

NOTE: This handout is intended only for purposes of facilitating discussion at the interested parties meeting on July 11, 2016.

Regulation Section 18662-5 is amended to read:

§ 18662-5. Other Types of Payments and Withholding Obligations.

(a) Payments to Nonresidents Subject to Withholding.

(1) General. As explained in Regulation section 18662-4, withholding agents are required to withhold from payments or distributions of California source income made to a nonresident when the payments or distributions are greater than \$1,500 for the calendar year, unless the withholding agent receives authorization for a waiver, pursuant to FTB Form 588, Nonresident Withholding Waiver Request, or any successor form designated by the Franchise Tax Board on its website at www.ftb.ca.gov ("FTB Form 588"), or a reduced withholding amount, pursuant to FTB Form 589, Nonresident Reduced Withholding Request, or any successor form designated by the Franchise Tax Board on its website at www.ftb.ca.gov ("FTB Form 589"). The required information specified in FTB Form 588 and FTB Form 589 is set forth in subsection (i) and (j), respectively, below. Payments of income that must be reported on a federal information return, such as form 1099-MISC, may be subject to California withholding at source if the recipient is a nonresident individual or a non-California business entity.

(2) California Source Income Subject to Withholding. The following types of California source income are examples of income subject to withholding on payments made to nonresidents:

- (A) Payments made for services performed in California. The source of income from services is the location where the services are performed, and not where the nonresident lives, the location where the contract for services is entered into, or the place of payment.
- (B) Payments received for a covenant not to compete in California.
- (C) Payments releasing a contractual obligation to perform services in California.
- (D) Income from options received as a result of performing personal services in California.
- (E) Bonuses paid for services performed in California.
- (F) Income from intangible personal property where the property has acquired a business situs in California.
- (G) Rent or lease payments where the property is located in California.
- (H) Royalty payments where the property is located in or has acquired a business situs in California.

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- (I) Prizes, awards, competitions, contests, game shows, or races performed in California.
 - (J) Distributions of California source income to nonresidents, including both cash and non-cash distributions.
 - (K) Gambling or gaming winnings won in California.
 - (L) Premiums, annuities, emoluments, compensation for services, partnership income or gains, and other fixed or determinable annual or periodical gains, profits, endorsement income, other types of income, and any other compensation representing California source income.
 - (M) Any other amount of California source income for which a state or federal information return is required to be filed.
- (3) **Business Situs.** Income from intangible personal property such as stocks, bonds, notes, etc., is not income from California sources unless the property has acquired a business situs in California. A California business situs is acquired when the property is employed as capital in California. A California business situs is also acquired when the possession and control of the property has been localized in connection with a business, trade, or profession in California so that its substantial use and value attach to and become an asset of that business. The entire income, including the gain from the sale of such an asset, is income from California sources. Examples include an intangible asset pledged as security for a loan connected to a California business or a bank account maintained to pay expenses related to business activities in California. (For rules governing the determination of business situs, see Regulation section 17952.)
- (4) **Payments to Nonresident Aliens or Foreign Entities.** Payments of California source income made to nonresident aliens or foreign entities are subject to withholding.
- (5) **Payments Made to Reimburse Expenses.** If the reimbursement is separately accounted for and is not subject to federal information return (Form 1099 or Form 1042) reporting, withholding is not required on payments to reimburse nonresidents for expenses relating to services performed in California. When the reimbursed expenses do not meet these requirements, withholding agents should withhold on the total payment.
- (6) **Services in Connection With the Sale of Goods.** Withholding is required on the portion of the sale that relates to services provided in California. FTB Form 587, Nonresident Withholding Allocation Worksheet, or any successor form designated by the Franchise Tax Board on its website at www.ftb.ca.gov ("FTB Form 587") may be used to distinguish the portion of payments made for goods from the portion for

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services. The required information specified in FTB Form 587 is set forth in subsection (k), below.

(b) **Payments to Independent Contractors.** See California Unemployment Insurance Code sections 13000 et. seq., for the definition of "employee" subject to wage withholding. Individuals other than employees who perform personal services in California are independent contractors subject to withholding for purposes of this regulation. If the independent contractor is a resident and provides FTB Form 590, Withholding Exemption Certificate, or any successor form designated by the Franchise Tax Board on its website at www.ftb.ca.gov ("FTB Form 590"), no withholding is required. The required information specified in FTB Form 590 is set forth in subsection (l), below.

(c) **Payments to Nonresident Subcontractors.**

(1) **Withholding Requirements.** The withholding agent is required to withhold when making payments directly to nonresident subcontractors for services performed in California.

(2) **Payments to California Residents.** Withholding is not required on payments to general contractors who are California residents.

(3) **General Contractor Obligations.** General contractors must withhold on payments made to nonresident subcontractors for services performed in California.

(4) **Multiple Contractors/Contractor-of-Record.** When the withholding agent makes payments to more than one contractor, the withholding agent should provide each contractor with FTB Form 587 and FTB Form 590 to determine if withholding is required. If the withholding agent knows of only one contractor, then the withholding agent should use the information provided by the contractor-of-record. If the contractor is a resident and provides an FTB Form 590, no withholding is required. If the contractor-of-record is a nonresident, withholding is required on the total payment.

(d) **Rent or Lease Payments to Nonresidents.**

(1) **Rent or Lease Payments Made to Nonresidents.** Withholding on rent or lease payments to nonresidents is required when all of the following criteria are met:

(A) The rented or leased property, either personal or real property, or a combination thereof, is located in California for all or part of the year.

(B) The payments are made in the course of a trade or a business. Except as provided in subsections (B)1., (B)2., or (B)3., a person or business entity making rent or lease payments to a nonresident, as well as a property manager who collects rent or lease payments on behalf of a nonresident owner, is considered to be making payments in the course of a trade or business and is considered a withholding agent.

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1. A tenant of residential property who directly makes rent payments to a nonresident property owner is not making a payment in the course of a trade or business and, thus, is not required to withhold on payments.
2. An employee of a nonresident property owner who collects rent payments on behalf of the nonresident property owner is not a withholding agent and, thus, is not required to withhold on payments.
3. An individual, whether or not a family member of the nonresident owner, who collects rent payments on behalf of the nonresident property owner, and who receives no compensation from the nonresident owner, is not considered to be acting "in the course of a trade or business." Thus, the individual is not required to withhold on payments to the nonresident property owner.
4. A property manager providing services to a nonresident property owner, including but not limited to renting, leasing, or collecting rent or lease payments on behalf of the nonresident owner, is considered the withholding agent for withholding purposes. Rent or lease payments derived from real property as well as personal property located in California are California source income payments and subject to California withholding requirements as set forth in Revenue and Taxation Code section 18662 and Regulation sections 18662-0 through 18662-8.

- (C) The total payments of California source income to the nonresident owner, excluding property management fees, exceed \$1,500 for the calendar year.
- (2) Types of Rental or Leased Property Subject to Withholding. Withholding is required on income derived from renting or leasing real or personal property such as machinery equipment, vehicles, aircraft, land, and buildings.

Example: A property management company collects rents from tenants for a nonresident California property owner. The property management company is required to withhold 7 percent of all payments associated with rents paid to nonresident owners when the payments are greater than \$1,500 per calendar year. The property management company may deduct its management fees and then calculate the 7 percent withholding based on the amount to be sent to the property owner.

- (e) Royalty Payments Made to Nonresidents.
- (1) Compensation for the Right to Use Natural Resources. Withholding is required on royalty payments made to nonresidents for the right to use natural resources located in California, including, but not limited to, oil, gas, other minerals, geothermal, and timber.
 - (2) Compensation for Services Derived from Intangible Property Having a Taxable or Business Situs in California. Withholding is required on royalty payments made to nonresidents for services performed in California and for other compensation derived from a business or activity with a business situs in California. Royalty payments include compensation for such services derived from, but not limited to, patents,

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copyrights, secret processes and formulas, good will, trademarks, franchises, and other like property having a taxable or business situs in California. (For rules governing income from sources within California, see Regulation section 17951-2.)

(f) Payments to Corporate Directors.

(1) Withholding Not Required. Withholding is not required for wages, salaries, fees or other compensation paid by a corporation for services performed in California for that corporation to a nonresident corporate director for director services, including attendance at a board of directors' meeting. Each nonresident director must file a California income tax return reporting this California source income, unless he or she elects to be included in a group return under Revenue and Taxation Code section 18536.

(2) Filing of Information Return. An entity paying wages, salaries, fees or other compensation to a nonresident director must file an information return with the Franchise Tax Board and provide the payee with a payee statement. To meet this requirement, a payer who is required to file a federal information return (e.g., Form 1099-MISC) with the Internal Revenue Service must provide a copy of that same return to the payee.

(g) Seminar Speakers and Expert Witnesses. Withholding is required on payments that are compensation for services performed in California by a nonresident, including services performed as a seminar speaker or as an expert witness.

(h) Income Allocation.

(1) Nonresident Contractors. When nonresident contractors perform services within California as well as outside of California, reasonable methods may be used by the withholding agent to determine what portion of the services are provided within California. In addition to the two approved methods below, withholding agents may use other reasonable methods of allocation.

Method 1: Allocation By Payer in Accordance with Contract: If by contract an athlete or entertainer is required to perform services in California on behalf of a sponsor, the payments received on the contract are considered to be personal services income subject to tax by where the services are performed, which is California. The payer may make a reasonable allocation of the California source income based on the contract and in accordance with the actual number of California performances, and should withhold California tax on the California payment.

For instance, where a contract requires an athlete to appear at a California tournament wearing the sponsor's clothing bearing its logo or using a sponsor's golf clubs, that athlete has performed a service on behalf of the sponsor in California, and the income is subject to California tax. If the contract requires appearances in California and other states, a portion of the endorsement income is California source income and subject to California income tax. The payer-sponsor should make a reasonable allocation of the

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payment based on the facts and circumstances of each contract, and withhold California tax on the California payment.

Method 2. Nonresident Income Allocation Worksheet: The withholding agent may request that the payee complete FTB Form 587 to determine the amount of California source income subject to withholding. The withholding agent uses the information provided by the payee in FTB Form 587 to determine what portion of the payment is subject to withholding.

For instance, a withholding agent sends FTB Form 587 to an out-of-state independent contractor before making a payment for services. The total contract amount is \$100,000. The nonresident contractor returns FTB Form 587, certifying that \$60,000 is for services performed in California and \$40,000 is for services performed in another state. The amount of withholding would be:

$\$60,000 \text{ California source income} \times 7 \text{ percent Withholding rate} = \$ 4,200$. Note: If the amount subject to withholding (\$60,000 in the example above) is equal to or less than \$1,500 for the calendar year, withholding is optional.

(2) Reliance on Allocations Provided by Payees. Except as otherwise provided in this subsection (h)(2), withholding agents may generally rely on allocations provided by payees on a properly completed and signed FTB Form 587. The withholding agent will be relieved of the withholding requirements if the withholding agent relies in good faith on a completed and signed FTB Form 587. If the withholding agent has actual knowledge that FTB Form 587 is incorrect, the withholding agent should not rely on it and should withhold at 7 percent on the entire payment. The withholding agent may not rely upon an incomplete, unsigned, or fraudulent FTB Form 587.

(3) Allocation Based on Time. Compensation for personal services performed by nonresident independent contractors will normally be allocated to California based on working days in California to total working days in and out of California ("duty days" for professional athletes – see Regulation section 18662-6). The number of days covered by the contract can be used to determine the total working days in and out of California only when the payee is:

- (A) Hired for the exclusive use by the withholding agent for the entire contract period,
- (B) Required to be available to work each day at the discretion of the withholding agent during the contract period, and
- (C) Being paid whether or not providing services.

Days spent acquiring knowledge, skills, or necessary experience are not considered work days. Professionals and others who bill by the hour should allocate compensation based on the number of billable hours worked in California to the total number of billable hours related to the particular service.

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(4) Reasonable Method of Allocation Based on Goods and Services. Withholding agents must use a reasonable method. One reasonable method is to use the same allocation of goods and services that is used for sales and use tax purposes in the sales contract. The portion of the payment not subject to sales or use tax is considered payment for services and subject to withholding. If a payment is not subject to California sales or use tax, but is subject to another state's sales or use tax, withholding agents may also use the allocation for the other state to determine the portion relating to services and subject to withholding.

Except as set forth in California Code of Regulations, Title 18, sections 1506, 1521, 1524, 1523, 1546, 1548, 1549, 1550, 1551 and 1553, under California sales and use tax laws, charges for labor or services for installation are not subject to sales or use tax. Payments for installation are subject to withholding. Charges for designing, consulting, performing feasibility studies, evaluating bids, and providing training services are also considered service activities if they are separately stated and not part of the sale of tangible personal property. Payments for repairs are subject to withholding, except for parts that are separately stated on the invoice. As payments for mandatory maintenance contracts or warranties are subject to sales tax, even if the cost of the maintenance contract or warranty is separately stated, the payments are not subject to withholding. Payments for maintenance contracts or warranties not subject to sales tax are subject to withholding.

(5) Allocation of Distributions. Allocation of distributions between California and non-California source income based on past year's allocations for withholding purposes may be made by the trustee of a trust. If the trustee does not know the amount of California source income included in a distribution, the trustee may use the most recently filed year's ratio of California source income to total income to allocate the distribution.

(i) FTB Form 588, Nonresident Withholding Waiver Request. See Regulation section 18662-4, subsection ~~(k)~~(l).

(j) FTB Form 589, Nonresident Reduced Withholding Request. See Regulation section 18662-4, subsection ~~(k)~~(m).

(k) FTB Form 587, Nonresident Withholding Allocation Worksheet. FTB Form 587 shall contain the following information:

(1) Withholding Agent's name and address.

(2) Nonresident Payee information, which includes the payee's name, identification number (SSN or ITIN, FEIN, California corporation number, or California Secretary of State file number), address, and a check box indicating the payee's entity type (individual/sole proprietor, corporation, partnership, LLC, or estate or trust).

(3) A check box indicating one of the following types of payments:

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- (A) Performs services totally outside California (no withholding required);
 - (B) Provides goods and services in California (complete Income Allocation);
 - (C) Provides only goods or materials (no withholding required);
 - (D) Provides services within and outside California (complete Income Allocation); or
 - (E) Other—For "Other," an explanation of the service performed must be provided.
- (4) Income Allocation, which includes three categories of payments for the calendar year: (1) Within California (2) Outside California; and (3) Total payments.
- (5) For each Income Allocation category, the payments expected from the withholding agent in the following areas must be indicated:
- (A) Goods/materials (no withholding required);
 - (B) Services (withholding required);
 - (C) Rents or lease payments;
 - (D) Royalty payments;
 - (E) Prizes and other winnings;
 - (F) Other payments;
 - (G) Total payments subject to withholding.
- (6) The name, telephone number, and dated signature, ~~date~~ of the payee.
- (7) The name, telephone number, and dated signature of the payee's authorized representative.
- (l) FTB Form 590, Withholding Exemption Certificate. See Regulation section 18662-4, subsection (h).

Note: Authority cited: Section 19503, Revenue and Taxation Code.
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