STATE OF CALIFORNIA — DEPARTMENT OF FINANCE

MAJOR REGULATIONS STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

DF-131 (NEW 11/13)

STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

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1. Statement of the need for the proposed major regulation.

California Revenue and Taxation Code (RTC) section 18662 sets forth the general withholding requirement structure for nonresident and real estate withholding. RTC section 18662, at subdivision (a), provides that the FTB may issue regulations to implement the withholding at source statutory requirements. California Code of Regulations, title 18 (18 CCR), sections 18662-0 through 18662-6 and 18662-8 (Regulations) detail the specific regulations with respect to California's nonresident and real estate withholding procedures.

The proposed adoption of 18 CCR section 18662-7, (Proposed Regulation) would provide specific and clear guidance with respect to domestic pass-through entity withholding. The Proposed Regulation is necessary to provide the public with clear requirements on how domestic pass-through entities with California source income remit and report withholding. This is necessary to increase withholding filing compliance and ease FTB's burden in administration of allocating withholding paid through a tiered pass-through entity structure. The Proposed Regulation also is necessary to update domestic pass-through entity withholding to be more consistent with the language of RTC section 18662 and the taxation of pass-through entities under the Internal Revenue Code (IRC), which California generally conforms to under RTC section 17851. Finally, the Proposed Regulation is necessary to provide penalty relief to upper tier pass-through entities in a tiered pass-through entity structure when an upper tier pass-through entity certifies that it is filing Form 592-PTE within 30 days of receiving Form 592-B from a lower tier pass-through entity.

The proposed amendments to the Regulations (Proposed Amendments to the Regulations) include language from the Proposed Regulation relating to domestic pass-through entity withholding to ensure consistency across all the Regulations, revise the regulatory language to reflect federal language for federal foreign partner withholding to which California generally conforms to under RTC section 18666, and clarify withholding rules relating to trusts and estates, among other changes. The Proposed Amendments to the Regulations are necessary to ensure the Regulations are consistent and operate together, to ensure the Regulations are consistent with federal language, and to mitigate taxpayer confusion.

2. The categories of individuals and business enterprises who will be impacted by the proposed major regulation and the amount of the economic impact on each such category.

The taxpayers affected by the Proposed Regulation and Proposed Amendments to the Regulations are domestic nonresidents with distributive share of income from a pass-through entity with California source income. The withholding required by the Proposed Regulation and Proposed Amendments to the Regulations would only be paid by businesses with nonresident owners. Two types of Personal Income Taxpayers (PIT) and Corporate taxpayers will experience impacts over any 12-month measurement period: taxpayers who file returns by the extended return due date; and taxpayers who do not file tax returns. The total output generated would be between $149 million and $224 million in the first year of implementation.

3. Description of all costs and all benefits due to the proposed regulatory change (calculated on an annual basis from estimated date of filing with the Secretary of State through 12 months after the estimated date the proposed major regulation will be fully implemented as estimated by the agency).

The FTB expects that the Proposed Regulation and Proposed Amendments to the Regulations would be fully implemented in the first 12-month period after the first full quarter in which the regulation will be in effect, and that there will be an increase in tax payments to the state. The withholding required by the Proposed Regulation and Proposed Amendments to the Regulations would only be paid by pass-through entities with California source income that have a nonresident owner, so there would be no direct impact on California businesses owned by residents. Helping pass-through entities with California source income and nonresident owners to become more tax compliant would level the competitive playing field for in-state business and may provide some indirect benefits for California businesses owned by residents. Any resulting economic impacts are likely to be minor. The impact on the domestic nonresident owner would be limited to the tax paid on the nonresident owner's distributive share of the pass-through entity's California source income. The initial increase in cash-flow would range from approximately $96 million to $145 million in the first full year of implementation.

4. Description of the 12-month period in which the agency estimates the economic impact of the proposed major regulation will exceed $50 million.

The FTB expects that the Proposed Regulation and Proposed Amendments to the Regulations would be fully implemented in the first 12-month period after the first full quarter in which the regulation will be in effect. The estimated increase in tax payments of between $70 million and $105 million to the state resulting in an economic impact of between $149 million $224 million exceeds the minimum threshold for a major regulation in this first year.

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5. Description of the agency's baseline:

The Proposed Regulation and Proposed Amendments to the Regulations provide regulatory guidance on domestic pass-through entity withholding and addresses taxpayer issues raised about late filing penalties. The baseline assumption is that, absent the Proposed Regulation and Proposed Amendments to the Regulations, withholding amounts would continue to be inconsistent under the law, and California policy would differ with policies in other jurisdictions. Under the baseline, taxpayers will continue to be subject to late filing penalties that are often viewed as unfair.

6. For each alternative that the agency considered (including those provided by the public or another governmental agency), please describe:

a. All costs and all benefits of the alternative
b. The reason for rejecting alternative

The FTB analyzed the impacts of two regulatory alternatives:
1) The FTB examined the option of requiring an upper-tier pass-through entity with a nonresident individual owner to withhold tax on the distributive share of the pass-through entity's California source income, rather than the current requirement of lower tier pass-through entity withholding tax on behalf of an upper tier pass-through entity.
Benefits: There is no benefit to the state. It would potentially ease workload for the lower-tier pass-through entities which would not have to track withholding payments made on behalf of their upper-tier pass-through entity payee.
Costs: There would be an increase in administrative costs in determining which upper-tier pass-through entities have California source income and a nonresident individual owner.
This alternative was rejected because placing the withholding responsibility on the upper-tier pass-through entity that is a non-California business entity with a nonresident individual owner would result in a negation of the effort by the FTB to improve administrative efficiency and reduce the number of nonfilers.

2) The FTB examined the option of no longer requiring withholding on distributions paid to nonresident owners of tiered pass-through entity structures.
Benefits: There is no benefit to the state from this alternative other than a potential decrease in workload. It would decrease workload for the pass-through entity which would not have to pay withholding, track withholding payments, or file withholding returns. Nonresident filers would likely have less incentive to file California income tax returns without an incentive to claim withholding paid on their behalf, which may decrease payment tracking and filing burden on such nonresidents.
Costs: Currently, because there is a requirement to withhold and file a withholding form for distributions paid to nonresident owners of a pass-through entity, the FTB estimates that slightly over $800 million in PIT and corporation withholding was collected from nonresident partners or members during calendar year 2020. The alternative regulation would result in a loss of these prepayments to the FTB from nonresident pass-through entity owners.
This alternative was rejected because removing withholding for this population would increase the likelihood of filing noncompliance

7. A description of the methods by which the agency sought public input. (Please include documentation of that public outreach).

FTB held a first Interested Parties Meeting (IPM) on December 12, 2014 for the public to provide input on requiring a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's California source income rather than on distributions paid to a nonresident owner. Additionally, at the first IPM the FTB solicited feedback on issues which were arising from domestic pass-through entity withholding, particularly relating to the late filing of withholding forms in tiered pass-through entity structures. The Proposed Regulation would address these topics discussed at the first IPM. Prior to the first IPM, FTB published the following documents: the Meeting Notice and Information; and the Tiered Structure Handout. Following the first IPM, FTB published the Summary of IPM.
The FTB held a second IPM on September 8, 2017 for the public to provide input on the draft text of the Proposed Regulation, which included language which would require a pass-through entity to withhold on a nonresident owner's distributive share of the pass-through entity's California source income. Additionally, it included language creating a new withholding form for pass-through entities which would be due on an annual basis rather than on a quarterly basis, and language which would provide a 10-Day Notification period to address the issue of late filing of withholding forms in tiered pass-through entity structures. Prior to the second IPM, FTB made the following documents available: Meeting Notice and Information; Draft Language of the Proposed Regulation; Diagrams to illustrate the examples of the Proposed Regulation text; and Explanation and Background for Proposed Adoption of Regulation 18662-7. Following the second IPM, FTB published a Summary of IPM.
After considering public comments, on March 15, 2019 FTB published a Ninety-Day Notice of Proposed Amendments (Ninety-Day Notice) to revise the Proposed Regulation draft language. The revisions to the Proposed Regulation draft language included the deletion of the 10-Day Notification Requirement and the addition of a safe harbor for an upper tier pass-through entity from the imposition of a late-filing penalty when it self-certifies that it is filing the withholding form within 30 days of receiving the withholding information from the lower tier pass-through entity. In lieu of a third IPM, the FTB provided a 90-day public comment period. FTB published the following documents: the Ninety-Day Notice, Discussion of Amendments; Amended Proposed Regulation Draft Language. After the close of the comment period, FTB considered public comments.
On June 25, 2020, FTB published a Thirty-Day Notice of Proposed Amendments (2020 Thirty-Day Notice) and Proposed Amendments for 2020 Thirty-Day Notice to propose additional revisions to the Proposed Regulation, including language specifying an applicability date of the Proposed Regulation as the first full quarter beginning after the effective date of the Proposed Regulation. The Proposed Amendments for 2020 Thirty-Day Notice were made available with the 2020 Thirty-Day Notice. After the close of the comment period, FTB staff considered public comments.
On June 8, 2021, FTB published a Forty-Five-Day Notice of Proposed Amendments (Forty-Five-Day Notice) and Proposed Regulatory Text for Forty-Five Day Notice, to propose additional revisions to the Proposed Regulation and Proposed Amendments to the Regulations. The revisions included a proposed deletion of the applicability date subsection of the Proposed Regulation following FTB staff's determination to prescribe the effective date as January 1st following the filing of the Proposed Regulations with the Secretary of State under Government Code section 11343.4, subdivision (b)(2). Additionally, FTB proposed to amend the Regulations for purposes of consistency with the Proposed Regulation. The Proposed Regulatory Text for Forty-Five-Day Notice was made available with the Forty-Five-Day Notice. After the close of the comment period, FTB staff received no public comments and decided to make no further changes to the Proposed Regulation and the Proposed Amendments to the Regulations.
On December 30, 2022, FTB published a Thirty-Day Notice of Proposed Amendments to propose additional revisions the FTB staff determined were necessary to resolve issues FTB discovered. In general, the Proposed Regulation provided specific withholding requirements relating to domestic pass-through entity withholding, however, such specificity created unintended gaps or conflicting withholding requirements in the Proposed Amendments to the Regulations. The additional proposed revisions were necessary to simplify the requirements and to ensure all the withholding regulations operate together. After the close of the comment period, FTB staff received considered public comments and decided to make no further changes to the Proposed Regulation and the Proposed Amendments to the Regulations.
The methods by which the FTB sought public input were posted online on the FTB's website at the Regulatory Activity page: https://www.ftb.ca.gov/tax-pros/law/regulatory-activity/index.html.

8. A description of the economic impact method and approach (including the underlying assumptions the agency used and the rationale and basis for those assumptions).

This economic impact analysis is based on changes over a 12-month period and depends on the timing of payments made by withholding pass-through entities and their nonresident owners. Tax return, income, payment, and withholding data for domestic nonresident owners of a pass-through entity with California source income affected by this regulation was analyzed to get a net direct revenue impact. It is assumed that taxpayers who file on or before the initial tax return due date of April 15 would not be impacted because any withholding change from April 15 of the prior year (the first quarterly withholding due date) would be offset within the 12-month window at the time their return is filed. Pass-through entities that historically do not file their return by the initial due date may or may not be affected if they make other prepayments during the year which they may adjust to offset withholding changes. To arrive at the final economic impact the direct revenue impact was grown beyond the first year of implementation and regional multipliers were applied to the results.

Agency Signature	Date
Justyn Howard Digitally signed by Justyn Howard Date: 2024.08.07 18:01:45 -07'00'	
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