UNDERSTANDING WITHHOLDINGS ON REAL ESTATE SALES

FAST FACT #19

When did withholding start for California residents? The withholding law applies to dispositions of California real estate by both residents and non-residents which close on and after January 1, 2003. Previously, withholding was only required of non-resident sellers.

Why was this withholding law enacted? As part of attempting to balance the state budget, this withholding provision was added to legislation on the last day of the Legislative session in 2002. It was estimated to accelerate collection of $285 million in additional state revenue.
Who is responsible for withholding? The law requires the buyer (called the transferee) to withhold from what would otherwise be paid to the seller.

What unit at the Franchise Tax Board handles the withholding? The Withholding Services and Compliance Section handles the withholding. The phone number is (888) 792-4900 and information can be found on their website at: http://www.ftb.ca.gov/individuals/index.html#wh. *You may check the Franchise Tax Board website both to see how the process currently works and for any updates. The Franchise Tax Board website currently has guidelines which include over 100 questions and answers. See FTB Pub. 1016.*

How much is the withholding? The withholding is 3 1/3% of the gross sale price. It does not take into account costs of the sale such as real estate commissions or other settlement costs. Withholding is currently due by the 20th day of the calendar month following the date title is transferred or may be remitted on a monthly basis in combination with other transactions closed during that month. California Forms 593 and 593B are used to report and a remit copy must be provided to the seller to attach to their tax return.

What exemptions apply? If you are an individual selling property, the buyer will not have to withhold from your proceeds if the sale price is less than $100,000, or you are selling your principal residence or if you are selling at a loss. Other exemptions are for tax deferred exchanges and involuntary conversions of property.

Does the seller have to do anything to qualify for exemptions? Yes. The seller will be required to sign a statement under penalty of perjury to establish eligibility for the exemption.

Does the seller have to do anything to qualify for exemptions? Yes. The seller will be required to sign a statement under penalty of perjury to establish eligibility for the exemption.

Can the seller apply to the Franchise Tax Board for an exemption? The law allows applications for reduced withholding and waivers but not by individuals, only by corporations and other entities.

What happens if there are several sellers on title? If the total purchase price exceeds $100,000.00, withholding rules apply. To determine the amount of withholding, each owner is considered separately and the withholding is calculated on each owner's pro-rata share of sales proceeds. It is possible for thetransaction to be exempt for one seller but not for the other part owners.

How do I know if the property qualifies as my principal residence? The rules incorporate Internal Revenue Code Section 121 to determine whether the property qualifies as a principal residence. There are two separate exemptions under California law which relate to the use and ownership tests under Section 121. Generally, the seller will either have had to have owned and lived in the property for two of the previous five years or the last use will have to have been as the seller's principal residence. Note that the two year period may be made up of different blocks of time which add up to two years over the five year period. A seller who lived in the property for one year, then rented it out for a period of time followed by another year of residency in the property would qualify for the exemption.

What is the role of the escrow holder regarding withholding? The law requires the escrow holder to provide a notice of the requirements. The escrow holder cannot make a legal determination as to whether any exemption applies.

Will the escrow agent do the withholding of the seller's money on behalf of the buyer? The escrow agent may withhold and remit to the Franchise Tax Board if the parties agree. The fee for this service may not exceed $45.00.

How will a seller get the withholding returned? The only way to recover the withholding is by filing a California State Income Tax Return for the year in which the sale occurred. The seller will be entitled to a refund in the amount that the withholding exceeds the amount of capital gains tax due by reason of the sale.

Does it matter if the seller lost money on other real estate or non-real estate transactions? No. Each transaction is considered separately.

What happens if the property is held in trust? If the trust is revocable, then the rules apply as if the seller was the individual who has the power to revoke the trust. If the trust is irrevocable then the trust itself is treated as the seller and withholding may be required if there are no exceptions.

What type of real estate is covered by the law? All real estate interests are covered unless one of the exemptions applies. This means the sale of fee title or easements or other interests may be subject to withholding.