NOTE: This handout is intended only for purposes of facilitating discussion at the September 8, 2017 interested parties meeting.

Franchise Tax Board

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

Regulation 18662-7 is adopted to read:


(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.

(b) Definitions.

(1) Distributive Share of Income. For purposes of this subsection, 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. 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 an owner that is a pass-through entity.

(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).

(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.

(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:

(i) 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.

(ii) Pass-Through Entity Owner That is an S Corporation. The tax rate applicable to the distributive share of each nonresident owner
owner that is itself a non-California S corporation owner of the pass-through entity shall consist of the tax rate in effect under Revenue and Taxation Code section 23802. 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.

(iii) 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.

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

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

(i) 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.

(ii) 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.

(I) 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.

(II) 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.

(III) 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).

(2) Notification to Owners of Withholding.

(A) 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. See Regulation section 18662-8, subsection (m).

(i) **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.

(ii) **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.

(B) **10-Day Notification Requirement.** A pass-through entity must notify each nonresident owner of the withholding paid on the nonresident owner's behalf when the pass-through entity remits a withholding payment to the Franchise Tax Board. The notice required to be given must be provided within 10 days of the withholding payment due date, or, if paid later, the date such payment is made. No particular form is required for a pass-through entity's notification to a nonresident owner, but each notification must include the pass-through entity's name, identification number, address, and the owner's name, identification number, address, the owner's distributive share of income, and the amount of tax paid on behalf of the owner for both the current pass-through entity's taxable year.

(C) **10-Day Notification Exception.** A pass-through entity is not required to notify a nonresident owner of a withholding payment made on the owner's behalf, unless requested by the owner, if –

(i) The pass-through entity's agent responsible for providing notice pursuant to this paragraph is the same person that acts as an agent of the owner for purposes of filing the owner's California income tax return for the owner's taxable year that included the withholding payment date; or
(ii) The pass-through entity has at least 500 nonresident owners and the total withholding the pass-through entity determines it is required to pay for the tax year on behalf of such owner's distributive share of income is less than $1,000; or

(iii) The pass-through entity is an upper tier pass-through entity that is only allocating withholding paid on its behalf.

(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. 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 section18662-8(d), and Revenue and Taxation Code sections 18668 and 19183.

(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.

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 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
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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-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 5: 10-Day Notification Requirements.

Same facts as Example 2. A is required to notify C within 10 days of making each withholding payment that it remits throughout Year X. C is not required to notify its owners of the withholding A paid on its behalf throughout Year X because C is only required to allocate this withholding to its owners following the end of Year X. Similarly, E is not required to notify its owners of the withholding A paid on its behalf because E is only required to allocate this withholding to its owners following the end of Year X.
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 notify D within 10 days of each withholding payment, 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: 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 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.