

TITLE 18. FRANCHISE TAX BOARD

As required by section 11346.4 of the Government Code, this is notice that a public hearing has been scheduled to be held at 1:00 p.m., on April 4, 2013, at Franchise Tax Board, 9646 Butterfield Way, Town Center, Sacramento, California, to consider the following regulatory actions under Title 18 of the California Code of Regulations: a) adopt Regulation section 18662-0; b) amend Regulation sections 18662-1 through 18662-6; c) repeal existing Regulation section 18662-7 and reserve it for future use; d) repeal existing Regulation sections 18662-11 through 18662-14; and 3) amend and renumber Regulation section 25401b to Regulation section 19002 (Credit for Tax Withheld).

An employee of the Franchise Tax Board will conduct the hearing. Government Code section 15702, subdivision (b), provides for consideration by the three-member Franchise Tax Board of any proposed regulatory action, if any person makes such a request in writing. If a written request is received, the three-member Franchise Tax Board will consider the proposed regulatory action prior to adoption.

Interested persons are invited to present comments, written or oral, concerning the proposed regulatory action. It is requested, but not required, that persons who make oral comments at the hearing also submit a written copy of their comments at the hearing,

WRITTEN COMMENT PERIOD

Written comments will be accepted until 5:00 p.m., April 4, 2013. All relevant matters presented will be considered before the proposed regulatory action is taken. Comments should be submitted to the agency officer named below.

AUTHORITY AND REFERENCE

Revenue and Taxation Code (RTC) section 19503 authorizes the Franchise Tax Board to prescribe regulations necessary to implement, interpret and make specific Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), Part 10.7 (commencing with Section 21001) and Part 11 (commencing with Section 23001) of the RTC. Specifically, the authority for the proposed regulatory action to adopt Regulation section 18662-0, amend Regulation sections 18662-2 through 18662-6, repeal existing Regulation Section 18662-7 and to reserve it for future use, repeal existing Regulation sections 18662-11 through 18662-14, and amend and renumber Regulation section 25401b to section 19002 (Credit for Tax Withheld), is RTC section 19503. The reference for the proposed regulatory action stated above is RTC sections 18662, 18668, and 19002.

INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

The proposed adoption, amendment, and repeal of the above regulations will provide clear, comprehensive guidance to taxpayers, tax practitioners, withholding agents, and the public as to the requirements for withholding of tax at source relating to California source income. Withholding of tax at source (termed, "withhold at source" or "withholding at source") is an

essential part of Franchise Tax Board's Tax Gap compliance initiative. Withholding's "pay as you go" process helps taxpayers by ensuring that tax is collected as income is received. It helps the state by ensuring that tax is paid as it is incurred on specific transactions, encouraging taxpayers to file returns at the end of the year.

Current Regulation Sections 18662-1 through 18662-14, and Section 25401b

California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements (RTC section 18662, subdivision (a).) In 1971, RTC sections 18805 and 26131 (renumbered in 1993 to RTC section 18662) were enacted to require "any person" to withhold on payments of California source income to nonresidents. Thereafter, the withholding regulations under RTC sections 18805 and 26131 were renumbered to correspond to RTC section 18662.

While withholding regulations remain in effect (California Code of Regulations, Title 18, Regulation (CCR) sections 18662-1 through 18662-14), these regulations have not been updated in over 20 years. The current withholding regulations do not reflect the changes that have been made as a result of enactment of more recent withholding laws. For example, statutory changes such as the addition of real estate withholding, the adoption of an alternative real estate withholding election, the inclusion of nonresident partnership withholding, and the use of different types of business entities, especially pass-through entities, are not addressed in the regulations. The current regulations are also not organized in a useful framework, given the number of legislative amendments and new statutes that have been adopted since the current regulations went into effect, and given the new processes adopted by Franchise Tax Board staff.

The Proposed Regulatory Action: Adopt Section 18662-0; Amend Sections 18662-1 through 18662-6; Repeal Existing Section 18662-7 and Reserve It for Future Use; Repeal Existing Sections 18662-11 through 18662-14; and Amend and Renumber Section 25401b to Section 19002

This rulemaking is necessary because the current Franchise Tax Board withholding regulations are not well-suited to piecemeal amendment but instead require a complete reorganization and restructuring. The new withholding regulations are designed to provide guidance consistent with the current statutory framework, reflect Franchise Tax Board's current practices and procedures, and reflect changes determined to be necessary or desirable after consulting with taxpayers, tax practitioners, and other parties at the interested parties meeting held August 13, 2007 and July 14, 2011.

Beginning in 2008, Franchise Tax Board staff implemented a new quarterly withholding process, which changed due dates to report and remit withholding to match the estimated tax due date schedule, and required withholding agents to identify taxpayers for immediate posting of the credit to the taxpayers' accounts. In 2008 and 2009, the Legislature adopted amendments to the real estate withholding statute (Stats. 2008, ch. 305), changed the withholding requirements regarding real estate installment sales (Stats. 2008, ch. 305),

changed the maximum withholding rate (Stats. 2009 3rd Ex. Sess, ch.18), and enacted legislation dealing with modified backup withholding (Stats. 2009 4rd Ex. Sess, ch.18).

Since 2007, Franchise Tax Board staff has been working on the Withhold at Source System Project (WASS), a modernization project designed to integrate Franchise Tax Board withholding system into its other systems, implement greater security, and provide greater transparency for the taxpayer. For the past two years of its development, Franchise Tax Board staff has further refined the proposed regulations to ensure consistency with the new statutes, the WASS project forms and practices, and other departmental changes (such as electronic banking and file processing) into the withholding process.

The Franchise Tax Board proposes to adopt, amend, repeal, and/or renumber the current withholding regulations in order to comprehensively replace the existing procedural rules with improved regulations that consistently, clearly, and fully describe Franchise Tax Board's current withholding processes in a structurally integrated and logical framework. In this way, the Franchise Tax Board intends to provide additional clarity and transparency for taxpayers, tax practitioners, withholding agents, and the public. The new regulations also retain the flexibility to respond to individual circumstances and new or changed responsibilities.

The regulations are rewritten and reorganized into a simpler, more descriptive order. For example, the regulations contain a Table of Contents, definitions, and general rules applicable to all withholding at source. The regulations then provide specific guidance for major withholding areas that Franchise Tax Board administers (e.g., real estate withholding, nonresident withholding, nonresident independent contractors, entertainers, athletes, and pass-through entities), provide guidance on different types of California source income, set forth reporting and remitting obligations and penalties, and provide rules for the crediting of withheld amounts.

Below are general cross-references between the proposed regulatory section and the former section.

General Framework of Proposed Regulatory Action and Cross-References

Proposed	Proposed Action	New Content or Derived From Former Section(s)	General Topics of Proposed Section
18662-0	Adopt	New	Table of Contents
18661-1	Amend	18662-1 18662-2 18662-11 18662-13 25401b	General Application; areas not covered; notice to withhold; withholding on payments, reporting and remitting amounts, credit for tax withheld; notice to withhold; other conditions as may be required.

18662-2	Amend	18662-1 18662-2 18662-6 18662-11 18662-13	Definitions
18662-3	Amend	New	Real Estate Withholding, Rate, Alternative Election Method, Exclusions, Exemptions, Special Entities, Procedures
18662-4	Amend	18662-2 18662-3 18662-11 18662-12 18662-13	Withholding on Payments – General; Nonresident Persons and Non-California Business Entities, Rates, Optional Withholding, Withholding Exceptions, Persons and Entities Specifically Subject to Withholding, Exemption Certificates, Waivers, Filing Requirements
18662-5	Amend	18662-2 18662-3 18662-11 18662-12	Other Types of Payments and Withholding Obligations
18662-6	Amend	18662-2 18662-3 18662-11 18662-12	Nonresident Withholding, Entertainers, Athletes, and Speakers
18662-7	Repeal Text and Reserve Section		Nonresident Withholding – Domestic (U.S.) Pass-Through Entities
18662-8	Amend	18662-5 18662-6	Reporting and Remitting Amounts withheld; Penalties and Interest
19002	Amend/ Renumber	25401b 18662-5	Credit for Tax Withheld
18662-11	Repeal		Content incorporated into other sections.
18662-12	Repeal		Content incorporated into other sections.
18662-13	Repeal		Content incorporated into other sections.
18662-14	Repeal		Content not incorporated into other sections.

Content of Existing Regulations Not Incorporated Into the Proposed Regulations

The following sections have not been incorporated into the proposed regulations:

Section 18662-4. This section (Withholding of Delinquent Taxes Due) is now addressed under other sections. The proposed amendment to Regulation section 18662-4 will operate to delete the content of the existing section in its entirety.

Section 18662-7. The proposed repeal of this section will operate to delete the content of the existing section in its entirety. The section will be reserved for rules applicable to domestic (U.S.) pass-through entities.

Section 18662-8. This section (Time and Place for Filing Returns of Tax Withheld) is now replaced by FTB forms and procedures as addressed in these regulations. The proposed amendment to Regulation section 18662-8 will operate to delete the content of the existing section in its entirety.

Section 18662-14. This section (Interpleader Action by Withholding Agent) is repealed. The repeal of Regulation section 18662-14 will operate to delete the content of the existing section in its entirety.

IS THERE AN EXISTING, COMPARABLE FEDERAL STATUTE OR REGULATION

There is no existing, comparable federal statute or regulation.

ANTICIPATED BENEFITS FROM THE PROPOSED REGULATION

Statewide benefits are derived from the withholding statutes, not from the proposed regulations. However, nonmonetary benefits to taxpayers, tax practitioners, withholding agents, the public, and the state from the proposed regulations include the following:

- The proposed regulations revise outdated withholding regulations and bring the regulations up to current statutory laws and existing withholding procedures.
- The proposed regulations are intended to provide additional clarity and transparency for taxpayers, taxpayer practitioners, withholding agents, and the public.
- The new regulations retain the flexibility to respond to individual circumstances and new or changed responsibilities.
- The proposed regulations align with Franchise Tax Board's newly modernized WASS.

EVALUATION OF WHETHER THE PROPOSED REGULATION IS INCONSISTENT OR INCOMPATIBLE WITH EXISTING STATE REGULATIONS

California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements. (RTC section 18662, subdivision (a).) The proposed regulations revise outdated withholding regulations and bring the regulations up to current statutory laws and existing withholding procedures. The Franchise Tax Board has evaluated and determined that adoption of the proposed regulations is not inconsistent with

or incompatible with existing state regulations. There are no other comparable existing stage regulations.

IS THE PROPOSED REGULATION MANDATED BY FEDERAL STATUTE OR REGULATION?

The proposed regulation is not mandated by federal statute or regulation.

ARE THERE OTHER STATUTORY REQUIREMENTS IDENTIFIED IN THE NOTICE THAT ARE SPECIFIC TO THE AGENCY OR TYPE OF REGULATION?

There are no other statutory requirements identified in the notice.

MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

None.

COST TO ANY LOCAL AGENCY OR SCHOOL DISTRICT WHICH MUST BE REIMBURSED UNDER PART 7, COMMENCING WITH GOVERNMENT CODE SECTION 17500, OF DIVISION 4

None. There is no fiscal impact with the adoption of the proposed regulations. The proposed regulations revise outdated withholding regulations and bring the regulations up to current statutory laws and existing withholding procedures.

COST OR SAVINGS TO ANY STATE AGENCY

None. There is no fiscal impact with the adoption of the proposed regulations. The proposed regulations revise outdated withholding regulations and bring the regulations up to current statutory laws and existing withholding procedures.

OTHER NON-DISCRETIONARY COST OR SAVINGS IMPOSED UPON LOCAL AGENCIES

None.

COST OR SAVINGS IN FEDERAL FUNDING TO THE STATE

None.

SIGNIFICANT EFFECT ON HOUSING COSTS

None.

WHETHER THERE IS A SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS INCLUDING THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE WITH BUSINESSES IN OTHER STATES

The Franchise Tax Board has made an initial determination that the proposed regulations do not create a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.

WHAT ARE THE FACTS, EVIDENCE, AND DOCUMENTS ON WHICH THE AGENCY RELIES TO SUPPORT AN INITIAL DETERMINATION THAT THE ACTION WILL NOT HAVE A SIGNIFICANT ADVERSE ECONOMIC IMPACT ON BUSINESS, INCLUDING THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE WITH BUSINESSES IN OTHER STATES?

Franchise Tax Board staff has found no facts or evidence that the proposed regulations create a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states. The proposed regulations revise outdated regulations and bring the regulations up to current statutory laws and existing withholding procedures. Franchise Tax Board staff conducted two interested parties meetings and received detailed input from the public and interested parties, as detailed below. Staff received no comments from interested parties or the public that the proposed regulations create a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.

In 2007, Franchise Tax Board staff began its project to revise the outdated withholding regulations. Staff determined that the proposed regulations were outdated and sought public input to bring the regulations up to current withholding laws and Franchise Tax Board procedures. Through interested parties meetings, staff considered the below alternatives and/or mitigation measures.

On June 27, 2007, Franchise Tax Board staff received approval from the three-member Franchise Tax Board to proceed with the first interested parties meeting on the proposed amendments to the withholding regulations. Staff included the first draft of the proposed regulations in the Board materials. Staff explained that it was necessary to begin to revise and update the withholding regulations and to bring them into conformity with then-current law and current withholding practice, in anticipation of the Withholding at Source System modernization system to be implemented over the next four years.

The first interested parties meeting was held on August 13, 2007. The following documents were provided to the public in advance of the meeting: a topic list, an outline of the history of California withholding, the first draft of the proposed regulations, and draft forms and instructions for 2008. Franchise Tax Board staff also invited questions and comments on the draft regulations.

For the Board meeting of November 28, 2007, Franchise Tax Board staff requested permission to proceed with the formal regulatory process, which was granted. The following materials were provided in advance of the meeting: a report of the first interested parties meeting; staff responses to comments received from the public; and the second draft of the proposed regulations showing revisions made as a result of the interested parties meeting.

During 2008 through 2009, the Legislature enacted a number of new laws, which substantially changed the withholding requirements. Some of these laws related to real estate installment sales (Stats. 2008, ch. 305), real estate withholding (Stats. 2008, ch. 305), the maximum withholding rate (Stats. 2008 3rd Ex. Sess, ch.18), and backup

withholding (Stats. 2009 4th Ex.Sess, ch. 18). As a result of these new laws, Franchise Tax Board staff prepared a third draft of the proposed regulations.

On July 14, 2011, Franchise Tax Board staff held the second interested parties meeting to solicit input on the third draft of the proposed regulations. Several documents were provided to the public in advance of the meeting: discussion topics; an overview of the purpose and scope of the regulations; revisions since 2007; a cross-reference chart of proposed regulations to existing regulations; and the third draft of the proposed regulations. Staff discussed that it planned to repeal the existing Regulation section 18662-7 and reserve this section for a future interested parties meeting relating to domestic (U.S.) pass-through entities as a separate regulatory action. Staff received comments and encouraged the submission of additional comments for an additional month, through August 12, 2011.

For the Board meeting of December 1, 2011, Franchise Tax Board staff requested permission to proceed with the formal regulatory process, which was granted. The following materials were provided in advance of the meeting: a report of the second interested parties meeting; a detailed response to the comments received and revisions implemented by staff as a result of public comments; and the fourth draft of the proposed regulations showing revisions made as a result of the interested parties meeting.

As a result of the above, in accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board has determined that no alternative considered by it would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons and businesses than the proposed regulatory action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS

Pursuant to Government Code Section 11346.3, subdivision (b), the results of the Economic Impact Analysis are shown below.

1. Impact on business and individuals: See Item 2 below.
2. Total number of businesses impacted:

The types of businesses impacted are those businesses and individuals that are required to act as withholding agents in compliance with California's withholding at source laws.

The Franchise Tax Board estimates that approximately 105,000 businesses will be impacted by the proposed regulations. Of this amount, it is anticipated that approximately ninety percent (90%) of such businesses are small businesses. In addition, the proposed regulations address the process by which withholding credits are claimed by businesses and individuals on tax returns. Since the proposed regulations are revised to comply with current statutory withholding laws and existing withholding procedures, the Franchise Tax Board has concluded that there is no economic impact on businesses and individuals as a result of the adoption of the proposed regulations.

3. Number of businesses created or eliminated:

None. Since the proposed regulations are revised to comply with current statutory laws and existing withholding procedures, the Franchise Tax Board has concluded that no business will be created or eliminated as a result of the adoption of the proposed regulations.

4. Geographic extent of impacts:

Statewide. See Item 2 above.

5. Number of jobs created or eliminated:

Since the proposed regulations are revised to comply with current statutory laws and existing withholding procedures, Franchise Tax Board has concluded that no new jobs will be created or eliminated as a result of the adoption of the proposed regulations.

Will the regulation affect the ability of California business to compete with other states by making it more costly to produce goods or services here?

No. See the above topic heading, "What Are The Facts, Evidence, And Documents On Which The Agency Relies To Support An Initial Determination That The Action Will Not Have Create A Significant Statewide Adverse Economic Impact On Businesses, Including the Ability of California Businesses to Compete with Businesses in Other States?"

SECTION B. ESTIMATED COSTS TO BUSINESSES AND INDIVIDUALS

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime?

None. The proposed regulations revise outdated withholding regulations. There is no economic impact on businesses or individuals as the proposed regulations conform to current statutory laws and existing withholding procedures. In fact, the regulations as proposed reduce the burden on businesses by providing a more organized and up-to-date source of information.

2 . Multiple Industries Impacted: There is no economic impact on businesses as the proposed regulations conform to current statutory withholding laws and existing withholding procedures.

3. Reporting requirements :

Since the proposed regulations are revised to comply with current statutory laws and existing withholding procedures, a typical business will incur no additional costs in compliance with the proposed regulations.

4. Direct Impact to housing costs:

None.

5. Existence or absence of state or federal regulations:

There are no comparable federal regulations. California law requires the Franchise Tax Board to issue regulations to implement the withholding at source statutory requirements. (RTC section 18662, subdivision (a).) The proposed regulations revise outdated California withholding regulations and bring the regulations up to current statutory laws and existing withholding procedures.

SECTION C. ESTIMATED BENEFITS

I-3. What are the total statewide benefits from this regulation over its lifetime?

None. Statewide benefits are derived from the withholding statutes, not from the regulations. See the nonmonetary benefits under the above topic heading, “Anticipated Benefits from the Proposed Regulation.”

SECTION D. ALTERNATIVES TO THE REGULATION

1. List Alternatives. See the above topic heading, “What Are The Facts, Evidence, And Documents On Which The Agency Relies To Support An Initial Determination That The Action Will Not Have A Significant Adverse Economic Impact On Business, including the Ability of California Businesses to Compete with Businesses in Other States.”

2. List total statewide costs and benefits.

For statewide costs, see Item 1 in Section B. For statewide benefits, see Items 1-3 above in Section C.

3. Quantification of costs and benefits for the regulation or alternatives.

See Item 1 in Section D above.

4. Mandated Technologies.

The proposed regulations do not mandate any specific technologies or equipment.

COST IMPACTS ON REPRESENTATIVE PRIVATE PERSONS OR BUSINESSES

The types of businesses impacted are those businesses and individuals that are required to act as withholding agents in compliance with California’s withholding at source laws. The Franchise Tax Board estimates that approximately 105,000 businesses will be impacted by the proposed regulations. Of this amount, it is anticipated that approximately ninety percent (90%) of such businesses are small businesses. In addition, the proposed regulations address the process by which withholding credits are claimed by businesses and

individuals on tax returns. Since the proposed regulations are revised to comply with current statutory withholding laws and existing withholding procedures, the Franchise Tax Board has concluded that there is no economic impact on businesses and individuals as a result of the adoption of the proposed regulations.

The Franchise Tax Board is not aware of any additional cost impacts that a business or representative private person would necessarily incur in reasonable compliance with the proposed regulation.

REPORTING REQUIREMENTS IMPOSED BY THE REGULATION

Since the proposed regulations are revised to comply with current statutory laws and existing withholding procedures, a typical business will incur no additional costs in compliance with the proposed regulations. .

EFFECT ON SMALL BUSINESS:

See the above topic heading, “Cost Impacts on Representative Private Persons or Businesses.”

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Franchise Tax Board must determine that no reasonable alternative considered by it or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed regulatory action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Franchise Tax Board has prepared an initial statement of the reasons for the proposed regulatory action. The express terms of the proposed regulatory action, the initial statement of the reasons for the regulatory action, and all the information upon which the proposed regulatory action is based, are available upon request from the agency officer named below. When the final statement of reasons is available, it can be obtained by contacting the agency officer named below, or by accessing the Franchise Tax Board’s website at www.ftb.ca.gov.

CHANGE OR MODIFICATION OF ACTIONS

The proposed regulation may also be adopted with modifications if the changes are nonsubstantive or the resulting regulations are sufficiently related to the text made available to the public so that the public was adequately placed on notice that the regulations as modified could result from that originally proposed. The text of the regulation as modified will be made available to the public at least 15 days prior to the date on which the

regulations is adopted. Requests for copies of any modified regulation should be sent to the attention of the agency officer named below.

ADDITIONAL COMMENTS

If you plan to attend or make an oral presentation at the regulation hearing, please contact the agency officer named below. The hearing room will be accessible to persons with physical disabilities. Any person needing a language interpreter, including sign language, should contact the agency officer named below at least two weeks prior to any scheduled hearing so that the services of an interpreter can be arranged.

CONTACT

All inquiries concerning this notice or any request for a public hearing should be directed to Colleen Berwick at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Tel.: (916) 845-3306 Fax: (916) 845-3648; E-Mail: Colleen.Berwick@ftb.ca.gov. In addition, all questions on the substance of the adoption, revision, and/or repeal of the existing regulations, as outlined above, should be directed to Kenneth A. Davis, Tax Counsel III, Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720; Tel.: (916) 845-3839; Fax: (916) 843-6146; E-Mail: Kenneth.Davis@ftb.ca.gov. The notice, initial statement of reasons and express terms of the regulation are also available at the Franchise Tax Board's website at www.ftb.ca.gov.