



Real Estate Law Alert

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Seller Beware!

State Budget Crisis Prompts Expansion Of Real Estate

Sales Tax Withholding To California Residents *by Heidi Lamb, Esq.*

Sellers may be in for an unpleasant surprise this year. As of January 1, 2003, all California residents selling real property valued over \$100,000 must withhold 3 1/3 percent of their sales proceeds. Previously only non-residents were subject to this requirement.

Growing budgetary concerns and the search for cash flow prompted the State to extend the withholding requirement to California residents. Sellers now **are forced to lend** the State 3 1/3 percent of their sales proceeds interest free. For example, in a transaction with net proceeds val-

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ued at \$1 million, the buyer's escrow distribution will be reduced by approximately \$33,333. The State estimates that this change will affect 300,000 transactions valued at approximately \$6.8 billion in sales. This requirement applies to all real property sales by individuals completed after January 1, 2003. Business entities are **not** subject to this withholding requirement.

The following summarizes the changes made to Revenue and Taxation Code §18662 by Assembly Bill 2065.

1. Who is covered?

All individuals who sell California real property and do not qualify for an exemption are covered. Revocable trusts are considered "individuals" for taxable purposes. There is **no** administrative waiver process for individuals and parties cannot set up an alternative to the withholding obligation. However, business entity sellers are excluded, i.e. partnerships, corporations, LLCs, irrevocable trusts, professional corporations and estates.

2. What transactions are exempt?

A transaction is exempt if it is:

- valued at less than \$100,000;
- the seller's principal residence;
- considered a loss for California tax purposes;
- a like-kind exchange, with the exception of "boot"; or
- considered a foreclosure.

3. How is the withholding calculated?

Sellers are required to withhold $3\frac{1}{3}$ percent of the **total sale price**. The withholding obligation is not based on anticipated gain. The sale price is equal to the sum of: (1) cash paid or to be paid; (2) the fair market value of any other property transferred or to be transferred; and (3) the amount of any outstanding liability assumed. Technically buyers are responsible for filing the Franchise Tax Board Form 597 by the 20th day of the month following the date of the title transfer, although normally an escrow agent will make the filing on the buyer's behalf.

4. How are installment sales and multiple seller transactions handled?

Installment sales are subject to withholding. But, it is possible to defer withholding on the full sales price if the buyer agrees to withhold $3\frac{1}{3}$ percent of the down payment and $3\frac{1}{3}$ percent of each subsequent payment. The buyer must file a Form 593-I in addition to the Form 597 to take advantage of this procedure. If there are multiple sellers involved in a transaction, the withholding is allocated based on the percentage ownership of each seller.

5. What penalties and interest charges exist for noncompliance?

The penalty for not withholding is the greater of \$500 or 10 percent of the withholding amount. Interest charges also are assessed on late payments from the withholding due date until payment is received. Penalties also apply for inaccurate and late filing. These penalties range from \$15 to \$1,000 or 20 percent of the withholding amount.



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Ms. Lamb is an associate in the firm's Health Law Section specializing in business transactions for health care providers.

Her experience includes business formations, affiliations, financings, mergers and acquisitions, real estate leasing and sales, and other corporate matters. Ms. Lamb is also a member of the firm's Emerging Companies Group and represents a variety of early stage companies.

Ms. Lamb is licensed to practice law in California and Massachusetts.

Education

University of Minnesota (J.D., cum laude, 1997); University of Notre Dame (M.A., 1990); Smith College (B.A., cum laude, 1987).

Memberships

Bar Association of San Francisco; California Society for Healthcare Attorneys; Society of Professional in Healthcare; Healthcare Financial Management Association.

The Hanson Bridgett Real Estate Group provides experienced and effective counsel in all aspects of real estate acquisition, development and management. Our areas of expertise include:

- **Entity Formation and Tax Counseling** Optimizing the investment structure and exit planning, including tax deferred (Section 1031) exchanges.
- **Project Financing** Equity/debt financing, construction loans, ground leasing, loan facilitation and documentation, conduit loan arrangements, synthetic leases, low-cost housing tax-exempt bonds.
- **Property Acquisition, Construction and Sales** Acquisition structure, negotiation and agreements, title insurance and closings, construction/development logistics, all due diligence (e.g. ADA, DRE, environmental and other regulatory compliance), housing and common interest developments.
- **Environmental Assessment, Environmental Regulations and Remediation** "Brownfields" development, environmental site assessment, prospective purchase agreements, indemnity and remediation arrangements, environmental and regulatory compliance analysis and remediation, contribution and indemnity claims.
- **Land Use and Entitlements** Negotiation of entitlements and development agreements, land use due diligence, CEQA/NEPA compliance, subdivision, zoning and map approvals.
- **Lease Negotiations and Management** Office and retail lease, ground leases, lease financing and tax counseling, subleases and management agreements.
- **Dispute Resolution/Litigation** Purchase and sale disputes, landlord and tenant litigation, loan workouts and foreclosures, eminent domain, and construction-related disputes.

Real Estate Group Clientele

Our clientele includes developers, investors, REITS, corporate real estate departments, senior housing and care facilities, title companies, management companies, as well as institutional and individual businesses.