STATE OF CALIFORNIA

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PROPERTY AND SPECIAL TAXES DEPARTMENT
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February 14, 2003

No. 2003/014

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

WITHHOLDING TAX ON SALE OF REAL PROPERTY

This letter is being sent for informational purposes only. The Board and many assessors' offices are receiving calls on the new withholding requirements for sales of real estate. In California, real estate withholding is a prepayment of state income taxes for sellers of California real estate. Calls regarding real estate withholding can be referred to the Franchise Tax Board.

Effective January 1, 2003, Chapter 488 of the Statutes of 2002 (AB 2065) amends Revenue and Taxation Code section 18662 and expands the existing 3-1/3 percent income tax withholding to include individual sellers who are California residents. Previously, this withholding applied only to sellers who were nonresidents or corporations with no permanent place of business in California. The new withholding requirements apply to sales of real estate in California that close escrow on or after January 1, 2003.

Enclosed for your information is the Franchise Tax Board's FAQs and a comparison table on the change in law. Additional information and forms are available from the Franchise Tax Board's Web site at www.ftb.ca.gov/geninfo/wscs/realestate.html . Or, you may contact the Franchise Tax Board by telephone at (888) 792-4900 or by e-mail at wscs.gen@ftb.ca.gov.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:grs
Enclosure

Real Estate Withholding Law Changes Effective January 1, 2003

1. **What are the changes to real estate withholding?**

   Assembly Bill 2065 (Chapter 02-488) revised Revenue and Taxation Code Section 18662 for sales of California real property that close on or after January 1, 2003. For sales closing before January 1, 2003, withholding is required when the seller is a nonresident or a corporation with no permanent place of business in California. The new law expands the withholding requirement to include resident individuals. In addition, the new law eliminates the waiver process for individuals, but provides more exemption possibilities.

2. **What is real estate withholding?**

   Real estate withholding is a prepayment of state income taxes for sellers of California real estate. California, like the federal government, has a "pay as you go" tax system, meaning taxes are due as you earn income, not after the end of the year when you file your state income tax return. Real estate withholding will, in many cases, save the seller from having to make estimate payments to cover the tax due on the gain on the real estate sale.

3. **Who is subject to withholding?**

   For sales closing on or after January 1, 2003, all individuals who sell California real property and do not qualify for an exemption are subject to withholding. All non-individual sellers with a last known street address outside of California who do not qualify for an exemption remain subject to withholding.

4. **Who are individuals?**

   Individuals are human beings as opposed to entities such as corporations, partnerships, estates, trusts, etc. Individuals also include husbands and wives who are on title together.

5. **What are non-individuals?**

   Non-individuals are any type of entity, other than individuals, such as corporations, estates, partnerships, trusts, etc. An exception is revocable (grantor) trusts. Revocable trusts are not considered to be entities for taxable purposes. Therefore, if the property is held in the name of a grantor trust, the seller is considered to be the grantor, who are frequently individuals.

6. **Is the trustee or the trust considered to be the seller?**

   If the trust is irrevocable, then the trust is the seller and falls under the requirements for non-individuals. If the trust is revocable, then the seller is the grantor. Usually the grantor of a revocable trust is an individual and would fall under the requirement for individuals.

7. **What are the withholding exemptions for individual sellers?**

   The exemptions for individuals are:
   - Total sales price does not exceed $100,000,
   - Property is the seller's principal residence (IRC Section 121),
   - Sales resulting in a loss for California tax purposes,
   - Like-kind exchanges, with the exception of boot (IRC Section 1031),
   - Involuntary conversions (IRC Section 1033), or
   - Certain foreclosures.

   Sellers meeting one of the above exemptions must sign a written certification under penalty of perjury (Form 593-C) to be exempt from withholding.

8. **What are the exemptions for non-individual sellers?**

   The exemptions for non-individuals are:
   - Corporations with a permanent place of business in California,
   - Partnerships or LLCs,
   - Tax exempt entities, insurance companies, IRAs, or qualified pension plans,
   - Irrevocable trusts with a California trustee,
   - Estates with a California decedent, or
   - Banks or banks acting as a fiduciary for a trust.

   Although the exemptions for non-individuals have not changed, sellers meeting one of the above exemptions must sign a different form (Form 593-W) to certify under penalty of perjury that they are exempt from withholding.

9. **Is there still a waiver process for individuals?**

   No. For all real estate transactions closing on or after January 1, 2003, the waiver process is eliminated. However, many of the reasons for which waivers were previously granted are now certifiable exemptions.

10. Can individual sellers who will have a small gain still apply for reduced withholding?

No. The new law does not allow individuals to apply for reduced withholding for any real estate transaction closing on or after January 1, 2003. The full 3 1/3 percent of the total sales price must be withheld even though the sale will only result in a small gain.

11. Must the full 3 1/3 percent of the total sales price be withheld on installment sales?

Yes. Sellers of real property selling on the installment basis are subject to the full 3 1/3 percent withholding. However, withholding on the full sales price can be deferred if the buyer agrees to withhold 3 1/3 percent of the down payment and 3 1/3 percent of each payment thereafter. The buyer must complete and sign Form 593-I, Real Estate Withholding Installment Sales Agreement. This form must be attached to the Form 597 with the down payment withholding.

12. How much should be withheld when there are multiple sellers?

The total withholding is calculated on the total sale price and then allocated to each seller in proportion to their ownership interest.

Example:

Total sale price	$200,000
Withholding rate	3.33%
Total withholding =	$ 6,660

Sellers' share:
A = 20%, B = 30%, C = 50%

Withholding per seller:

A	$1,332	$6,660 x 20%
B	1,998	6,660 x 30%
C	3,330	6,660 x 50%
	$6,660	100%

13. How many Forms 597 should be filed when there is more than one seller (other than husband and wife)?

A separate Form 597 must be filed for each seller. Each seller's Form 597 should include only the seller's proportional share of the withholding.

14. **How many Forms 597 should be filed when the sellers are husband and wife?**

    Normally, just one Form 597 should be filed for a husband and wife. However, if the husband and wife are intending to file separate returns and wish to have the withholding applied to separate accounts, then a Form 597 should be filed for each spouse. Each spouse's Form 597 should include only the spouse's proportional share of the withholding.

15. **When sellers certify that they meet a withholding exemption, should the information be sent to FTB for review/approval?**

    No. The withholding exemption certificate (Form 593-C for individuals or Form 593-W, Part I for non-individuals) should not be sent to FTB unless specifically requested by the FTB. The escrow office must keep these forms in their files.

16. **Is there still a waiver process for non-individuals?**

    Yes. The law has not changed for non-individuals. However, requests for waivers or reduced withholding must be made using the new Form 593-W, Real Estate Withholding Exemption Certificate & Waiver Request for Non-Individual Sellers.

17. **Will the procedures change for paying and reporting the withholding?**

    No. The basic procedures will not change for 2003. However, we are exploring ways to streamline the payment and reporting processes for 2004.

18. **Has the due date for Form 597 and payment of withholding changed?**

    No. The due date is still the 20th day of the month following the month title is transferred.

19. **Will interest be assessed on late payments of withholding?**

    Yes. The assessment of interest on late payments is mandatory. The imposition of interest is not a penalty, but compensation for the use of funds. Interest is computed from the due date of the withholding payment to the date payment is received.

20. **Who is responsible for withholding?**

    The buyer or other transferee is responsible for withholding, completing Form 597, providing two copies of Form 597 to the seller, and providing one copy of Form 597 to the FTB along with the withholding payment by the due date. However, buyers normally delegate these responsibilities to the escrow company.

21. What is the escrow company required to do?

The escrow company is required to notify buyers in writing of their withholding obligation. When the escrow company has been directed to withhold by the buyer, or has assumed responsibility to withhold, the escrow company must withhold and complete Form 597, provide two copies of Form 597 to the seller, and provide one copy of Form 597 to the FTB along with the withholding payment by the due date.

22. How will the new law impact intermediaries or accommodators in tax-deferred exchanges?

The new law requires intermediaries or accommodators to withhold 3 1/3 percent on any cash or cash equivalent (boot) an individual receives or to withhold 3 1/3 percent of the total sale price if the exchange does not occur or does not meet the requirements of IRC Section 1031. There is no longer a minimum amount of boot that must be received before withholding is required on the boot.

The intermediary or accommodator will no longer need to sign Form 597-E since the law automatically requires the intermediary or accommodator to withhold. In addition, when FTB grants a waiver to non-individuals because they intend to treat the transfer as the first part of a non-simultaneous IRC Section 1031 exchange, FTB will only require 3 1/3 percent withholding on any boot. If the exchange does not occur or does not meet the requirements of IRC Section 1031, withholding will still be 3 1/3 percent of the total sale price.

23. Will there be new forms?

Yes. The proposed form numbers and titles are listed below.

<u>For Individual Sellers:</u>

Form 593-C, Real Estate Withholding Certificate for Individual Sellers. (Used to certify that the individual seller meets one of the allowed exemptions).

Form 593-I, Real Estate Withholding Installment Sales Agreement. (Used by buyers when the buyer agrees to withhold on each payment instead of on the full price at the time of sale).

Form 593-L, Real Estate Withholding – Computation of Gain or Loss. (Used by sellers to compute the gain or loss on the sale).

<u>For Non-Individual Sellers:</u>

Form FTB 593-W, Real Estate Withholding Exemption Certificate and Waiver Request for Non-Individual Sellers. (Used to certify that the non-individual seller meets one of the allowed exemptions).

24. When will the new forms be available?

We anticipate that Forms 593-C, 593-L, 593-I, and 597 (revision 2002) will be available on the Internet in early December. Go to www.ftb.ca.gov/geninfo/nrw/forms.html to get updated forms. Printed forms will be available in January 2003. Publication 1016, Real Estate Withholding Guidelines, should be updated and available in early January 2003.

25. Can we use the old forms for sales closing on or after January 1, 2003?

No. Forms 597-W, 597-E, and 597-I will not be accepted. Also, the 2002 revision of Form 597, Real Estate Withholding Tax Statement, must be used for payments made in 2003.

26. What is the penalty for failing to withhold?

The penalty is the greater of $500 or 10 percent of the amount required to be withheld.

27. What is the penalty if the escrow person fails to notify the buyer in writing of the withholding requirements?

The penalty is the greater of $500 or 10 percent of the amount required to be withheld.

28. What is the penalty if the seller signs a false exemption certificate?

If the seller knowingly executes a false exemption certificate, the penalty is the greater of $1,000 or 20 percent of the amount required to be withheld.

29. What is the penalty for failing to file a correct or timely Form 597 with the FTB?

If a correct Form 597 is filed within 30 days after the due date, the penalty is $15. If a correct Form 597 is filed 30 days or more after the due date or a correct Form 597 is never filed, the penalty is $50. If the failure is due to intentional disregard of the requirements, then the amount is increased to the greater of $100 or ten percent of the amount required to be reported. The penalty is for each Form 597 that is not filed correctly or timely.

30. What is the penalty for failing to furnish a correct or timely Form 597 to the seller?

The penalty for failing to provide sellers with their copies of Form 597 is $50 if a correct Form 597 is not provided by the due date. If the failure is due to intentional disregard of the requirements, then the amount is increased to the greater of $100 or ten percent of the amount required to be reported. The penalty is for each Form 597 that is not furnished correctly or timely.

31. Where can I get a copy of the new law?

For information on Assembly Bill 2065, go to: http://www.leginfo.ca.gov/bilinfo.html

32. How can we get more information?

We will send updates via e-mail to the escrow associations and escrow offices that we have on file. We will also post updates to our website at: www.ftb.ca.gov . You may also call us toll free at 888-792-4900, or E-mail us at nrws@ftb.ca.gov.

California Real Estate Withholding

	Escrows Closing On or Before December 31, 2002	Escrows Closing On or After January 1, 2003
Sellers Subject to Withholding	• Individuals with a last known street address outside of California (nonresidents) and • Non-individuals (corporations, estates, trusts, etc.) with a last known street address outside of California	The new law expands real estate withholding to include all individuals (residents and nonresidents). It continues to apply to non-individuals with a last known street address outside California.
Rate	The withholding rate is 3-1/3 percent of the total sales price.	No change.
Threshold	There is a withholding requirement only if the total sales price exceeds $100,000.	No change.
Certifiable Exceptions – Individuals	There is no withholding requirement if an individual seller is: • A resident of California or • Selling a principal residence.	Individuals will no longer have an exemption for being a resident. However, individuals can be exempt from withholding if they certify that they are: • Selling the property for $100,000 or less, • Selling their principal residence, • Selling the property at a loss for California income tax purposes, • Selling the property as part of an Internal Revenue Code Section 1031 exchange, or • Selling the property because of an involuntary conversion and will replace the property within the provisions of Internal Revenue Code Section 1033.
Certifiable Exceptions – Non-individuals	There is no withholding requirement if a non-individual seller is: • A corporation with a permanent place of business in California, • A partnership or LLC, • A tax exempt entity, insurance company, IRA, or qualified pension plan, • An irrevocable trust with CA trustee, • An estate with CA decedent, or • A bank or bank acting as fiduciary for a trust.	No change.
Waivers & Reduced Withholding – Individuals	Individuals can request a waiver or reduced amount of withholding when there is little or no gain on the sale or the estimated California income tax is significantly less than the statutory withholding amount.	There is no waiver process for individuals. The full amount of withholding is required unless the sellers can certify that they meet one of the exceptions or the buyer agrees to withhold on each payment of an installment sale.
Waivers & Reduced Withholding – Non-individuals	Non-individuals can request a waiver or reduced amount of withholding when there is little or no gain on the sale or the estimated California income tax is significantly less than the statutory withholding amount.	No change.
Multiple Sellers	If there are multiple sellers only some of which are nonresident individuals or non-individuals, you must withhold on the total sales price even though the nonresidents only own a portion of the property. However, the nonresident individual or non-individual may request a reduced withholding amount.	• For individual sellers, withhold according to the seller's interest in the property. • For non-individual sellers, there is no change.
Loss on Sale – Individuals	Individuals can request a waiver if the sale will result in a loss.	There is no withholding on individual sellers if they can certify that the sale will result in a loss. The law no longer allows individuals to request a withholding waiver.

	Escrows Closing On or <u>Before</u> Dec. 31, 2002	Escrows Closing On or <u>After</u> January 1, 2003
Loss on Sale – Non-individuals	Non-individuals can request a waiver if the sale will result in a loss.	No change.
Small Gain – Individuals	Individuals can request a waiver or reduced amount of withholding if the gain on the sale will result in significantly less California income tax than the statutory withholding amount.	Full withholding is required unless the individual has a loss on the sale for California income tax purposes. The Franchise Tax Board cannot allow reduced withholding for individual sellers.
Small Gain – Non-individuals	Non-individuals can request a waiver or reduced amount of withholding if the gain on the sale will result in significantly less California income tax than the statutory withholding amount.	No change.
Exchanges	If the sale is part of an Internal Revenue Code Section 1031 exchange, the seller may request a waiver of withholding from the Franchise Tax Board. Any boot (cash or cash equivalent) received by the seller is subject to withholding.	• <u>Individuals</u> can certify that the sale is part of an Internal Revenue Code Section 1031 exchange and 1. If it is a simultaneous exchange, only the proceeds (boot) going to the seller will be withheld upon in escrow, or 2. If it is a deferred exchange, the proceeds will go to an intermediary who will withhold, if necessary. • <u>Non-individuals</u> must still request a waiver from FTB to eliminate or reduce withholding in escrow.
Due Dates	Withholding is due to the Franchise Tax Board by the 20th day of the month following the month escrow closes.	No change.
Forms	• **Form 597**, Nonresident Withholding Tax Statement for Real Estate Sales • **Form 597-E**, Nonresident Withholding Exchange Affidavit • **Form 597-I**, Nonresident Withholding Installment Sale Agreement • **Form 597-W**, Withholding Exemption Certificate and Nonresident Waiver Request for Real Estate Sales	• **Form 597, Real Estate Withholding Tax Statement** (Used to report withholding on all individuals and non-individuals.) • **Form 593-C, Real Estate Withholding Exemption Certificate for Individual Sellers** (Used by individual sellers when they can certify that they meet one of the exceptions.) • **Form 593-I, Real Estate Withholding Installment Sale Agreement** (Used by buyers when the seller is an individual and the buyer wants to withhold on each payment instead of withholding the full amount at the time of sale.) • **Form 593-L, Real Estate Withholding – Computation of Gain or Loss** (Used by individual sellers to compute the gain or loss on the sale.) • **Form 593-W, Real Estate Withholding Exemption Certificate and Waiver Request for Non-individual Sellers** (Used by non-individual sellers to certify that they meet one of the exceptions or to request a waiver or reduced amount of withholding when there will be little or no gain.) **Note: <u>Only</u> the 2002 revision of Form 597 and new Forms 593-C, 593-L, 593-I and 593-W can be used for sales closing on or after January 1, 2003. Forms 597-E, 597-I, and 597-W may not be used.**