



Chicago Title

# 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 holding).

### *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, or
- The seller qualifies for one of the exemptions discussed in this publication.

### *What is the withholding rate?*

The withholding rate is 3 1/3 % of the total sale price, unless an election is made to withhold on the gain of sale, where you would apply the following rates: 9.3% for individuals, 8.84% for corporations, or 10.84% for banks and financial 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 the sale is \$100,000; d) the seller is an individual and therefore the maximum tax rate is 9.3%. The following illustrates the two withholding methods:

1. Applying the Total Sale Price Method
2. Applying the Maximum Tax Rate to the Gain on Sale method

	1	2
Total Sale Price	\$500,000	\$500,000
Less Basis		(400,000)
Gain on Sale		\$100,000
Withholding Rate	x 3 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% surtax), corporations, or banks and financial corporations to the gain on the sale of the property. The Franchise Tax Board (FTB) withholding forms will provide the certification.

### *How do I calculate my gain?*

The Franchise Tax Board (FTB) will provide an electronic form to assist you in computing your gain on its website at [www.ftb.ca.gov](http://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 escrow officer has properly notified the buyer of the withholding requirements. However, as part of the escrow services, the escrow officer generally assumes the responsibility for withholding or documenting why no withholding was done and for sending payment to the FTB. 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?*

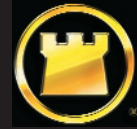
The penalty for not withholding is the greater of \$500 or 10% of the required withholding amount.

### *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](http://www.irs.gov) or contact the IRS toll-free at (800) 829-3676.
- The property was last used by the seller 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 nonrecognition 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 nonrecognition under IRC Section 351 or 721.

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## CALIFORNIA REAL ESTATE WITHHOLDING – CONTINUED

- 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 escrow officer before the close of escrow to claim an exemption. However, sellers should give the completed Form 593-C to their escrow officer as soon as possible to avoid delaying close of escrow. As with all tax documents, sellers are required to provide their social security number 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 form your escrow officer on on the FTB website at [www.ftb.ca.gov](http://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% of the required withholding amount.

### ***If the withholding tax is paid at closing, how does the seller apply for a refund?***

When escrow closes, the escrow officer 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 escrow officer have any responsibilities for withholding?***

Escrow officers are required to notify buyers in writing of the withholding requirements. Generally, the buyer and seller will instruct the escrow holder to pay the withholding tax from the seller's proceeds at closing.

**Note:** The escrow officer's notification to the buyer has been amended to language regarding the alternative withholding amount. Escrow persons are not authorized to provide legal or accounting advice for the purposes of determining the withholding amounts. Competent tax professionals should be consulted.

### ***How do I get more information about real estate withholding?***

The 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](http://www.ftb.ca.gov) to find answers to frequently asked questions, updates, the Form 593-C/593-E Booklet and 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/TTD for hearing impaired: (800) 822-6268

**Website: [www.ftb.ca.gov](http://www.ftb.ca.gov)**

Dento de los Estados Unidos,

llame al \_\_\_\_\_ (800) 852-5711

Fuerta de los Estados Unidos,

llama 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](http://www.ftb.ca.gov)

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