-through entity shall consist of the highest marginal tax rate in effect under Revenue and Taxation Code section 17041. The highest marginal tax rate or rates under Revenue and Taxation Code section 17041 include the 1 percent mental health tax rate and additional tax rates imposed by Proposition 30.

(8) Upper Tier Pass-Through Entity. An upper tier pass-through entity is a pass-through entity owner that is itself a pass-through entity. An upper tier pass-through entity also includes any owner of an upper tier pass-through entity that is itself a pass-through entity owner.

(c) Withholding Payment Due Dates. Payment of withholding on distributive share of income is due by the federal estimated due date as required by Regulation section 18662-8(c)(1)(B). An upper tier pass-through entity that is only allocating withholding paid on its behalf is not required to remit withholding under this subsection unless it has a separate withholding requirement under subsection (f).

(d) Reporting Requirements.

(1) Reporting to Franchise Tax Board.

(A) Form 592-Q, Payment Voucher for Pass-Through Entity Withholding. A pass-through entity must submit a Form 592-Q with each withholding remittance in accordance with Regulation sections 18662-0 through 18662-8. An upper tier pass-through entity that is only allocating withholding paid on its behalf is not required to file Form 592-Q unless it has a separate withholding requirement under subsection (f). (See Regulation section 18662-8, subsection (l).)

(B) Form 592-PTE, Pass-Through Entity Annual Withholding Return. A pass-through entity that has withheld on the income of a nonresident owner or has had its income withheld upon is required to file a Form 592-PTE on an annual basis no later than January 31<sup>st</sup> of the year following the year in which such withholding was remitted to the Franchise Tax Board to

allocate withholding in accordance with Regulation sections 18662-4 and 18662-8. (See Regulation section 18662-4, subsection (j).)

1. Lower Tier Pass-Through Entity. A lower tier pass-through entity that has withheld on income of nonresident owners is required to file a Form 592-PTE to allocate withholding to each nonresident owner that has income that has been withheld upon, in accordance with each nonresident owner's interest in the lower tier pass-through entity.
2. Upper Tier Pass-Through Entity. An upper tier pass-through entity that has income that has been withheld upon by a lower tier pass-through entity is required to file a Form 592-PTE to allocate withholding paid on its behalf to each owner, whether a resident or nonresident of California, in accordance with each owner's interest in the upper tier pass-through entity.
  - a. Upper Tier Pass-Through Entity Owner. Any owner of an upper tier pass-through entity that is itself a pass-through entity must likewise file a Form 592-PTE to allocate withholding to each owner, whether a resident or nonresident of California.
  - b. Allocation of Withholding Paid. Once Form 592-PTE allocates withholding paid to an upper tier pass-through entity, the withholding payment made by the lower tier pass-through entity is treated as having been paid on behalf of each upper tier pass-through entity owner.
  - c. Credit for Tax Withheld. If an upper tier pass-through entity claims any of the amount withheld on its tax return for the entity-level tax imposed, it must attach a schedule to Form 592-PTE specifying the amount claimed on the upper tier pass-through entity's income tax return and amount to be allocated to the upper tier pass-through entity's owners. (See subsection (e)(2) and Regulation section 19002, subsection (b).)
  - d. Self-Certification. An upper tier pass-through entity may certify on Form 592-PTE under penalty of perjury that the Form 592-PTE is filed by the upper tier pass-through entity within 30 days of receipt by the upper tier pass-through entity of the Form 592-B from the lower tier pass-through entity. If the upper tier pass-through entity certifies on Form 592-PTE under penalty of perjury that the Form 592-PTE is filed within 30 days of receipt of the Form 592-B from the lower tier pass-through entity and the Form 592-PTE is received by FTB within 30 days of the upper tier pass-through entity's receipt of the Form 592-B from the lower tier pass-through entity, then a late filing penalty will not be imposed on the upper tier pass-through entity for a late filed Form 592-PTE. A late filing penalty may still be imposed if the self-certification is fraudulent or otherwise factually incorrect.

(2) Notification to Owners of Withholding. Form 592-B, Resident and Nonresident Withholding Tax Statement. A pass-through entity that has withheld on income of a nonresident owner or has income that has been withheld upon is required to provide a Form 592-B to each owner that is allocated withholding in accordance with Regulation sections 18662-0 through 18662-8 no later than January 31<sup>st</sup> of the year following the year in which such withholding was remitted. (See Regulation section 18662-8, subsection (m).)

(A) Lower Tier Pass-Through Entity. A lower tier pass-through entity that has withheld on income of nonresident owners is required to provide a Form 592-B to each nonresident owner that has income that has been withheld upon.

(B) Upper Tier Pass-Through Entity. An upper tier pass-through entity that has income that has been withheld upon by a lower tier pass-through entity is required to provide a Form 592-B to each owner, whether a resident or nonresident of California, that is to be allocated withholding. Any owner of an upper tier pass-through entity that is itself a pass-through entity must likewise provide a Form 592-B to each owner, whether a resident or nonresident of California, that is to be allocated withholding.

(e) Credit for Tax Withheld.

(1) Individuals and Corporations. An individual or corporation, not including an S corporation, that has income that has been withheld upon may claim a refund for withholding paid on the respective individual or corporate franchise or income tax return. To receive a credit for withholding paid, a copy of Form 592-B received from the pass-through entity must be attached to the individual or corporate or income tax return.

(2) Upper Tier Pass-Through Entities. An upper tier pass-through entity that has income that has been withheld upon may not claim a refund for withholding paid on the upper tier pass-through entity's income tax return. The owners of the upper tier pass-through entity may authorize the pass-through entity to use some or all of the withholding credit to satisfy the entity-level tax of the pass-through entity due for the taxable year. (See Regulation section 19002, subsection (b).) If the upper tier pass-through entity claims any of the amount withheld on its income tax return, then the upper tier pass-through entity must:

(A) Attach a copy of Form 592-B received from the lower tier pass-through entity to the income tax return as well as a schedule specifying the amount to be claimed on the upper tier pass-through entity's income tax return and amount allocated to the upper tier pass-through entity's owners; and

(B) Attach a schedule to Form 592-PTE specifying the amount claimed on the upper tier pass-through entity's income tax return and amount to be allocated to the upper tier pass-through entity's owners.

(f) Separate Withholding Requirement for Upper Tier Pass-Through Entities. If an upper tier pass-through entity that has income that has been withheld upon has California source income, other than income that has already been withheld upon by a lower tier pass-through entity, then it may have a separate withholding requirement with respect to such income and may be required to withhold on behalf of each nonresident owner in accordance with Regulation sections 18662-0 through 18662-8.

(g) Penalties and Corresponding Provisions for Relief from the Applicable Penalty Provisions. Any pass-through entity required to withhold or report withholding that fails to meet its withholding obligation shall be subject to all applicable penalties under Regulation section 18662-8(d), and Revenue and Taxation Code sections 18668 and 19183, including, but not limited to:

(1) Penalty for failure to withhold or failure to transmit the withheld amounts to the Franchise Tax Board on or before the due date. (See Revenue and Taxation Code section 18668.)

(2) Penalty for failure to timely file information returns: Form 592-PTE and Form 592-Q. (See Revenue and Taxation section 19183(a)(1).) A penalty for failure to timely file Form 592-PTE will not be imposed on an upper tier pass-through entity if proper self-certification, which is not fraudulent and does not contain incorrect facts, is received pursuant to subsection (d)(1)(B)(ii)(IV).

(3) Penalty for failure to timely file payee statements: Form 592-B. (See Revenue and Taxation Code section 19183(b)(1).)

(4) Penalty relief for failure to timely file information returns and payee statements. (See Revenue and Taxation Code section 19183(d).)

(h) Examples.

Example 1: Upper Tier Pass-Through Entity and Lower Tier Pass-Through Entity Definition.

A is a California general partnership with two equal partners, B and C. B is an individual who is a resident of California. C is a non-California general partnership. C has two equal partners, D and E. D is an individual who is a nonresident of California and E is a California general partnership.

A is a lower tier pass-through entity because it has California source income and it has an owner that is a pass-through entity. C is an upper tier pass-through entity because it is an owner of a pass-through entity, A, and is itself a pass-through entity. E is also an upper tier pass-through entity because it is an owner of a pass-through entity, C, and is itself a pass-through entity.

Example 2: Payment Due Date and Tax Rate.

Same facts as Example 1. A has \$100,000 of California source income in Year X and remits withholding on behalf of C's \$50,000 distributive share of A's \$100,000 of

California source income at the highest marginal tax rate in effect under Revenue and Taxation Code section 17041 by the applicable federal estimated tax due date because C is a nonresident owner. A is not required to withhold on behalf of B's \$50,000 distributive share of A's \$100,000 of California source income because B is a resident of California.

Assuming C does not have any California source income other than its distributive share from A, C is not required to remit withholding on behalf of D or E with respect to its \$50,000 distributive share of A's \$100,000 of California source income by the applicable federal estimated tax due date because withholding has already been paid on that income on its behalf by A. Similarly, E is also not required to remit withholding on behalf of its owners with respect to its \$25,000 distributive share of C's \$50,000 of California source income by the federal estimated tax due dates because withholding has already been remitted on that income on its behalf.

#### Example 3: Form 592-PTE Filing Requirements.

Same facts as Example 2. A is required to file an annual Form 592-PTE following the end of Year X to report the withholding it paid on behalf of C. The filing of Form 592-PTE will allocate the withholding A paid on behalf of C to C. A is not required to file an annual Form 592-PTE following the end of Year X with respect to B because B was a resident of California and no withholding was required to be paid on his or her behalf.

C is required to file an annual Form 592-PTE following the end of Year X to report the withholding A paid on its behalf throughout Year X and that A allocated to C. The filing of Form 592-PTE will allocate the withholding A paid on C's behalf to C's owners, D and E, regardless of the owner's state of residency and in accordance with each owner's interest in C.

D is not required to file an annual Form 592-PTE following the end of Year X with respect to the withholding allocated to him or her because D is an individual and therefore is not required to allocate withholding. D can claim the withholding credit allocated to him or her on the individual California nonresident income tax return if he or she attaches a copy of Form 592-B received from C.

E is required to file an annual Form 592-PTE following the end of Year X to report the withholding A paid on behalf of C during Year X and that C allocated to E. The filing of Form 592-PTE will allocate the withholding A paid and that C allocated to E and E allocated to E's owners, regardless of the owners' state of residency, and in accordance with each owner's interest in E.

#### Example 4: Form 592-PTE Self-Certification.

Same facts as Example 3. A sends a late Form 592-B to B and C, which B and C receive on March 15<sup>th</sup> following the end of Year X instead of January 31<sup>st</sup> following the end of Year X. As a result of A's late Form 592-B, C also sends a late Form 592-B to E, which E receives on April 15<sup>th</sup> following the end of Year X.

B is not required to file an annual Form 592-PTE following the end of Year X because B was a resident of California and no withholding was required to be paid on his or her behalf.

C is required to file an annual Form 592-PTE following the end of Year X to report the withholding A paid on its behalf throughout Year X and that A allocated to C. Since C received the Form 592-B from A late, on March 15<sup>th</sup> rather than January 31<sup>st</sup> following the end of Year X, C may file its annual Form 592-PTE by April 15<sup>th</sup> following the end of Year X so long as C certifies on the late filed Form 592-PTE that it is filing the Form 592-PTE within 30 days of receiving the Form 592-B from A. A late filing penalty will not be imposed if such self-certification is received and the self-certification is not fraudulent or otherwise factually incorrect.

D is not required to file an annual Form 592-PTE following the end of Year X with respect to the withholding allocated to him or her because D is an individual and therefore is not required to allocate withholding.

E is required to file an annual Form 592-PTE following the end of Year X to report the withholding A paid on behalf of C during Year X and that C allocated to E. Since C received the Form 592-B from A late, on April 15<sup>th</sup> rather than January 31<sup>st</sup> following the end of Year X, E will obviously receive its Form 592-PTE after January 31<sup>st</sup> following the end of Year X. E may file its annual Form 592-PTE by May 15<sup>th</sup> following the end of Year X so long as E certifies on the late filed Form 592-PTE that it is filing the Form 592-PTE within 30 days of receiving the Form 592-B from C. A late filing penalty will not be imposed if such self-certification is received and the self-certification is not fraudulent or otherwise factually incorrect.

#### Example 5: Form 592-B Requirements.

Same facts as Example 2. A is required to send a Form 592-B following the end of Year X to C to notify C of withholding paid on its behalf throughout the year.

C is required to send a Form 592-B following the end of Year X to D and E to notify each owner of withholding paid on C's behalf throughout the year and that has been allocated to D and E.

E is required to send a Form 592-B following the end of Year X to its owners to notify each owner of withholding paid on E's behalf throughout the year and that has been allocated to E's owners.

#### Example 6: Separate Withholding Requirement for Upper Tier Pass-Through Entities.

Same facts as Example 2. C also has \$20,000 of California source business income from its own operations in Year X and, as the \$20,000 is unassociated with any ownership interests in pass-through entities, there has been no prior withholding on this income. C is required to remit withholding on behalf of D's \$10,000 distributive share of C's \$20,000 of California source income by the applicable federal estimated tax due date because D is a nonresident owner. As a result, C is additionally required to send D a Form 592-B reporting the total withholding paid following the end of the year, and file



Form 592-PTE with the Franchise Tax Board to report and allocate the withholding to D. C is not required to remit withholding on behalf of E's \$10,000 distributive share of C's \$20,000 of California source income by the applicable federal estimated tax due date because E is a California partnership.

Example 7: Non-California Upper Tier S Corporation Pass-Through Entity Withholding Payment and Filing Requirements.

A is a California partnership with two equal partners, B and C. B is an individual that is a resident of California. C is a non-California upper tier non-financial S corporation. C has two equal shareholders, D and E. D is an individual that is a nonresident of California and E is an individual that is a resident of California.

A is required to withhold tax on behalf of C at the 1.5 percent tax rate in effect under Revenue and Taxation Code section 23802 in addition to the highest marginal tax rate in effect under Revenue and Taxation Code section 17041 by the applicable federal estimated tax due date. A is not required to withhold tax on behalf of B because B was a resident of California in Year X.

A is required to file an annual Form 592-PTE following the end of Year X to report the withholding it paid on behalf of C. The filing of Form 592-PTE will allocate the withholding A paid on behalf of C to C. A is not required to file an annual Form 592-PTE following the end of Year X with respect to B because B was a resident of California and no withholding was required to be paid on his or her behalf in Year X.

C is required to file an annual Form 592-PTE following the end of Year X to report the withholding A paid on its behalf throughout Year X and that A allocated to C. The filing of Form 592-PTE will allocate the withholding A paid on C's behalf to C's owners, D and E, regardless of the owner's state of residency and in accordance with each owner's interest in C.

C cannot claim a refund for withholding paid on its income tax return. However, it can use some or all of the withholding credit to satisfy the 1.5% entity-level tax that was already withheld on its behalf by A. If C claims any of the amount withheld on its income tax return, then it must attach a copy of Form 592-B received from A and a schedule specifying the amount claimed on C's own income tax return as well as the balance allocated to the shareholders to its income tax return. Additionally, C must attach the same schedule to Form 592-PTE to allocate the balance of withholding paid on its behalf to its shareholders, D and E.

D and E are not required to file an annual Form 592-PTE following the end of Year X with respect to the withholding allocated to him or her because D and E are individuals and therefore are not required to allocate withholding. D and E can claim the withholding credit allocated to him or her on the respective individual income tax return if each attach a copy of Form 592-B received from C.

**(i) Applicability Date. The provisions of this regulation, including the payment due date specified in subsection (c), are applicable commencing with the first full quarter beginning after the effective date of this regulation.**

**Note: Authority cited: Section 18662 and 19503, Revenue and Taxation Code.**  
**Reference: Sections 17008, 17041, 17951, 18662, 18668, 19183, 23802, 23101,**  
**23151, 23186, and 25137 Revenue and Taxation Code.**