

## **WEBINAR SCRIPT WITHHOLDING ON CALIFORNIA REAL ESTATE INSTALLMENT SALES**

### **Slide 1**

Good morning and welcome to the Franchise Tax Board's Withholding on California Real Estate Installment Sales webinar. My name is Sonia Caramazza and I will be your presenter today. We also have, Linda Castles as our subject matter expert. Throughout the webinar, be sure to type in any questions you have and Linda will be available to answer them at the end.

We designed this presentation to provide an overview of California's real estate withholding installment sale process. At the end of this presentation we will take questions and provide our contact information.

### **Slide 2**

In today's webinar we will cover:

- Real estate withholding requirements
- The definition of an installment sale
- How to calculate the withholding on installment payments during and after escrow
- How to complete installment sale withholding forms, and
- How to elect-out of withholding on payments following the close of escrow, and
- Resources and contact information

### **Slide 3**

Before we discuss the specifics of an installment sale we want to review the real estate withholding basics.

We require withholding on any sale or transfer of California real estate unless a withholding exemption applies.

Withholding is not required if the:

- Total sales price is \$100,000 or less
- Seller is a bank acting as a fiduciary for a trust
- Property is being foreclosed, or
- Seller meets a full exemption on a certified FTB Form 593-C

### **Slide 4**

The real estate escrow person or REEP is required to give the buyer written notification of the withholding requirement and it is the buyers' responsibility to withhold on the seller during escrow. However, withholding may be performed by the real estate escrow person on the buyer's behalf.

Throughout the rest of this presentation we will refer to the real estate escrow person as the REEP.

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Now that we have reviewed the basics of real estate withholding, let's look at an installment sale transaction.

- An installment sale is defined by the Internal Revenue Service (IRS) as: a sale of property where at least one payment is received AFTER the tax year in which the sale occurred.

An installment sale is often referred to as a "seller carry back" or "seller take back" during escrow.

One way to identify an installment sale transaction is by the presence of a promissory note which outlines the payment terms. Using the promissory note you can determine if a payment will be received in a tax year other than the year of the sale. This information will allow you to determine if the transaction meets the definition of an installment sale.

If the sale qualifies as an installment sale, the seller may have a partial or full exemption from withholding at the close of escrow.

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Now let's take a look at some scenarios.

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In our first scenario, we will review the facts to determine if the transaction is an installment sale and if withholding is required.

321 Escrow Company closed escrow on January 15, 2015 for Jane Smith, the buyer. Jane Smith will make all the installment payments to John Doe, the seller, by the end of 2015, as agreed per the promissory note.

So first we need to determine is this an installment sale?

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No, this does not meet the definition of an installment sale because all payments will be made in 2015, the tax year of the sale.

Next question, is withholding required?

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Yes, withholding is required on the total sales price, unless the seller qualifies for a full exemption on Form 593-C.

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Now let's take a look at a second scenario. Again, we want to review the facts to determine if the transaction qualifies as an installment sale and if withholding is required.

321 Escrow Company closed escrow on July 1, 2015 for Steve Jones, the buyer. The sale price was \$1.5 million and there is a seller take back of \$1 million. 321 Escrow Company will handle the first installment payment during escrow. The first installment payment is often referred to as the down payment during escrow. Steve Jones, the buyer will make all the subsequent installment payments to Veronica Lee, the seller, as agreed per the promissory note by the end of 2025.

Again, the first question that should be asked, is this an installment sale?

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In this scenario the answer is yes, the transaction meets the definition of an installment sale because there will be payments made after the tax year in which the transaction closed.

Next question, is withholding required?

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Yes, withholding is required unless the seller qualifies for a full exemption on Form 593-C. 321 Escrow Company will withhold 3 1/3 percent on the first installment payment during escrow. After the close of escrow, Steve Jones will withhold on the principal portion of all installment payments to the seller until the promissory note is paid in full.

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No let's look at how to calculate the amount of the first installment payment or down payment during escrow for scenario 2:

The total sales price in this scenario is \$1.5 million. Subtract from that the amount specified in the promissory note, \$1,000,000. The amount remaining is \$500,000. This is the amount of the first installment payment.

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Now let's look at how to calculate the withholding required during escrow on the first installment payment of \$500,000. There are two withholding calculation methods that can be used, the total sales price method, and the alternate withholding calculation method which is also referred to as the optional gain on sale.

In this scenario we will assume the seller has elected to use the total sales price method. Using the total sales price method, multiply the first installment payment of \$500,000 by 3 1/3 percent or .0333. This results in a withholding amount due of \$16,650.

\*Please note that title and escrow persons, and exchange accommodators are not authorized to provide legal or accounting advice for purposes of deciding which withholding calculation method to use or determining withholding amounts. Sellers are strongly encouraged to consult with a competent tax professional for this purpose.

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Now let's look at how to remit the withholding to FTB. Remember, it is the buyer's responsibility to withhold but the REEP may assist the buyer. The REEP may charge a fee for this assistance, not to exceed \$45 per escrow.

Once the withholding has been done, the buyer or the REEP will remit the amount withheld by the 20<sup>th</sup> day of the month following the month escrow closes along with the following completed forms:

- FTB Form 593
- FTB Form 593-I
- FTB Form 593-V, and a
- Copy of the Promissory Note

The REEP must retain all completed withholding forms for 5 years following the close of escrow.

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Following the close of escrow, the buyer is responsible for withholding on the principal portion of each installment payment sent to the seller. To calculate the withholding, the buyer will take 3 1/3 percent of the principal portion of each installment payment, in this example, \$10,000. This results in a withholding amount due of \$333.

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The withholding of \$333 must be mailed to FTB by the 20<sup>th</sup> day of the month following the month of the installment payment along with:

- FTB Form 593 and
- FTB Form 593-V

The buyer must send the remaining payment, in this example \$9,667 plus any interest to the seller.

The buyer must also send the seller a completed copy of the FTB Form 593 by the 20<sup>th</sup> day of the month following the month of the installment payment.

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Now let's take a look at how to complete the withholding forms needed for the first installment payment during escrow. Remember the tax year on all of the withholding forms must match the tax year of the first installment payment.

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Let's look at Scenario #2 again. In this scenario, 321 Escrow Company closed escrow on July 1, 2015 for Steve Jones, the buyer. The sale price was \$1.5 million and a seller take back of \$1 million. The escrow company will handle the first installment payment during escrow and the buyer will make all the subsequent installment payments to Veronica Lee, the seller, as agreed per the promissory note.

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First let's complete FTB Form 593, Real Estate Withholding Tax Statement. As you can see we are using a 2015 form. The tax year on the form must match the tax year in which the transaction happened. In our scenario escrow closed on July 1<sup>st</sup>, 2015 so we are using a 2015 form. In Part one, the withholding agent section, enter the REEP name, identification number, and address because the REEP completed the withholding on the buyers behalf.

In Part two, seller or transferor, enter the name, identification number, and address of the seller, Veronica Lee. At the bottom of part two enter the address or parcel number and county of the property being sold.

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Now let's fill out items 1-5 in Part three escrow or exchange information. In number 1 enter the escrow number. Number 2 is the date of the installment payment. Enter July 1, 2015 from our scenario. In number 3 we need to check the appropriate box for our transaction type, for this scenario we will check installment sale payment. In number 4, withholding calculation, we will check box A, total sales price method. Lastly, in number 5, enter the total amount withheld \$16,650.

Next is the seller or transferor signature box. The seller is only required to sign and date the form under penalty of perjury when the optional gain on sale is elected.

The preparer name and phone number should also be entered in this section.

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Next let's complete the FTB Form 593-V, Payment Voucher for Real Estate Withholding. Again we will use a 2015 form because escrow closed in 2015. Complete the payment voucher using the REEP name, identification number, address, and phone number, exactly as given on the 593. In the amount of payment section, we enter the amount withheld, \$16,650.

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Moving on to the 2015 FTB Form 593-I, Real Estate Withholding Installment Sale Acknowledgement. Part one is the buyer's information. As you can see we have entered Steven Jones, his social security number, address, and phone number. Part two is the seller or transferor information. We have entered Veronica Lee, her social security number and her address. Like Form 593, we have entered the address of the property being sold at the bottom of part two.

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In Part three, we need to enter the installment agreement terms. First we enter \$1 million, the principal amount of the note, then \$10,000, the installment amount; next we enter 3% which is the interest rate, and lastly, 100, the number of months in the repayment period.

In Part four, the buyer must sign and date the form to acknowledge the withholding obligation.

It is important to note here that the Form 593, Form 593-V, and Form 593-I must all be submitted to FTB to avoid processing delays and ensure proper and timely allocation of the withholding credit to the seller. It is also important to remember that the buyer must retain a copy of the 593-I so they have the information needed to perform withholding on subsequent withholding payments.

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The last form we will complete today is the 2015 FTB Form 593-C, Real Estate Withholding Certificate.

In Part one we will enter the seller or transferor information. In this scenario that is Veronica Lee. As you see we entered her name, social security number, and address. We have also entered the property address as well as her ownership percentage, 100%, in this section.

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Since we are completing Form 593-C for an installment sale we will move down to Part three, certifications that may partially or fully exempt the sale from withholding and check box 12.

Finally the seller must sign and date the form under penalty of perjury. A 593-C is void and should not be accepted by the REEP if there is no tax identification number or signature.

The seller must provide the 593-C to the REEP before the close of escrow and the REEP must retain the form for 5 years.

We have now completed all of the necessary forms to remit withholding on the first installment payment or down payment during escrow. Remember the buyer is responsible for submitting the withholding on the principal portion of all subsequent installment payments. The form 593 and form 593-V are completed following the same instructions we just demonstrated.

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Sellers DO have an option to elect out of the installment sale withholding after the close of escrow. If the seller files a California tax return and reports the entire gain in the year of the sale they can submit a written request to us to release the buyer from the withholding on the installment sale payments.

The seller will receive a written approval or denial from us in 30 days. The buyer must continue to withhold on all installment payments until they receive notice of the approval.

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Now lets' go over how you can contact us.

For more information please visit our Real Estate Installment Sales Webpage. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for “**installment sales**”.

You can also email us questions. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov), select “**Contact Us**”, and select “**Withholding**” under “**Contact Information**”

Or you call us Monday through Friday from 8 am to 5 pm toll free at **888.792.4900** or **916.845.4900**.

That concludes our webinar on real estate installment sales, how to calculate the withholding, and how to complete the necessary withholding forms. We hope that the information provided today will be helpful when withholding on future installment sales.

We will now take any questions you have related to withholding on installment sales.

(After Q&A session)

We have now completed the question portion of the webinar. A copy of today's PowerPoint and text, along with the webinar recording will be available on our website soon.

On behalf of the Franchise Tax Board, thank you for joining us today and have a great rest of your day!