

California Real Estate Withholding

Information for Sellers and Buyers

(For Sales Closing in 2007)

Who should read this information?

If you are buying or selling California real property, you should read this information.

What is real estate withholding?

Real estate withholding is a prepayment of California state income tax for sellers of California real property (similar to wage withholding).

Are there changes in the real estate withholding laws for January 1, 2007?

Yes. There have been a number of changes. Please see form FTB 677A, *Changes to California Real Estate Withholding Law for 2007*, AB 2962.

When is withholding required?

Withholding is required on all transfers of real property unless:

- The total sales price does not exceed \$100,000.
- The property is being foreclosed upon.
- The seller is a bank acting as a trustee other than a trustee of a deed of trust.
- The seller qualifies for one of the exemptions discussed in this publication.

What is the withholding rate?

The withholding rate is $3\frac{1}{3}$ percent of the total sale price, unless an election is made to withhold on the gain on sale, where you would apply the following rates: 9.3 percent individuals, 8.84 percent corporations, 10.84 percent banks and financial corporations, 1.5 percent S corporations, or 3.5 percent financial S corporations.

The following examples are based on the following facts:

a) total sale price is \$500,000; b) the property basis is \$400,000; c) the gain on sale is \$100,000; and d) the seller is an individual and therefore the maximum tax rate is 9.3 percent. The following illustrates the two withholding methods:

1. Applying the total sale price method
2. Applying the alternative withholding amount method

	1	2
Total sale price	\$500,000	\$500,000
Less basis		(400,000)
Gain on sale		\$100,000
Withholding rate	x $3\frac{1}{3}\%$	x 9.3%
Withholding amount	\$16,650	\$9,300

How do I make the election to withhold on the gain?

The seller is to elect and certify in writing under penalty of perjury the alternative withholding amount based on applying the maximum tax rate for individuals (without 1 percent surtax), corporations, banks and financial corporations, S corporations, or financial S corporations

to the gain on sale of the property. Our withholding form FTB 593-B, *Real Estate Withholding Tax Statement*, will provide the certification.

How do I calculate my gain?

Franchise Tax Board (FTB) will provide an electronic form to assist you in computing your gain on its Website at www.ftb.ca.gov.

Is withholding required if there is not enough cash?

Yes. The parties must arrange to pay the withholding unless the seller qualifies for an exemption.

Who must withhold?

The law requires the buyer to withhold when the real estate escrow person has properly notified the buyer of the withholding requirements. However, the real estate escrow person has the responsibility for withholding, sending payment to FTB, or documenting why no withholding was done. If the buyer has been notified of the withholding requirements, the buyer is liable for any penalty for failing to withhold.

What is the penalty for not withholding?

The penalty for not withholding is the greater of \$500 or 10 percent of the required withholding amount.

What are the exemptions for real estate withholding?

The seller may be exempt from withholding if:

- The property qualifies as the seller's principal residence under Internal Revenue Code (IRC) Section 121. Generally, a home will qualify as a principal residence if, during the five-year period ending on the date of sale, the sellers owned and lived in the property as their main home for at least two years. There may be other restrictions, limitations, or exceptions for special circumstances. For more information, get IRS Publication 523, *Selling Your Home*, at www.irs.gov or contact the IRS toll-free at (800) 829-3676.
- The property was last used by the sellers as their principal residence under IRC Section 121, even if the seller did not meet the two out of the last five years requirement or one of the special circumstances.
- The seller will incur a loss or zero gain on the sale for California income tax purposes. The seller must complete Form 593-E, *Real Estate Withholding – Computation of Estimated Gain or Loss*.
- The property is being involuntarily converted and will qualify for non-recognition of gain for California income tax purposes under IRC Section 1033.
- The seller is transferring the property to the seller's corporation or partnership and the transfer will qualify for non-recognition under IRC Section 351 or 721.

- The seller is a corporation (or an LLC classified as a corporation for federal and California income tax purposes) that is either qualified through the California Secretary of State or has a permanent place of business in California.
- The seller is a partnership (or an LLC that is not a disregarded single member LLC and is classified as a partnership for federal and California income tax purposes) with recorded title to the property in the name of the partnership or LLC.
- The seller is a tax-exempt entity under either California or federal law.
- The seller is an insurance company, individual retirement account, qualified pension/profit sharing plan, or charitable remainder trust.

Withholding may also be reduced or deferred when:

- The sale qualifies as an IRC Section 1031 exchange. However, withholding will be required on any cash or cash equivalent the seller receives unless the cash or cash equivalent does not exceed \$1,500.
- The sale is an installment sale and the buyer agrees in writing to withhold on the down payment, each principal payment, and any balloon payment. The buyer must complete Form 593-I, *Real Estate Withholding Installment Sale Agreement*.

How can the seller claim an exemption?

Sellers must complete Form 593-C, *Real Estate Withholding Certificate*, and give it to their real estate escrow person before the close of escrow to claim an exemption. However, sellers should give the completed Form 593-C to their real estate escrow person as soon as possible to avoid delaying close of escrow. As with all tax documents, sellers are required to provide their social security numbers and sign under penalty of perjury that they meet the exemption. The Form 593-C/593-E Booklet will be available effective January 1, 2007 from your real estate escrow person or on the FTB Website at www.ftb.ca.gov.

What is the penalty when a seller falsely claims an exemption?

The penalty is the greater of \$1,000 or 20 percent of the required withholding amount.

If the seller is withheld upon, how does the seller get the withholding back?

When escrow closes, the real estate escrow person will give the seller a completed Form 593-B, *Real Estate Withholding Tax Statement*, showing the withholding. To claim the credit, the seller must file a California income tax or franchise tax return at the end of the year and attach the completed Form 593-B to the lower-front portion of the return. If withholding exceeds the seller's actual tax liability, the state will refund the overpayment. If the withholding is less than the actual tax liability, additional tax will be due.

Does my real estate agent have any responsibilities for withholding?

No. Real estate agents have no responsibilities regarding withholding. If you want advice concerning real estate withholding or your specific tax situation, you should seek professional advice and counsel from an accountant, tax specialist, or an attorney.

Does my real estate escrow person have any responsibilities for withholding?

Real estate escrow persons are required to notify buyers in writing of the withholding requirements. Generally, the buyer will have the real estate escrow person assume responsibility for withholding as part of the escrow procedures.

Note: The real estate escrow person's notification to the buyer was amended to include language regarding the alternative withholding amount. Real estate escrow persons are not authorized to provide legal or accounting advice for the purposes of determining the withholding amounts, and that competent tax professionals should be consulted.

How do I get more information about real estate withholding?

FTB's Website, forms, and publications will incorporate the new changes to the withholding laws, effective January 1, 2007.

Visit the FTB Website at www.ftb.ca.gov to find answers to frequently asked questions, updates, the Form 593-C/593-E Booklet and the FTB Publication 1016 – *Real Estate Withholding Guidelines*. You may also contact the Withholding Services and Compliance Section at the FTB. See the contact information below.

Contact Information

Office Hours: 8:00 – 5:00, Monday through Friday
 Toll-Free Call: (888) 792-4900
 Local or International: (916) 845-4900
 TTY/TDD for hearing impaired: (800) 822-6268
 Website: www.ftb.ca.gov

Assistance for Persons with Disabilities

We comply with the Americans with Disabilities Act. Persons with hearing or speech impairments please call:
 TTY/TDD (800) 822-6268

Dentro de los Estados Unidos,
 llame al (800) 852-5711
 Fuera de los Estados Unidos,
 llame al (cargos aplican) (916) 845-6500

Asistencia para personas discapacitadas. Nosotros estamos en conformidad con el Acta de Americanos Discapacitados.

Personas con problemas auditivos pueden llamar al TTY/TDD (800) 822-6268

Sitio en el Internet: www.ftb.ca.gov

This information is only valid for sales closing in 2007.

Changes to California Real Estate Withholding Law for 2007

- AB 2962 -

Assembly Bill 2962 amends R&TC Sections 18662 and 18668 making changes to real estate withholding requirements for all transactions closing on or after January 1, 2007. The main changes are:

- A seller of California real estate may elect an alternative withholding amount by applying the maximum tax rate for individuals, corporations, banks and financials, S corporations, and financial S corporations on the gain on sale.
- If the seller makes this election, the seller certifies the alternative withholding amount in writing under penalty of perjury.
- Franchise Tax Board (FTB) will provide an electronic form on its Website at www.ftb.ca.gov, to assist sellers in calculating the amount of gain and the alternative withholding amount.
- The escrow officer's notification to the buyer will include language regarding the alternative withholding amount.
- FTB forms for calculating and electing the alternative withholding amount will state that title and escrow persons are not authorized to provide legal or accounting advice for the purposes of determining the withholding amounts, and that competent tax professionals should be consulted.

Comparison of the real estate withholding requirements before and after AB 2962 changed the requirements:

	Escrows Closing prior to January 1, 2007	Escrows Closing on or after January 1, 2007
Seller Subject to Withholding	Sales by individuals and non-individuals must be withheld upon unless the seller meets one of the certifiable exemptions (for non-individuals a California street address is no longer a general reason for not withholding).	Prior requirements apply. In addition, individuals and non-individuals may elect and certify an alternative withholding amount based on applying the applicable maximum tax rate to the gain on sale.
Withholding Rate	The withholding rate is 3 $\frac{1}{3}$ % of the total sales price.	Withhold at 3 $\frac{1}{3}$ % of sale price or make an election to withhold on gain on sale as follows: 9.3% individuals, 8.84% corporations, 10.84% bank and financials, 1.5% S corporations, or 3.5% financial S corporations.
Forms	593, 593-B, 593-C, 593-I, and 593-L	593, 593-B, 593-C, 593-E, and 593-I
Threshold	Withholding is required only if the total sales price exceeds \$100,000.	No change.
Small Gain	Withholding is required unless there is a loss on the sale for California income tax purposes. Sellers cannot request a waiver or a reduced withholding rate based upon a small gain.	FTB will provide an electronic form on its Website to assist sellers in calculating the amount of gain and the alternative withholding amount.
Multiple Sellers	Withhold according to the seller's interest in the property of the total sale price.	Withhold at 3 $\frac{1}{3}$ % of sale price or make an election to withhold on gain on sale as follows: 9.3% individuals, 8.84% corporations, 10.84% banks and financials, 1.5% S corporations, or 3.5% financial S corporations.
Exchange	Individuals and non-individuals can certify, under penalty of perjury, the transfer is part of an IRC Section 1031 exchange.	No change.