

**Summary of First Interested Parties Meeting
Proposed Regulation § 18662-0 Through -6 and -8,
First Topic: Nonwage and Real Estate Withholding
Second Topic: Pass-through Entity Withholding Filing Requirements**

I. Administration:

On October 12, 2015 at approximately 10:00 a.m., interested members of the public (participants) attended an Interested Parties Meeting (IPM) at the Franchise Tax Board central office in Sacramento. Participants attended in person and by telephone. Those physically present were asked to register at the entrance and those on the telephone were asked to fax a business card to Mari Anderson for later correspondence. Phone participants introduced themselves. The session was audio recorded for reference, but participants were informed there would be no attribution of comments and no transcript would be made.

IPM Facilitators, David Muradyan and Leah Thyberg, listed the two documents made available as handouts: (1) notice of the meeting; and (2) a tiered structure handout. Participants were told they had until December 1, 2015 to submit written comments.

The purpose of the meeting was to provide participants with an opportunity to discuss and provide comments on possible amendments to California Code of Regulations (CCR), title 18, sections 18662-0 through 18662-6, and section 18662-8 (Withholding Regulations), which would make 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.

II. Discussion:

The discussion was organized topically. The first part of the discussion covered nonwage and real estate withholding, while the second part of the discussion covered PTE withholding filing requirements. The numbering of the comments in this summary is for ease of reference and thus, readers should not assign any importance to one comment over any other comment.

a. Part 1: The first part of discussion covered nonwage and real estate withholding.

The first part of discussion covered nonwage and real estate withholding. At the outset, the facilitator stated that possible proposed amendments to the Withholding Regulations would include changing certain terms for consistency and clarification purposes. Specifically, the term "buyer" would be changed to the term "buyer/transferee," and the term "seller" would be changed to the term "seller/transferor." In addition, the facilitator stated that the term "SSN" would be changed to the term "SSN or ITIN," which would make all of the applicable fields 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.

Next, the facilitator opened up discussion about possibly amending the Withholding Regulations to change the phrase "California tax" to the phrase "resident and/or nonresident tax," indicating the change should make it easier for taxpayers to accurately claim their withholding credits. Participants asked where in the Withholding Regulations this change would be effectuated and also asked about the status of foreign residents. The facilitator noted that this change would be contained in 18 CCR Section 18662-8(m)(6) and that a foreign resident would be considered a nonresident.

Next, the facilitator opened up discussion about clarifying what forms can and cannot be filed electronically to make the Withholding Regulations consistent with what is current practice on the forms. For example, the Form 592 and the Form 592-F both state that they can be filed by paper or electronically, and this change would simply ensure that the regulations are consistent with the forms. The facilitator also noted that the possible proposed amendments to the Withholding Regulations would clarify the process by which a waiver is requested under FTB Form 588, Nonresident Withholding Waiver Request, and went over a possible change in the forms about adding property address information for property management reduced withholding requests. The facilitator also stated that the FTB Form 593 would be revised to add the total sales price and ownership percentage fields to make the audit process more accurate.

The facilitator then opened up discussion about determining whether the terms of the installment agreement and the buyer/transferee information currently reported on FTB Form 593-I, Real Estate Withholding Installment Sale Acknowledgement, should instead be reported on FTB Form 593, Real Estate Withholding Statement, with the FTB Form 593-I being discontinued. Participants asked for some background on this change, expressed concern about buyers generally being confused about the reporting process, and asked whether the buyer's signature would be necessary on this new form.

The facilitator noted that prior to the enactment of AB 3078 (in the 2007-2008 legislative session), a nonresident seller of California real property pursuant to an installment agreement was not subject to withholding when payments were received by the seller in later years, unless the buyer made an election to withhold on a payment-by-payment basis rather than on the entire sale in the year of sale. The facilitator further noted that following enactment of AB 3078, the buyer is required to withhold on each installment sale payment if the sale of California real property is structured as an installment sale within the meaning of Section 453(b) of the Internal Revenue Code, and that the withholding provisions would be separately applied to each principal payment to be made under the terms of the installment sale agreement between the parties. The facilitator indicated that under AB 3078 (which was sponsored by the FTB), there would no longer be an option to do withholding at the beginning of the transaction that qualifies as an installment sale under the meaning of Section 453(b) of the Internal Revenue Code, withholding must be done separately to each principle payment, and the option to withhold all at once (i.e., to withhold off of the entire sale price) is no longer available. The facilitator also indicated that when options with respect to the manner of withholding existed, anyone who wanted to withhold on a payment-by-payment basis had to sign a Form 593. Further, the facilitator indicated that following enactment of AB 3078, there was no longer a need to do this, and FTB changed the name of FTB Form 593-I to an Acknowledgement form, and the buyer only would sign the installment agreement (as they would be the one to do the withholding). In addition, the facilitator noted that because it is now a requirement to withhold using the installment sale method under AB 3078 when there is a promissory note or deed of trust at the time of the sale, there is no longer an option to withhold all at once. Finally, the facilitator also explained that were this change to be

implemented (i.e., FTB Form 593-I would collapse into FTB Form 593), the buyer would not be required to sign the new FTB Form 593.

The facilitator then opened up discussion about the possibility of amending the Withholding Regulations 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. The facilitator explained that this form 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, the facilitator indicated that FTB Staff is examining the possibility of making adjustments to the Withholding Computation formula to ensure that FTB Form 589 is used for its intended purpose.

Next, the facilitator opened up discussion about adding a new term, "Remitter", to the definition section of the regulations (18 C.C.R. section 18662-2), and revising the definition of "Withholding Agent" and other terms, to the extent necessary. Participants wanted more general detail about this change, and also wanted to know whether the term "remitter" would apply to foreign partnership and LLC nonresident withholding (or just to real estate withholding), and whether there would be an incentive for the remitter to remit the payment. The facilitator explained that the Franchise Tax Board 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 the real estate escrow person. Thus, the facilitator indicated that it appears a change is necessary to clarify that the remitter (typically, the escrow officer)—not the buyer—is the person responsible for sending the payment to the Franchise Tax Board. The facilitator also mentioned that the remitter is not subject to the same penalties as a withholding agent. The withholding agent—typically, the buyer—will still be subject to the penalties if withholding is not performed. In contrast, the remitter, who is usually the person making the payment, will not be subject to the penalty. The facilitator then stated that the term remitter would likely apply only to real estate withholding—and not to foreign partnership and LLC nonresident withholding, stating also that there would be an incentive for the remitter to remit the payment because there would be penalties for not remitting the payment, though these would be different and separate from the failure to withhold penalties.

Finally, the facilitator noted that in addition to all of the discussed changes, there would likely need to be other technical revisions to the Withholding Regulations, as necessary, and that all of the possible proposed changes to the amendments would be in writing posted to FTB's public website prior to the second IPM.

b. Part 2: The second part of discussion covered PTE withholding, and was organized topically, covering the following four areas:

1. Annual Reconciliation Form Due Date For Pass-Through Entity Withholding

The facilitator opened up discussion by noting that pass-through entities, tiered structures in particular, have difficulty in timely filing Form 592 to allocate withholding to the ultimate owner (see Page 1 of [Handout](#)). The facilitator noted that more specifically, it appears that an upper tier pass-through entity may not receive its withholding information from the lower tier pass-through entity (typically through Form 592-B) until after the Form 592 quarterly due date. This may then cause a second problem in which the ultimate individual owner is denied a claimed withholding

credit due to the untimely filing of Form 592 and subsequent untimely allocation of withholding to that owner.

The facilitator mentioned that the annual reconciliation idea was raised in the first IPM held for CCR, title 18 section 18662-7 in December 2014, and that Michigan's annual reconciliation form, with a due date of February 28, was discussed at length. The discussion continued with the facilitator noting another option could be to model domestic pass-through entity withholding to our foreign pass-through entity withholding, which conforms to the IRS foreign pass-through entity withholding. The facilitator indicated participants could look at Page 2 of the [Handout](#) to see California's foreign pass-through entity withholding scheme and Page 3 of the [Handout](#) to see the IRS' foreign pass-through entity withholding scheme. The facilitator indicated that both foreign withholding schemes have an annual filing requirement of April 15, rather than FTB's current domestic pass-through entity's quarterly filing requirement, and that both require the lower tier pass-through entity to notify the upper tier pass-through entity of the withholding paid within 10 days of each withholding payment.

The facilitator next opened up discussion about the possibility of switching away from FTB's current quarterly filing due date to an annual filing due date for pass-through entities filing FTB Form 592, Resident and Nonresident Withholding Statement. The facilitator noted that annual reporting in general allows the upper tier pass-through entity more time to receive withholding information from their lower tier pass-through entity, which then helps them timely file their withholding return. This may also help prevent the individual partners from having their claimed withholding credit denied when they file their income tax returns since there is now more time for the withholding credit to be allocated to the individual. Participants noted that while this would likely work great for larger entities, they wanted to know whether the later due date would apply to all partnership withholdings, as there could be issues with smaller partnerships.

A participant also asked a question regarding smaller entities, specifically questioning if FTB were to switch to the April 15 deadline, whether that would mean for smaller entities that have less of an issue getting their withholding information late, if they would now need to wait until April 15 for all those forms to be processed. The facilitator noted in response that that is certainly an issue with the April 15 due date and that could be a reason why we would want an earlier deadline, such as a January 31 due date. A participant also wanted to know if filing could be done prior to the due date. The facilitator noted that if April 15 is the due date, but people filed earlier, this may create an issue with the ultimate individual owners filing too early before the withholding credit has been allocated. A participant also asked whether FTB had considered that tiered entities are not always just one tier, but multiple tiers. The facilitator acknowledged that that is something FTB was aware of, and noted that the IRS requires each tier to file by the April 15 due date, regardless of number of tiers. Finally, a participant asked about potentially getting rid of withholding on pass-through entities. The facilitator noted that FTB has had discussions about doing so, but that there was no additional information regarding this for discussion at the IPM.

The facilitator next opened up discussion regarding the specific annual due date should there be a change for pass-through entities from the quarterly to an annual filing system, specifically asking whether some practitioners would prefer an earlier due date of January 31 or February 28, like Michigan, or an even later due date of around April 15, which is similar to the IRS and FTB's current foreign PTE withholding scheme. The facilitator noted that a January 31 or February 28 due date may provide enough time for the withholding credit to be allocated and available for when the ultimate individual partner claims their withholding credit on their tax return. However, the

facilitator noted that requiring this form to be filed in the beginning of filing season may be difficult, and a April 15 due date may not provide enough time for the withholding credit to be allocated by the time the individual owners file their returns claiming the withholding credit. Participants noted that for smaller entities or smaller taxpayers, it is more beneficial to have an earlier due date.

Participants also noted that if FTB was going to ask for a due date for the paper filing, the January 31 due date would more closely coincide with payroll and 1099 reporting. A participant expressed concern with the January 31 deadline indicating that when dealing with real estate transactions occurring late in the calendar year, an escrow company is not given enough time to pass-through the relevant withholding information to their participants. The facilitator noted that it appeared that some CPAs were not receiving the Form 593 from their clients until filing season, but that if the Form 592 due date were to be late January or February, then they would still have time to receive the Form 593 before the due date. The facilitator also stated that the Form 593 is given to the seller during escrow, and that the 20th day of the month following the month after escrow is when the form and payment are due to the FTB—but that is not when the Form 593 is given to the seller. Thus, the facilitator explained, even if it is not received until December 31, the seller should have the Form 593 at the close of escrow and can immediately give that to their tax practitioner.

2. Mandatory 10-day Notification Period After Withholding Paid

For the next part of the discussion, the facilitator noted that California and the IRS, for foreign pass-through entity withholding, also require the pass-through entity to notify its payees within 10 days of each quarterly withholding remittance. The facilitator directed participants to pages 2 and 3 of the [Handout](#) noting that the primary purpose behind this requirement for the IRS is to allow the payee to credit the Internal Revenue Code section 1446 tax paid on his or her behalf against their estimated tax that they must pay during their own taxable year. However, the facilitator noted a secondary purpose seems to be to also allow the upper tier pass-through entity to receive the withholding information throughout the tax year, rather than only at the end of the year. Since the upper tier pass-through entity is receiving the withholding information throughout the year, the facilitator indicated it seems there should be no reason for it to fail to timely file its own withholding form at the end of the year.

The facilitator next opened up discussion about the possibility of a 10 day notification requirement, and whether it would help ensure the upper tier pass-through entity has the withholding information in enough time to file its withholding form at the end of the year. The facilitator also asked for comments about whether the participants felt that this might be unreasonably burdensome, though the facilitator noted it does not seem to be an issue with the IRS' foreign withholding or California's current foreign withholding. Several participants inquired whether this requirement was tied to a payment, especially for entities with multiple tiers (more than one layer). Those participants further noted that if the 10 day period would be 10 days after payment, then it would just be the first tier, since no other tier is making withholding payments. The facilitator stated that this requirement would only apply for the lower tier pass-through entity, and once the lowest tier sends in the withholding payment, that is when they notify the payee, and only at that point would the information need to be passed through all the tiers. The facilitator also noted that once there are multiple tiers, there would still be the January 31 deadline for each entity in the tiers for the Form 592-B to be sent to its partners, but the 10 day notification would only apply for the lower tier entity.

3. Current Requirement to Attach Form 592-B Copy To Income Tax Return To Receive Withholding Credit.

The facilitator's third discussion topic was the current requirement to attach a copy of the Form 592-B to the partner's income tax return to actually claim the withholding credit. The facilitator directed participants to page 3 of the [Handout](#), noting that the IRS also requires its Form 8805 copy (which is FTB's Form 592-B equivalent) to be attached in order to claim the withholding credit. The facilitator indicated that if FTB is provided with a Form 592-B copy this allows FTB to verify the withholding credit, especially if the withholding credit has not yet been allocated. The facilitator stated that requiring the individual to wait until they have received the Form 592-B to file their tax return may also prevent taxpayers from filing early and prematurely claiming withholding credits before the withholding has been allocated.

The facilitator provided some further background on the topic noting under the federal scheme, if a taxpayer files a return without federal Form 8805, then the return is rejected. The facilitator noted that the federal scheme is predicated on forcing the filing of this form and that a return cannot be filed until the taxpayer has Form 8805 or 592-B. The facilitator noted that if a taxpayer files before they have either of those forms then the return is rejected. The facilitator further noted that the purpose behind the Form 592-B is to ensure that people are not filing too early before the information is there. This requirement ties to the due date of the actual annual reconciliation form.

The facilitator opened up discussion about this requirement by asking whether it might be too difficult to follow this requirement, whether taxpayers are even following this requirement (since it is current law under the existing regulations), and whether it is even helpful. Participants noted that if the 592-B was actually processed by the FTB, then they could see value to that, but stated it was their understanding that FTB holds any refund until the FTB actually has the Form 592 allocation. As a result, participants wanted to know what difference it would make whether to include Form 592-B or not. In response, the facilitator noted that including Form 592-B would be a useful reconciliation and audit type of tool.

4. De Minimis Threshold Amount

The facilitator's final discussion topic was whether the current *de minimis* withholding threshold of \$1,500 should be increased in a possible proposed amendment to the Withholding Regulations. The facilitator noted that currently withholding is optional on the first \$1,500 of income paid for the calendar year to each payee.

The facilitator opened up discussion by asking whether participants believed that raising the *de minimis* threshold could alleviate a situation where an upper tier pass-through entity is imposed a penalty that seems disproportionate to the original withholding amount. The facilitator also asked participants whether they believed that most of their clients were exceeding this \$1,500 threshold pretty quickly anyway, such that raising the threshold would not necessarily be beneficial unless the increase were substantial. A participant asked whether FTB was applying the threshold requirement at every tier, or only to the initial lower-tier entity making the distribution. The facilitator responded that it was only being applied at the lower tier entity level.

Another participant stated that the issue they were commonly seeing was that where the initial distribution from a pass-through entity is a significant amount, then it disperses to the partners

and tiers and mushrooms as it goes up. This participant further stated that they saw pass-through entities that blow through the *de minimis* threshold on the initial distribution, but that when the distribution gets split up as it goes through the multiple tiers, it seems as if all the entities in each tier might be subject to the penalty, regardless of actual amount of income. The facilitator asked, specifically in reference to the lower tier entity, whether there was a number that the participant could suggest. The participant stated that it could be \$3,000 and gave an example that there could be a \$100,000 payment at the lower tier, but by the time it goes up to the partners, it could only be actually \$10 per partner. During discussion the facilitator noted that further issues participants might have on this topic would be more appropriately dealt with in the Section 18662-7 regulation.

III. Closing:

The IPM meeting closed with the facilitator noting that the FTB would accept written comments on the topics discussed at the meeting until December 1, 2015, and that FTB staff intends to consider all comments received on the day of the IPM through the comment deadline. The facilitator indicated that an additional IPM would be scheduled after draft language has been developed so that the public may have an opportunity to comment on the proposed language of the amended regulation. Finally, the facilitator also mentioned that a summary of the IPM would be published online in the future,