

## New California Pass-Through Entity Withholding Forms for 2020

### Overview

On October 8, 2019, the California Franchise Tax Board (FTB) promulgated amendments to the regulations governing withholding requirements for domestic pass-through entities.<sup>1</sup> As a result of the amendments, the FTB released two new forms that apply to domestic pass-through entities when reporting and remitting withholding on distributions of the entity's California source income made to their nonresident owners:

1. California Form 592-Q, Payment Voucher for Pass-Through Entity Withholding;<sup>2</sup> and
2. California Form 592-PTE, Pass-Through Entity Annual Withholding Return.<sup>3</sup>

Domestic pass-through entities must use these forms for taxable years beginning on or after January 1, 2020. Note that although Forms 592-PTE and 592-Q are new, the manner in which withholding is computed has not changed and continues to be computed at a rate of 7 percent of the distribution of California source income made to domestic nonresident owners.<sup>4</sup> As discussed below, there is an additional regulation project in progress that is expected to change the manner in which withholding is calculated and implement a self-certification process. However, those regulations are not yet in effect. This alert summarizes certain requirements relating to Forms 592-Q and 592-PTE, provides some clarification for certain instructions made in the Instructions to Form 592-PTE, and provides some taxpayer considerations.

### California Form 592-Q, Payment Voucher for Pass-Through Entity Withholding

Taxpayers should use Form 592-Q to remit pass-through entity quarterly withholding payments to the FTB where such payments will be reported to the FTB on Form 592-PTE.<sup>5</sup> Payments made using Form 592-Q are not reported on a by-payee basis (*i.e.*, no payee schedule is required with the Form 592-Q payment). Quarterly payments are due on the following dates for taxable year 2020:

- 1st payment - April 15, 2020 (but postponed to July 15, 2020)<sup>6</sup>;
- 2nd payment - June 15, 2020 (but postponed to July 15, 2020)<sup>7</sup>;
- 3rd payment - September 15, 2020; and
- 4th payment - January 15, 2021.

### California Form 592-PTE, Pass-Through Entity Annual Withholding Return

Domestic pass-through entities must use Form 592-PTE to report total withholding made on distributions of the entity's California source income for the taxable year and allocate the withholding to nonresident owners on a by-payee basis.<sup>8</sup> Specifically, total quarterly withholding payments made throughout the year, or total withholding paid by another entity and to be allocated to partners or members, must be reported to the FTB on Form 592-PTE on an annual basis and is due

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<sup>1</sup> See e.g., Cal. Code of Regs., tit. 18, §§ 18662-4(d), (j); 18662-8(c)(1)(B), (c)(2)(B), (k), (l) (revised Oct. 2019). These regulations are available [here](#).

<sup>2</sup> *Id.* (revised Oct. 2019). The form and instructions are available at this [link](#).

<sup>3</sup> *Id.* (revised Oct. 2019). The form and instructions are available at this [link](#).

<sup>4</sup> Cal. Code Regs. tit. 18, § 18662-4(a)(1), (3).

<sup>5</sup> Cal. Code Regs. tit. 18, § 18662-8(c)(2)(B) (revised Oct. 2019).

<sup>6</sup> As a result of the COVID-19 pandemic, the FTB has postponed the due dates for first and second quarter estimated tax payments to July 15, 2020. See FTB COVID-19 Extensions to file and pay, available [here](#), and related guidance, available [here](#).

<sup>7</sup> See *Id.*

<sup>8</sup> Cal. Code of Regs., tit. 18, § 18662-8(c)(1)(B), (c)(2)(B).

by January 31st of the year following the year for which withholding was remitted.<sup>9</sup> Accordingly, withholding remitted for taxable year 2020 will be reported on Form 592-PTE and is due on January 31, 2021.

#### *Clarification of Form 592-PTE Instructions*

The instructions for Form 592-PTE state that Form 592-PTE should not be used to report withholding on domestic nonresident individuals or corporations, and that Form 592, Resident and Nonresident Withholding Statement, should be used instead.<sup>10</sup> However, practitioners should note that although Form 592 continues to be the form that should generally be used to report withholding, *if the withholding agent is a domestic pass-through entity* reporting withholding made on distributions of the entity's California source income, the proper form that should be used to report withholding made to all types of owners (except foreign, non-U.S. owners) is Form 592-PTE.<sup>11</sup> Under the latter circumstance, Form 592-PTE should be used in lieu of Form 592. Form 592 will continue to apply to all other types of withholding, such as withholding on payments to nonresident contractors (except those made to foreign, non-U.S. owners).<sup>12</sup>

#### **Additional Regulations Pending**

##### *Withholding Tax Calculations*

FTB has proposed additional regulations affecting withholding for pass-through entities. Draft California Code of Regulations, Title 18, Section 18662-7 ("Draft Regulation Section 18662-7") requires domestic pass-through entities to calculate withholding based on the nonresident owner's distributive share of the pass-through entity's California source income using generally the highest tax rate in effect for the owner's specific classification (e.g., an individual or entity type). However, this proposed regulation has not yet been finalized and does not yet apply.<sup>13</sup>

##### *Tiered Partnership Self-Certification Process*

The draft regulations include a self-certification safe harbor for tiered partnerships. Under the safe harbor, if an upper-tier pass-through entity receives a Form 592-B after the January 31<sup>st</sup> due date of its own Form 592-PTE, the FTB will not impose a late filing penalty on the upper-tier pass-through entity if that upper-tier pass-through entity certifies that it is filing the Form 592-PTE within 30 days of receiving the Form 592-B.<sup>14</sup> However, as noted, the draft regulations are not yet in effect and the self-certification rule is not yet operative. Under existing law taxpayers who receive notification of lower tier withholding after the due date are advised to attach a letter to their withholding tax return stating the reason for filing late and documenting their attempts to obtain the information on time.<sup>15</sup> FTB will consider this information in abating late filing penalties.

#### **Considerations**

Taxpayers should continue to monitor developments relating to Draft Regulation Section 18662-7. If finalized, Draft Regulation Section 18662-7 will provide for significant changes to the calculation of domestic pass-through entity withholding.

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<sup>9</sup> Cal. Code of Regs., tit. 18, § 18662-8(c)(2)(B).

<sup>10</sup> Specifically, Form 592-PTE instructions state: "Do not use Form 592-PTE if any of the following apply: . . . You are reporting withholding on domestic nonresident individuals or corporations. Use Form 592, Resident and Nonresident Withholding Statement."

<sup>11</sup> See Cal. Code of Regs., tit. 18, § 18662-8(c)(1)(A)-(B), (c)(2)(A)-(B) (emphasis added). For withholding payments that are reported on Form 592, taxpayers should use Form 592-V, Payment Voucher for Resident or Nonresident Withholding, to remit withholding payments to the FTB. Cal. Code of Regs., tit. 18, § 18662-8(c)(1)(A); (c)(2)(A); 2020 Instructions for Form 592-V, Payment Voucher for Resident and Nonresident Withholding. Furthermore, withholding made on foreign (non-U.S.) owners must continue to be reported on Form 592-F, Foreign Partner or Member Annual Return and remitted using Form 592-A, Payment Voucher for Foreign Partner or Member Withholding. See Cal. Code of Regs., tit. 18, § 18662-8(c)(1)(C), (c)(2)(C); 2020 Instructions to Form 592-F, Foreign Partner or Member Annual Withholding Return. Finally, where withholding is reported using a Form 592, 592-PTE, or 592-F, withholding agents should still use Form 592-B, Resident and Nonresident Withholding Tax Statement, to report such withholding by-payee amounts to each owner. See Cal. Code of Regs., tit. 18, § 18662-8(c)(2)(E); 2020 Instructions for Form 592-B, Resident and Nonresident Withholding Tax Statement.

<sup>12</sup> See *Id.*

<sup>13</sup> Draft Cal. Code Regs., tit. 18, § 18662-7(a), (b)(7) (March 15, 2019). The current version of the draft regulations is available [here](#).

<sup>14</sup> Draft Cal. Code Regs., tit. 18, § 18662-7(d)(1)(B)(2)(d) (March 15, 2019). The current version of the draft regulations is available [here](#).

<sup>15</sup> FTB Publication 1017 Resident and Nonresident Withholding Guidelines, Question 97.

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