

## Background and Explanation of Proposed Amendments to Regulation Sections 18662-0 through 18662-6 and 18662-8

Revenue and Taxation Code (RTC) section 18662 is the law setting forth the general withholding requirement scheme for nonresident and real estate withholding. The corresponding regulations at California Code of Regulations, Title 18, Sections 18662-0 through 18662-6 and 18662-8 (Withholding Regulations) provide more specific guidelines with respect to California's nonresident and real estate withholding procedures.

The Withholding Regulations were last amended in 2014, operative on July 1, 2014, and can be accessed [here](#). Subsequent to the amendments, the Franchise Tax Board ("FTB") determined that the Withholding Regulations may require additional updates.

FTB held a first Interested Parties Meeting ("IPM") on October 12, 2015. The purpose of the meeting was to provide the public with an opportunity to discuss and provide comments on possible amendments to the Withholding Regulations, and to suggest various technical changes to the Withholding Regulations, including changes to terminology in the current regulatory language. In addition, the purpose was to discuss possible amendments to the Withholding Regulations related to domestic pass-through entity (PTE) withholding filing requirements. A summary of the first IPM was thereafter made available to the public and can be accessed [here](#).

For this second IPM, additional documents are being made available, identified as follows: the second IPM announcement, which can be found [here](#); the proposed amended regulation drafts, which can be found on the FTB's [Regulatory Activity](#) page, and this document, which provides a background and more explanation on the proposed amended language.

The key proposed revisions to the regulation are set forth immediately below, with explanations describing the reasoning for the suggested changes within each description:

- Section 18662-1, *Withholding--Generally*:
  - Subsections (a)(1) and (a)(1)(C) have been revised to note that the Withholding Regulations do not cover withholding on foreign (non-U.S.) partners and members, "except with respect to the reporting on and filing of information returns and remittance of payments as set forth in Regulation sections 18662-4 and 18662-8." Previously, Regulation sections 18662-4 and 18662-8 did not cover issues relating to withholding on foreign (non-U.S.) partners and members, but since both of these sections have been amended with respect to filing of information returns and remittance of payments, subsections (a)(1) and (a)(1)(C) have been revised to reflect these new changes.
  - Subsection (b)(2) has been revised by changing the phrase "California resident and nonresident individuals and non-California business entities" to "a seller/transferor," because RTC section 18662, subdivision (e) uses the term "transferor" when referring to the seller of a California real property interest, and since the term "transferor" is defined in Regulation section

18662-2 as the "seller of the real property." Given that the terms "seller" and "transferor" are used interchangeably both in the Withholding Regulations and in the withholding forms, this change is necessary for consistency and clarity.

- Subsection (c) (specifically, the Example) has been revised by inserting the term "nonresident" in front of the term "entertainer" because the example pertains to "nonresident entertainers" since there is no withholding requirement for resident entertainers.
- Section 18662-2, *Definitions*:
  - Subsection (c) has been revised by changing the term "transferor" to the term "seller/transferor" because RTC section 18662, subdivision (e) uses the term "transferor" when referring to the seller of a California real property interest, and since the term "transferor" is defined in Regulation section 18662-2 as the "seller of the real property." Given that the terms "seller" and "transferor" are used interchangeably both in the Withholding Regulations and in the withholding forms, this change is necessary for consistency and clarity.
  - Subsection (v) has been revised to include a definition for the term "remitter", and prior subsections (v), (w), (x) and (y) are now subsections (w), (x), (y) and (z), respectively. 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 often the real estate escrow person. Thus, a change is necessary to clarify that the remitter (typically, the escrow officer)—not the buyer/transferee—is the person responsible for sending the payment to the FTB.
- Section 18662-3, *Real Estate Withholding*:
  - Throughout Regulation section 18662-3, the term "seller" or "transferor" has been changed to the term "seller/transferor" because RTC section 18662, subdivision (e) uses the term "transferor" when referring to the seller of a California real property interest, and since the term "transferor" is defined in Regulation section 18662-2 as the "seller of the real property." Given that the terms "seller" and "transferor" are used interchangeably both in the Withholding Regulations and in the withholding forms, this change is necessary for consistency and clarity.
  - Throughout Regulation section 18662-3, the term "buyer" or "transferee" has been changed to the term "buyer/transferee" because RTC section 18662, subdivision (e) uses the term "transferee" when referring to the buyer of a California real property interest, and since the term "transferee" is defined in Regulation section 18662-2 as the "buyer of the real property." Given that the terms "buyer" and "transferee" are used interchangeably both in the

Withholding Regulations and in the withholding forms, this change is necessary for consistency and clarity.

- Throughout Regulation section 18662-3, the phrase "alternate withholding calculation" has been changed to "alternative withholding calculation" for consistency and clarity, as other subsections, including subsections (b) and (d)(3) already use the phrase "alternative withholding calculation."
- FTB Form 593, Real Estate Withholding Statement, has been changed to now include elements of the following forms, which will no longer exist: FTB Form 593-I, Real Estate Withholding Installment Sale Acknowledgement, FTB Form 593-C, Real Estate Withholding Certificate, and FTB Form 593-E, Real Estate Withholding Computation of Estimated Gain or Loss. The decision to merge FTB Form 593-C, FTB Form 593-E and FTB Form 593-I into FTB Form 593 was done for consolidation purposes as there was a significant amount of information repeated throughout these forms. This 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/transferors 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 change will be effectuated by deleting previously numbered subsection (h) (FTB Form 593-E), subsection (i) (FTB Form 593-C), and subsection (l) (FTB Form 593-I), and by renumbering previously numbered subsection (j) to subsection (h) (FTB Form 593). Revised subsection (h) will now include information that was previously included in previous subsection (h) (FTB Form 593-E), subsection (i) (FTB Form 593-C), subsection (j) (FTB Form 593) and subsection (l) (FTB Form 593-I), as the FTB Form 593-C, FTB Form 593-E and FTB Form 593-I will now all be consolidated into the FTB Form 593. In addition, revised subsection (h) (FTB Form 593) will also include information pertaining to "Remitter," as defined in Regulation section 18662-2 and as explained above under changes for Regulation section 18662-2. In addition, additional information will be included in the Form, including "ownership percentage" and "sales price."
- Subsection (h)(3) has been revised by inserting the phrase "ownership percentage" in the last sentence. As drafted, this subsection of this regulation inadvertently omitted the phrase "ownership percentage." When the FTB is dealing with multiple sellers, FTB will have a difficult time ascertaining the ownership percentages of each respective seller, as databases containing publicly available information do not always yield results in the most efficient manner. As a result, FTB must contact the appropriate party involved to obtain such information. For these reasons, this subsection is revised by inserting the phrase "ownership percentage" to capture information that FTB would otherwise receive by less efficient means. It should also be noted that some parts of Regulation section 18662-3 already include "ownership percentage," but this particular subsection inadvertently left that phrase out. (See

Regulation Section 18662-3, previous subsection (i)(1) (i.e., as the subsection currently stands before these changes have taken place).)

- Subsection (d)(1)(B) has been revised by changing the term "Total Sales Price" to the term "sales price" because the term used in the federal form 1099-S (as well as in Treasury Regulation section 1.6045-4) is "gross proceeds"—not "Total sales price." Thus, this change clarifies that the threshold amount pertains to the "sales price"—which is the same as the "gross proceeds" in the federal form 1099-S. This change will also be effectuated in revised subsection (h) (FTB Form 593). Throughout Regulation section 18662-3, all references to "total sales price" are changed to "sales price."
- Subsection (d)(1)(C) has been revised to clarify that with respect to "deferred exchanges," no withholding is required other than by an intermediary or an accommodator, even if the real estate escrow person fails to provide written notice. This change tracks with and follows RTC section 18662, subdivision (e)(3)(B). The portion pertaining to written notification is deleted because per RTC section 18662, subdivision (e)(3)(B), intermediaries and accommodators in a deferred exchange must withhold, even if written notice is not given by the "real estate escrow person."
- Subsection (d)(3)(A)(2) has been revised to clarify that in a deferred like-kind exchange, where the seller/transferor receives any proceeds from the sale in excess of \$1,500, the intermediary or the accommodator must withhold (as required by RTC section 18662, subdivision (e)(3)(B)), unless an election was made to use the alternative withholding Calculation on FTB Form 593. This avoids any confusion as to the withholding obligations in a deferred like-kind exchange, making it clear that the party responsible for withholding would be the intermediary or the accommodator.
- Subsection (d)(3)(A)(3) has been revised to clarify that in a failed exchange, the intermediary or the accommodator must withhold (as required by RTC section 18662, subdivision (e)(3)(B)), unless an election was made to use the alternative withholding Calculation on FTB Form 593. This avoids any confusion as to the withholding obligations in a failed exchange, making it clear that the party responsible for withholding would be the intermediary or the accommodator.
- Subsection (d)(3)(B)(1) has been revised by changing the phrase "real estate escrow person" to the word "buyer/transferee." As drafted, Regulation 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. However, under RTC sections 18662, subdivision (e)(3) and 18668, subdivision (e)(1), and Regulation 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 transferee/buyer—not the real estate escrow person. In

summary, the real estate escrow person has a requirement to notify the transferee/buyer of the transferee's/buyer's withholding obligations, but it has no requirement to withhold. For these reasons, this subsection changes the phrase "real estate escrow person" to the word "buyer." Moreover, because the Form 593-I will no longer exist, the buyer/transferee will now provide the real estate escrow person with the installment agreement terms—rather than the Form 593-I, where some of the information from that form will be merged and be included in the Form 593.

- Subsection (d)(3)(B)(3) has been revised by changing the phrase "real estate escrow person" to the word "buyer/transferee" in proposed subsections (d)(3)(B)(1) and (d)(3)(B)(3) such that the withholding obligation remains with the buyer/transferee—not the real estate escrow person. As drafted, this regulation inadvertently imposed a withholding requirement for installment sales on the real estate escrow person—rather than the buyer/transferee. However, under RTC sections 18662, subdivision (e)(3), and 18668, subdivision (e)(1), and Regulation Section 18662-3, subsection (a), once the real estate escrow person provides the transferee/buyer with written notice of the buyer's/transferee's withholding requirements, the requirement to withhold is on the buyer/transferee—not the real estate escrow person. Thus, the real estate escrow person has a requirement to notify the buyer/transferee of the buyer's/transferee's withholding obligations, but it has no requirement to withhold. For these reasons, this subsection changes the term "real estate escrow person" to the term "buyer/transferee."
- Subsection (d)(3)(B)(1) has been revised by changing the phrase "first installment payment" to the phrase "down payment" to clarify that withholding is required on the down payment. This change was made because some individuals in the escrow industry were inadvertently misconstruing the language in this subsection to mean the first installment payment *after* the down payment, resulting in no withholding on the down payment itself—in accordance with RTC section 18662, subdivision (e)(3)(E). Similarly, proposed subsection (d)(3)(B)(2) has been revised to ensure that all installment payment following the close of escrow are also subject to withholding. The term "installment" payment—as opposed to "subsequent" payment—more closely mirrors the statutory language found in RTC, section 18662, subdivision (e)(3)(E).
- Subsection (g)(2), Example 2 has been revised to include the current maximum tax rate (which is now 12.3 percent instead of 9.3 percent) for purposes of calculating the withholding using the Alternative Withholding Calculation method.

- Section 18662-4, *Withholding on Payments (Nonresident Individuals and Non-California Business Entities) - General*:
  - Subsection (b)(2), Example 2, has been revised to clarify that Withholding agents may rely on a printout from the Secretary of State (SOS) website showing that the payee is a California corporation or qualified to do business in California. Previously, this regulation stated that withholding agents could determine if a corporate payee is a California corporation or qualified to do business in this State "by contacting the Office of the Secretary of State." The amended language now clarifies that one way of contacting the SOS and verifying the information is through the SOS's public website, which includes all the necessary information to ascertain whether or not the payee is a California corporation or qualified to do business in California. In addition, the last sentence in Example 2 states that withholding agents who rely on the SOS's website will not be subject to penalties for failure to withhold, unless they have actual knowledge that the information received from the SOS's website is false. This language makes Example 2 consistent with the protection language afforded to withholding agents in Example 1 (which is reliant on FTB Form 590), so it is done for consistency purposes such that withholding agents who rely either on the Form 590 or on SOS's website will not be subject to penalties for failure to withhold.
  - Subsection (d) has been revised to reflect the creation of a new FTB Form, specifically, FTB Form 592-PTE, Pass-Through Entity Annual Withholding Return, which will be used specifically by pass-through entities, who, as withholding agents, withhold tax at source on lower tier pass-through entities. For more information on this change, please see the explanation to subsections (i) and (j).
  - Subsections (e) and (e)(1) have been revised to clarify that the FTB has the "sole discretion" to grant waivers from withholding using FTB Form 588, Nonresident Withholding Waiver Request. These revisions are necessary to clarify that withholding of tax at source is required for payments of California source income made to nonresident individuals and non-California business entities, unless the individual or entity falls into one of the categories set forth in Regulation Section 18662-4, subsection (b), there is a withholding exemption certificate on FTB Form 590, or the FTB, at its sole discretion, authorizes a waiver from withholding on FTB Form 588.
  - Subsection (e)(2) has been revised to clarify the threshold requirements for FTB Form 589, Nonresident Reduced Withholding Request, to ensure that this form would only be used for reduced withholding, because without a threshold requirement, the FTB Form 589 has been used to effectively obtain a waiver from withholding (due to the expenses/deductions being sufficiently high enough to ensure there is no net income) without following the requirements of FTB Form 588, Nonresident Withholding Waiver Request. Accordingly, these

adjustments to the Withholding Computation formula have been made to ensure that FTB Form 589 is used for its intended purpose.

- Subsection (h)(2) has been revised by inserting the phrase "or ITIN" after the word "SSN," to make all of the applicable fields on FTB Form 590 more generic such that they could apply to both resident and nonresident individuals, as well as business entities (since a nonresident individual or a business entity may have an ITIN), and to match what is currently on FTB's forms.
- Subsection (j) has been revised to include information regarding a new Form, FTB Form 592-PTE, Pass-Through Entity Resident and Nonresident Annual Withholding Return. The FTB Form 592-PTE is very similar to current FTB Form 592 (contained in revised subsection (i)), with this form being applicable only for pass-through entities. With the exception of the following primary additions, FTB Form 592-PTE is very similar to FTB Form 592: (1) Subsection (j)(3) has been revised to be more similar to its counterpart found in FTB Form 592, with the difference being that the check box here will indicate the total withholding paid "at the end of the year" rather than one of four due dates for the tax withheld. The purpose behind this change was to mirror the changed quarterly due date to an annual date. Quarterly withholding remittances will still be required; (2) Subsection (j)(5) has been added to include withholding agent information for lower tier pass-through entities, which will allow the upper tier pass-through entity filing the FTB Form 592-PTE to properly account for the withholding to identify who the lower tier pass-through entity is, or the original withholding agent was; and (3) Subsection 18662-4(j)(9) has been drafted to be analogous to current Regulation section 18662-4(j)(10), for foreign pass-through entity withholding distribution. The purpose for this section is to identify the amount that was withheld by another entity (the lower tier pass-through entity).
- Subsection (l)(5)(C) has been revised to require certain payees to attach a copy of the Schedule R-7, Election to File a Unitary Taxpayers' Group Return, from the combined report. This is information that the FTB currently requests for verification purposes for approval of FTB Form 588, so requiring this information with the FTB Form 588 eliminates the extra step.
- Subsection (l)(5)(E) has been revised to require certain payees to attach a copy of Schedule 1067A, Nonresident Group Return Schedule, from the group return. This is information that the FTB currently requests for verification purposes for approval of FTB Form 588, so requiring this information with the FTB Form 588 eliminates the extra step.
- Section 18662-5, *Other Types of Payments and Withholding Obligations*:
  - Subsection (k)(2) has been revised by inserting the phrase "or ITIN" after the word "SSN," to make all of the applicable fields on FTB Form 587 more

generic such that they could apply to both resident and nonresident individuals, as well as business entities (since a nonresident individual or a business entity may have an ITIN), and to match what is currently on FTB's forms and its current practices.

- Section 18662-6, *Nonresident Withholding, Entertainers, Athletes, and Speakers*:
  - Throughout subsection (a), the term "Performer's Agent" has been revised to the term "Entertainer's Agent" as the withholding regulations apply to all "entertainers" not just "performers"—which is one type of an entertainer. In fact, as noted in subsection (a)(2)(A), "Withholding is required on California source income paid to the nonresident entertainer . . ." Thus, this subsection already notes that it applies to all nonresident entertainers and this revision from the "performer's agent" to the "entertainer's agent" merely makes the language consistent throughout.
  - Subsection (a)(2)(A) (specifically, the Example) has been revised by inserting the term "nonresident" in front of the term "entertainer" because the example pertains to "nonresident entertainers" as there is no withholding requirement for resident entertainers.
  - Subsection (a)(2)(B) has been added for California Corporations such that if the entertainer's agent or promoter is incorporated in California or qualified to do business in California with the SOS, the entertainment venue is not required to withhold if the entertainer's agent or promoter certifies to an exemption on FTB Form 590, or the venue verifies the entertainer's agent or promoter is a California corporation or qualified to do business in this state by contacting the SOS. The added subsection also notes that the entertainment venue may rely on a printout from the SOS, as noted in Subsection (b)(2), Example 2, in Regulation Section 18662-4 changes above. In addition, the entertainer's agent or promoter, as the withholding agent, must withhold and remit tax on the gross payments made to the nonresident entertainer, unless the nonresident entertainer meets one of the exceptions listed in Regulation section 18662-4, subsection (c), set forth in FTB Form 590. This change is made to clarify the exemptions that are available for California Corporations. The amended language clarifies that one way of contacting the SOS and verifying the information is through the SOS's public website which includes all the necessary information to ascertain whether or not the party in question is a California corporation or qualified to do business in California.
  - Subsection (b) has been revised to clarify that the FTB has the "sole discretion" to grant waivers from withholding using FTB Form 588, which is necessary to clarify that withholding of tax at source is required for payments of California source income made to nonresident individuals and non-California business entities, unless the individual or entity falls into one of the categories set forth in Regulation Section 18662-4, subsection (b), there is a

withholding exemption certificate on FTB Form 590, or the FTB, at its sole discretion, authorizes a waiver from withholding on FTB Form 588.

- Subsection (b) has been revised to clarify the threshold requirements for FTB Form 589, Nonresident Reduced Withholding Request, to ensure that this form would only be used for reduced withholding, because without a threshold requirement, the FTB Form 589 has been used to effectively obtain a waiver from withholding (due to the expenses/deductions being sufficiently high enough to ensure there is no net income) without following the requirements of FTB Form 588, Nonresident Withholding Waiver Request. In light of this, this subsection is revised to make adjustments to the Withholding Computation formula to ensure that FTB Form 589 is used for its intended purpose.
- Section 18662-8, *Reporting and Remitting Amounts Withheld, Penalties, and Interest; Other Procedures*:
  - Subsection (c)(1)(B) has been added to provide information with respect to payment due dates for domestic pass-through entities. Specifically, this subsection provides the manner in which domestic pass-through entities will report their annual withholding (i.e., using FTB Form 592-PTE, Pass-Through Entity Annual Withholding Return), and how to effectuate the payment (i.e., using FTB Form 592-Q, payment voucher). The addition of this subsection was done to provide clarity and to make this subsection more organized, such that the payment due dates would be separately stated for both domestic withholding and foreign withholding. FTB Form 592-PTE has two purposes: (1) to report total withholding payments made throughout the year; and (2) to allocate withholding paid on the Form 592-PTE on the filer's behalf.
  - Subsection (c)(1)(C) has been revised to provide the manner in which payments will be remitted for foreign partner or member withholding (i.e., using FTB Form 592-A, payment voucher). This subsection was revised to clearly identify the payment voucher that would be used for foreign partner or member withholding.
  - Subsection (c)(2)(A) has been revised simply for reorganization purposes to separate the different types of withholding and place them in separate sections (i.e., separate sections for general withholding, domestic pass-through entity withholding and foreign withholding). This reorganization makes it more reader friendly, such that it avoids having all of the various different types of withholding requirements in one large paragraph. The requirements for FTB Form 592 and FTB Form 592-V will not be changing.
  - Subsection (c)(2)(B) has been added to establish new/different reporting requirements for domestic pass-through entities. For domestic pass-through entities, FTB Form 592-Q shall be filed with the FTB with each quarterly withholding remittance, and that these quarterly payments shall also be

reported to the FTB pursuant to FTB Form 592-PTE on an annual basis no later than January 31st of the year following the year for which such withholding was required to be remitted to the FTB. This subsection clarifies that the FTB Form 592-PTE will be filed on a yearly basis, with the FTB Form 592-Q being filed on a quarterly basis to show each quarterly withholding remittance. This subsection also sets the due date for the filing of FTB Form 592-PTE as January 31<sup>st</sup> of the year following the year for which withholding was required to be remitted to the FTB.

- Subsection (c)(2)(C) had been added to distinguish the reporting requirements for foreign (non-U.S.) partner or member withholding. This information was previously included in subsection (c)(3)(A) in the "In General" section. Adding a specific subsection for foreign (non-U.S.) partner or member withholding will eliminate possible confusion. This subsection mirrors subsection (c)(1)(C), which discussed payment due dates for foreign (non-U.S.) partners or members, but further clarifies that FTB Form 592-A shall be filed with each quarterly remittance, and that the quarterly withholding payments shall then be reported on FTB Form 592-F on or before the 15<sup>th</sup> day of the 4<sup>th</sup> month following the close of the entity's taxable year.
- Subsection (c)(2)(E) has been revised to change the term "Information Returns" to the term "Payee Statement" for purposes of FTB Form 592-B. This change was necessary because FTB Form 592-B is a payee statement, not an information return, considering that an information return is a statement required to be filed with the State while a payee statement is a statement required to be furnished to the recipient (i.e., payee/partner). Because FTB Form 592-B is required to be furnished to the recipient—not filed with the state—the more appropriate term is "payee statement."
- Subsection (d)—which covers Interest and Penalties—has been revised throughout to reflect the fact that remitters may be subject to information return penalties in the context of real estate withholding. As was covered above, in real estate transactions, the person who is responsible for withholding is the buyer, and the person who actually performs the withholding is often the real estate escrow person. Thus, this change is necessary to clarify that the remitter (typically, the escrow officer)—not the buyer/transferee—who is the person responsible for sending the payment to the FTB will also be subject to information return penalties.